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Draft Legislative Guide on Insolvency Law

Note by the Secretariat: Revisions to A/CN.9/WG.V/WP.70: Reorganization

1. This note sets forth revisions and additions to the commentary and recommendations of chapter IV on reorganization in document A/CN.9/WG/V/WP.70 part II based upon the deliberations of Working Group V at its thirtieth session (March/April 2004) (see document A/CN.9/551 for the report of that meeting). The numbering of the commentary and recommendations remains unchanged; where the order of the paragraphs or recommendations has been changed, the numbering is not in sequence. With respect to recommendations, the use of square brackets indicates text added or revised subsequent to the thirtieth session of Working Group V.

2. For reasons of economy, commentary and recommendations that have not been revised are not reproduced in this document and remain as contained in A/CN.9/WG/V/WP.70 part II; those paragraphs and parts of the recommendations set forth in this document that have not been amended are shown as "*No change*". Footnotes to recommendations have not been reproduced in this document, unless they have been amended or deleted.

IV. Reorganization

5. Approval of a plan

506. Designing the provisions of an insolvency law on approval of the plan requires a balance to be achieved between a number of competing considerations, such as whether or not creditors should vote on approval of the plan in classes, whether all creditors are entitled to vote on the plan and the manner in which dissenting

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creditors will be treated. Some underlying principles are that creditors whose rights are impaired by the plan, including secured creditors, can only be bound by a plan if they have been given the opportunity to vote on that plan; that secured creditors should vote separately from unsecured creditors; that creditors of a class should each receive the same treatment under the plan; and that a dissenting class of creditors that is to be bound to the plan should receive as least as much as they would have received in liquidation proceedings.

(i) Classification of claims

506A. Insert paragraph 506, beginning with the third sentence.

(ii) Treatment of dissenting creditors

507. No change.

508. Revise the second and third sentences as follows:

> So, for example, the law might provide that dissenting creditors could not be bound unless assured of certain treatment. As a general principle, that treatment might be that the creditors will receive at least as much under the plan as they would have received in liquidation proceedings.

(a) Procedures for approval

509. In the first sentence, add the words “including equity holders” after “other interested parties”.

510. In the first sentence, change the reference to “required to vote” to “entitled to vote”.

(i) Treatment of abstaining or non-participating creditors

510A. Insert paragraph 510, commencing with the third sentence**.**

(ii) Use of presumptions

511. No change.

(b) Approval by secured and priority creditors

512. In the second sentence, change the reference to “required to vote” to “entitled to vote”, otherwise no change.

513. At the end of the second sentence, add the words “before creditors without priority are paid”. In the last sentence, change the reference “required to vote” to “entitled to vote”.

515. Recognizing the need for secured creditors to participate, a second approach provides for secured and priority creditors to vote as classes separate from unsecured creditors on a plan that would impair the terms of their claims, or to otherwise consent to be bound by the plan. Adopting an approach that allows for secured and priority creditors to vote as a separate class provides a minimum safeguard for the adequate protection of such creditors and recognises that the respective rights and interests of secured and priority creditors differ from those of unsecured creditors. In many cases, however, the rights of secured and priority

creditors will differ from each other and it may not be feasible to require all secured creditors to vote in a single class or priority creditors to vote in a single class. In such cases, some laws provide that each secured creditor forms a class of its own. Where secured creditors do vote, the requisite majority of a class of secured creditors would generally be the same as that required for approval by unsecured creditors, although there are examples of laws that require different majorities depending upon the manner in which secured creditors rights are to be affected by the plan (e.g. one law provides that a three-quarter majority is required where the maturity date is to be extended and a four-fifths majority where the rights are otherwise to be impaired).

516. Third and fourth sentences moved to 532A.

514. In the last sentence, change the reference "required to vote" to "entitled to vote".

517. No change.

(c) Approval by ordinary unsecured creditors

518. No change.

(i) Classes of unsecured creditors

519. No change.

520. Revise the second and third sentences as follows:

> The creation of these classes is designed to enhance the prospects of reorganization in at least three respects by providing: a useful means of identifying the varying economic interests of unsecured creditors; a framework for structuring the terms of the plan and ensuring that all creditors in a class receive the same treatment; and a means for the court to utilize the requisite majority support of one class to make the plan binding on other classes which do not support the plan. Since the creation of different classes has the potential to complicate the voting procedure, it may be desirable only where there are compelling reasons for special treatment of some ordinary unsecured creditors, such as where there is a large number of creditors that lack a common economic interest and the treatment to be offered to them under the plan differs.

(ii) Determination of classes

521. No change.

(d) Approval by equity holders

522. Add the following after the second sentence:

> Where equity holders are entitled to vote, they should be provided with the same notice and information as other creditors entitled to vote.

523. No change.

(e) Related persons

524. No change.

(f) Requirements for approval of the plan

525. No change.

(i) Where voting is not conducted in classes

526. No change.

(ii) Where voting is conducted by class

527. Add the following sentence at the end of the paragraph:

Whichever approach is adopted, it is important that it be set forth clearly in the law to provide certainty and transparency for parties to reorganization proceedings.

- *Majority within a particular class*

528. No change.

- *Majority of classes*

529. Revise the last two sentences as follows:

Other laws provide that support by classes of unsecured creditors cannot amount to approval of the plan if secured creditors oppose the plan. Requirements for binding dissenting classes are discussed further under 7 and 8 below.

6. Where a proposed plan cannot be approved

(a) Modification of a proposed plan

530. No change.

(b) Failure to approve a plan

531. No change.

7. Binding dissenting classes of creditors

532. Add the following after the third sentence:

These conditions include that the requisite approvals of the plan have been obtained and that the approval process was properly conducted; that creditors will receive at least as much under the plan as they would have received in liquidation proceedings; that the plan does not include provisions contrary to the insolvency law or to other relevant law; that administrative claims and expenses will be paid in full except to the extent that the holder of such a claim or expense has agreed to different treatment; that the claims of classes of creditors that do not support a plan are treated under the plan in accordance with the rank accorded to them under the insolvency law (in other words, that creditors in that class will be paid in full, whether in money or property, such as stock or other securities, before a junior rank is paid).

532A. Insert the third and fourth sentences from paragraph 516.

8. Court confirmation of a plan

533. No change.

(a) Challenges to approval of the plan

534-536. No change.

(b) Steps required for court confirmation

537. Add the words "As noted above in paragraph 532" to the beginning of the fourth sentence.

538. No change.

539. Revise the second sentence as follows:

> It is highly desirable, in particular, that the law does not provide for the court to review the economic and commercial basis of the decision of creditors (including issues of fairness that do not relate to the approval procedure, but rather to the substance of what has been agreed) nor that it be asked to review particular aspects of the plan in terms of their economic feasibility, unless the circumstances in which this power can be exercised are narrowly defined or the court has the competence and experience to exercise the necessary level of commercial and economic judgement.

9. Effect of an approved [and confirmed] plan

540. No change.

10. Challenges to a plan after court confirmation

541. Add the following words to the end of the last sentence: "and the extent to which the grounds upon which the plan was successfully challenged can be addressed."

11. Amendment of a plan after approval by creditors

542-4. No change.

12. Implementation of a plan

545. No change.

13. Where implementation fails

546-7. No change.

14. Conversion to liquidation

548. Add the following words at the end of the second sentence as a further ground for conversion: "or failure of implementation for some other reason."

> Add the following at the end of the paragraph: "Consideration may need to be given to the procedural requirements for commencement and conduct of those converted proceedings."

549-50. No change.

Recommendations

Contents of legislative provisions

Preparation of the plan—timing

(123)(a) The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings, or within a specified time period after commencement of the insolvency proceedings:

(i)-(ii) No change.

(b) The insolvency law should also address the time limits for proposal of a plan where liquidation proceedings are converted to reorganization proceedings.

Preparation of a disclosure statement

(126) The insolvency law should require a plan submitted for the consideration of [those] creditors and equity holders [entitled to vote on approval] to be accompanied by a disclosure statement that will enable an informed decision about the plan to be made. The statement should be prepared by the same party that proposes the plan.

Submission of the plan and disclosure statement

(127) The insolvency law should provide a mechanism for submission of the plan and disclosure statement to [those] creditors and equity holders entitled to vote on approval of the plan.

Content of disclosure statement

(129) The insolvency law should specify that the disclosure statement include:[92]

[(a) A detailed description of the plan;]

(b) Information relating to the financial situation of the debtor including assets, liabilities and cash flow;

(c) Non-financial information that might have an impact on the future performance of the debtor; (e.g. the availability of a new patent)

(d) A comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;

(e) The basis upon which the business would be able to keep trading and could be successfully reorganized;

(f) Information showing that, having regard to the effect of the plan, [the assets of the debtor will exceed its liabilities] [and that adequate provision has been made for satisfaction of all obligations provided for in the plan]; and

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[92] Where the insolvency representative does not prepare, or is not involved in the preparation of, the plan and the statement, the insolvency representative should be required to comment on both instruments. Information included in the disclosure statement should be subject to the obligations of confidentiality discussed in paras. .. and recommendation 96.

(g) Information on the voting mechanisms applicable to approval of the plan.

Content of the plan

(128) The insolvency law should specify the minimum contents of a plan. The plan should:

(a) Identify each class of creditors and the treatment provided for each class by the plan (e.g. how much they will receive and the timing of payment [if any]);

[(b) Detail the treatment of equity holders;]

[(c) Detail the treatment of statutory claims that cannot be modified under the plan;[91a]]

(d) Detail the terms and conditions of the plan;

(e) Identify the debtor's role in implementation of the plan;

(f) Identify those responsible for future management of the debtor and supervision of the implementation of the plan [and indicate their affiliation with the debtor and their remuneration]; and

(g) Indicate how the plan will be implemented.

Voting mechanisms

(130) Delete the last sentence – see recommendation 142.

[(130A) The insolvency law should specify that a creditor whose rights are modified by the plan should not be bound to the terms of the plan unless that creditor has been the given [the] [a reasonable] opportunity to vote.]

[(130B) The insolvency law should specify that where the plan provides that the rights of a creditor or class of creditors are not modified or adversely affected by a plan, that creditor or class of creditors is not entitled to vote on approval of the plan.]

[(130C) If the insolvency law specifies that secured or priority creditors can be bound to the terms of the plan, the insolvency law should also specify that those creditors [vote in [one or more] classes that are separate] [shall be separately classified by category and shall vote by class separately] from unsecured creditors without priority.]

[(130D) The insolvency law should specify that all creditors in a class should be offered the same [treatment] [menu of terms].

Approval by classes

(133) Where voting on approval of the plan is conducted by reference to classes [whose rights will be modified by the plan], the insolvency law should specify how the vote achieved in each class would be treated for the purposes of approval of the plan. Different approaches may be taken, including requiring [approval by all

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[91a] [For public policy reasons, some States do not permit claims such as tax claims and some claims arising from employee entitlements to be modified in insolvency. See paras. 291, 633-635 and recommendation 172.]

classes or] approval by a specified majority of the classes, [but at least one class of creditors whose rights are modified must approve the plan.]

(134) Where the insolvency law does not require approval by all classes [whose rights will be modified by the plan], the insolvency law should address the treatment of those classes that do not vote to support a plan that is otherwise approved by the requisite classes [consistent with the grounds set forth in recommendation (138)(a)-(e)].

Failure to approve a plan

(135) Deleted – see recommendations 142 and 145.

Continuing use of encumbered assets

(137) Deleted.

Confirmation of an approved plan

(138) Where the insolvency law requires court confirmation of an approved plan, the court should confirm the plan if the following conditions are satisfied:

(a) [The requisite approvals have been obtained and] the approval process was properly conducted;

(b) Creditors will receive [at least as much under the plan] [economic value worth at least as much, calculated as at the effective date of the plan,] as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;

(c) The plan does not contain provisions contrary to the law;

(d) Administrative claims and expenses will be paid in full except to the extent that the holder of the claim or expense agrees to different treatment; and

(e) [Except to the extent that [affected creditors or] [classes of creditors whose rights are modified by the plan] have agreed [otherwise, [94]] the treatment of [creditor] claims[93] in the plan conforms to the ranking of [creditor] claims under the insolvency law.] [The treatment accorded under the plan to the claims of a class of creditors that has voted against the plan, conforms to ranking of that class of claims under the insolvency law.]

Challenges to approval (where there is no requirement for confirmation)

(139) Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit interested parties, including the debtor, to challenge the approval of the plan. The insolvency law should specify criteria against which a challenge can be assessed which should include:

(a) Whether the grounds set forth in recommendation (138) are satisfied; and

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[94] Including claims for administrative costs and expenses.

[93] The court should satisfy itself that if one or more creditors are to receive less favourable treatment than prescribed for their rank under the insolvency law, those creditors have consented to that treatment.

(b) Fraud, in which case the requirements of recommendation (140)(a)-(c) should apply.

Challenges to a confirmed plan

(140) The insolvency law should permit a confirmed plan to be challenged on the basis of fraud. The insolvency law should specify:

(a)-(b) No change.

(c) That the challenge should be heard by the court.

Amendment of the plan

(142) The insolvency law should permit amendment of a plan and specify the parties that may propose amendments and the time at which the plan may be amended [including between submission and approval, approval and confirmation, after confirmation and during implementation, where the proceedings remain open.]

Approval of amendments

(143) The insolvency law should establish the mechanism for approval of amendments to the plan. [Where amendment occurs after the plan has been approved by creditors,] that mechanism should require notice to be given to the creditors and other parties [affected by the modification]; specify the party required to give notice; require the approval of creditors and other parties [affected by the modification] and satisfaction of the rules for confirmation (where confirmation is required). The insolvency law should also specify the consequences of failure to secure approval of proposed amendments.

Supervision of implementation

(144) No change.

Conversion to liquidation

(145) The insolvency law should provide that the court may convert reorganization proceedings to liquidation where:

(a) A plan is not proposed within any time limit specified by the law and no extension of time is approved by the court;

(b) An application for conversion is made by the insolvency representative or creditors;

(c) A proposed plan is not approved;

(d) An approved plan is not confirmed (where the law requires confirmation);

(e) An approved or a confirmed plan is successfully challenged; or

(f) There is substantial breach [by the debtor] of the terms of the plan [or implementation of the plan fails for other reasons].[95a]

[95a] [This course of action is only available where the proceedings remain open during implementation.]

B. Expedited reorganization proceedings[96a]

1. Introduction

551. As discussed above in part one of the Guide, reorganization can take one of several forms. These include informal (i.e. in the sense of being conducted out-of-court) voluntary restructuring negotiations which require little or no court involvement and essentially depend upon the agreement of the parties involved and reorganization proceedings conducted under the formal supervision of a court. These formal proceedings generally involve all creditors of the debtor and a reorganization plan formulated and approved by creditors and other interested parties after commencement of the proceedings. Reorganization may also include, however, proceedings commenced to give effect to a plan negotiated and agreed by affected creditors in voluntary restructuring negotiations that take place prior to commencement, where the insolvency law permits the court to expedite the conduct of those proceedings (referred to in this section as expedited reorganization proceedings).

551A. Because many of the costs, delays and procedural and legal requirements of formal reorganization proceedings can be avoided where voluntary restructuring negotiations and expedited reorganization proceedings are used, this often can be the most cost efficient means of resolving a debtor's financial difficulties, although it may not be effective in all instances of financial difficulty because it depends upon certain pre-conditions, discussed in part one of the Guide. These may include that a significant amount of debt is owed to a limited number of main banks or financial institution creditors; acceptance amongst creditors of the view that it may be preferable to negotiate an arrangement, as between the debtor and the financiers and also between the financiers themselves, to resolve the financial difficulties of the debtor; the prospect that there may be a greater benefit for all parties through the negotiation process than by direct and immediate resort to the insolvency law (in part because the outcome is subject to the control of the negotiating parties and the process is less expensive and can be accomplished quickly without disrupting the debtor's business); and that the debtor does not need relief from trade debts, or the benefits of formal insolvency, such as the automatic stay or the ability to reject burdensome debts.

551B. Notwithstanding the dependence upon such conditions, voluntary restructuring negotiations and expedited reorganization proceedings can be valuable tools in the range of insolvency solutions available to a country's commercial and business sector. Encouraging the use of such solutions need not stem from the fact that a country's formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such solutions can offer as an adjunct to a purely formal insolvency proceedings which deliver fairness and certainty. Moreover, such solutions work best where there is the possibility that if the negotiation process cannot be started or breaks down, there can be swift and effective resort to the insolvency law.

552. Add the words "To provide a negotiating framework that can be agreed by all participants and facilitates" to the beginning of the third sentence.

[96a] Because these proceedings are based on the agreement achieved in voluntary restructuring negotiations, th1s section should be read in conjunction with part one, chapter II.A.

553. Revise the third sentence and following:

> Under most existing legal systems, such a modification of contractual rights requires the commencement of full court-supervised reorganization proceedings under the insolvency law, involving all creditors and satisfaction of the requirements of the insolvency law governing the conduct of those proceedings. Timing is typically critical in business restructuring and delay (usually inherent in full court-supervised insolvency proceedings) can frequently be costly or even fatal to achieving an effective solution.

2. Creditors typically involved in voluntary restructuring negotiations

554. No change.

555. The limited classes of creditors that would normally participate in voluntary restructuring negotiations make an agreement easier to accomplish than full court-supervised reorganization because the latter proceedings typically affect all claims. Since it is usual in voluntary restructuring negotiations for certain types of non-institutional and other creditors, such as trade creditors, to continue to be paid in the ordinary course of business. These creditors are not likely to have any objection to the proposed restructuring and they do not need to participate in the negotiations. Where, however, the rights of those creditors are to be modified by the restructuring plan, their agreement to the proposed modifications would be required.

3. Proceedings to implement a voluntary restructuring agreement

556. An insolvency law can include in provisions on commencement of reorganization proceedings under the insolvency law, provisions for the recognition of a voluntary restructuring agreement and allowing expedition of those proceedings. Where it does so, consideration will need to be given to defining the debtors to whom such provisions might apply and the parties that can be affected by such expedited proceedings.

(a) Eligible debtors

557. Expedited reorganization proceedings may be available on the application of any debtor eligible to commence proceedings under the general reorganization provisions of an insolvency law on the basis that it is likely to be generally unable to pay its debts as they mature.

558. No change

(b) Obligations affected

559. Revise the last sentence as follows:

> The specific obligations to be affected in any given case would be those identified in the plan which is to be recognized under expedited proceedings.

(c) Application of the insolvency law

560. Revise the first and second sentences as follows:

> An insolvency law that permits expedited proceedings will need to identify those provisions of the insolvency law applicable to full court-supervised proceedings that will apply to these proceedings, particularly if any changes are to be made in the manner in which they apply. So, for example, the provisions which would generally apply to this type of proceedings in the same manner as for full court-supervised proceedings (unless specifically modified) might include provisions on: application procedures; commencement; application of the stay; requirements for preparation of a list of all creditors (in order to inform the court, and provide certainty as to who is affected by the plan and who is not); requirements for approval of the plan (including provision of the plan and supporting information to affected creditors, determination of classes of creditors, creditor committees, criteria and majorities required for approval); effect and confirmation of the plan, including standards of treatment that protect the interests of dissenting creditors; issues relating to implementation of the plan and discharge of claims.

561. Revise the first sentence as follows:

> Provisions of the insolvency law that might not apply to expedited proceedings would include those relating to the appointment of the insolvency representative, unless the plan specifically provides for that appointment; submission of claims; requirements for notice and time periods for plan approval (where such provisions are included in the insolvency law); and voting on the plan (since this occurred before commencement).

562. No change.

(d) Expedition of the proceedings

563. Revise the first sentence as follows:

> In order to take full advantage of the negotiated agreement and avoid the delays that may make that agreement impossible to implement, an insolvency law may need to consider how, in addition to recognizing the steps that have been completed before commencement as noted above, expedited proceedings can be handled more quickly than full court-supervised reorganization proceedings.

Revise the fourth sentence as follows:

> For example, if a plan has been negotiated and agreed to by a majority of creditors of a particular class—typically the institutional creditors—sufficient to satisfy the voting requirements of the insolvency law for approval of a reorganization plan and the rights of other creditors will not be impaired by the plan, it might be possible for the court to order a meeting or hearing of that particular approving class of creditors only.

564. Revise the first sentence as follows:

Even where the insolvency law provides for eligible cases to be treated expeditiously, it is highly desirable that it does not afford less protection for dissenting creditors and other parties than the insolvency law provides for dissenting creditors and other parties in full court-supervised reorganization proceedings.

565. Other laws may need to be modified to encourage or accommodate both voluntary restructuring negotiations and expedited reorganization proceedings. Examples of such laws might include those that expose directors to liability for trading during the conduct of voluntary restructuring negotiations; that do not recognize obligations for credit extended during such a period or subject those obligations to avoidance provisions; and that restrict conversion of debt to equity.

Recommendations

Content of legislative provisions

Commencement of expedited reorganization proceedings

(146) The insolvency law should specify that expedited proceedings can be commenced on the application of any debtor that:

(a) Is likely to be generally unable to pay its debts as they mature;

(b) Has negotiated a reorganization plan and had it accepted by each affected class of creditors and by each affected creditor not part of a voting class; and

(c) No change.

Application requirements

(147) The insolvency law should specify that the following additional materials should accompany an application for commencement of expedited reorganization proceedings:

(a) The reorganization plan and disclosure statement;

(b) A description of the voluntary restructuring negotiations that preceded the making of the application for commencement, including the information provided to affected creditors to enable them to make an informed decision about the plan;

(c) Certification that unaffected creditors are being paid in the ordinary course of business and that the plan does not modify or impair the rights or claims of preferential creditors, such as tax or social security authorities or employees, [without their agreement] [unless they have had an opportunity to vote on the plan];

(d) No change;

(e) A financial analysis or other evidence which demonstrates that the plan satisfies all applicable requirements for reorganization; and

(f) A list of the members of any creditor committee formed during the course of the voluntary restructuring negotiations.

Commencement

(148) The insolvency law should specify that the application for commencement will automatically commence the proceedings or that the court will be required to promptly determine whether the debtor satisfies the requirements of recommendation 146 and if so, commence proceedings.

Effect of commencement

(149) The insolvency law should specify that:

(a) Provisions of the insolvency law that apply to full reorganization proceedings will also apply to expedited proceedings unless specified as not applicable;[98]

(b) Unless otherwise determined by the court the effects of commencement should be limited to the debtor, individual creditors and classes of creditors and shareholders whose rights are modified or who are affected by the plan;

(c) No change; and

(d) A hearing on the confirmation of the plan by the court should be held as expeditiously as possible.

Notice of commencement

(150) The insolvency law should specify that notice of the commencement of expedited proceedings be given to [affected] creditors and [affected] equity holders using existing available means. The notice should specify:

(a)-(d) No change; and

(e) The impact of the plan on equity holders.

Confirmation of the plan

(151) The insolvency law should specify that the court will confirm the plan if:

(a) The plan satisfies the substantive requirements for confirmation of a plan in full reorganization proceedings, in so far as those requirements apply to affected creditors and affected equity holders;

(b) The notice given and the information provided to affected creditors and affected equity holders during the voluntary restructuring negotiations was sufficient to enable them to make an informed decision about the plan and any pre-commencement solicitation of acceptances to the plan complied with applicable law;

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[98] Provisions of the insolvency law that generally would not be applicable would include: full claim filing; notice and time periods for plan approval; the post-commencement mechanics of providing the plan and disclosure statement to creditors and other interested parties and for solicitation of votes and voting on the plan; appointment of an insolvency representative (who generally would not be appointed unless required by the plan); provisions on amendment of the plan after confirmation. An exception to the provisions of the insolvency law applicable to full reorganization proceedings would be that creditors not affected by the plan would be paid in the ordinary course of business during the implementation of the plan

(c) Unaffected creditors are being paid in the ordinary course of business and the plan does not modify or impair the rights or claims of priority creditors, such as tax or social security authorities or employees, without their agreement [unless they have had the opportunity to vote on the plan]; and

(d) No change.

Effect of a confirmed plan

(152) The insolvency law should specify that the effect of a plan confirmed by the court should be limited to the debtor and those creditors and equity holders affected by the plan.

Failure of implementation of a confirmed plan

(153) The insolvency law should specify that where there is a substantial breach of the terms of the plan confirmed by the court in accordance with recommendation (151), the proceedings may be closed and creditors may exercise their rights at law.