

Revised Draft

CREDITOR RIGHTS AND INSOLVENCY

ROSC

ASSESSMENT METHODOLOGY

based on

THE WORLD BANK

**PRINCIPLES FOR
EFFECTIVE CREDITOR RIGHTS AND INSOLVENCY SYSTEMS**

(Revised December 2005)

and

UNCITRAL

LEGISLATIVE GUIDE ON INSOLVENCY LAW

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LEGAL FRAMEWORK FOR CREDITOR RIGHTS

KEY ELEMENTS

WB Principle

Key Elements [A1]

A modern credit-based economy should facilitate broad access to credit at affordable rates through the widest possible range of credit products (secured and unsecured) inspired by a complete, integrated, and harmonized commercial law system designed to promote:

- Reliable and affordable means for protecting credit and minimizing the risks of nonperformance and default;
- Reliable procedures that enable credit providers and investors to more effectively assess, manage, and resolve default risks and to promptly respond to a state of financial distress of an enterprise borrower;
- Affordable, transparent, and reasonably predictable mechanisms to enforce unsecured and secured credit claims by means of individual action (e.g., enforcement and execution) or through collective action and proceedings (e.g., insolvency);
- A unified policy vision governing credit access, credit protection, credit risk management and recovery, and insolvency through laws and regulations that are compatible both procedurally and substantively.

CRITERIA FOR ASSESSING COMPLIANCE

A1. KEY ELEMENTS

1. The commercial law system facilitates broad access to credit [A1]
 - a. The commercial law system facilitates broad access to credit at affordable rates. [A1]
 - b. The commercial law system facilitates broad access to credit through the widest possible range of credit products (secured and unsecured). [A1] If yes,
 - c. Credit products are inspired by a complete, integrated, and harmonized commercial law system. [A1]

(Refer to criterion #5, below, on the integration of commercial laws and regulations.)
2. The commercial law system provides reliable and affordable means for protecting credit and minimizing the risks of nonperformance and default. [A1]
3. The commercial law system provides reliable procedures that enable credit providers and investors:
 - a. to effectively assess, manage and resolve default risks, and
 - b. to promptly respond to a state of financial distress of an enterprise borrower. [A1]
4. The commercial law system provides affordable, transparent, and reasonably predictable mechanisms to enforce unsecured and secured credit claims by means of:
 - a. individual action (e.g., enforcement and execution), or
 - b. collective action and proceedings (e.g., insolvency). [A1]

(Refer to criterion #8, below, on harmony among individual and collective enforcement systems.)

5. Laws and regulations governing credit access, credit protection, credit risk management and recovery, and insolvency are compatible both procedurally and substantively. [A1]
 - a. Commercial laws and regulations offer a unified policy vision governing credit access, credit protection, credit risk management and recovery, and insolvency. [A1]
 - (Refer to the criteria under A2 for security interests over immovable property.)
 - (Refer to the criteria under A3 for security interests over movable property.)
 - (Refer to the criteria under A4 for recording and registration of secured rights.)
 - (Refer to the criteria under A5 for commercial enforcement systems.)
 - (Refer to the criteria under Part B, "Risk Management and Corporate Workout.")
 - (Refer to the criteria under Part C, "Legal Framework for Insolvency.")
6. Laws and regulations governing credit access, credit protection, credit risk management and recovery, and insolvency are perceived to work in an integrated and harmonized fashion among themselves. [A1]
7. Laws and regulations governing enforcement systems for secured and unsecured claims are perceived to work in an integrated and harmonized fashion among themselves. [A1]
 - (Refer to criteria #41-#44 under A5.1 for enforcement of unsecured debt.)
 - (Refer to criteria #45-#49 under A5.2 for enforcement of secured debt.)
8. The commercial enforcement systems for secured and unsecured claims are perceived to work in an integrated and harmonized fashion with the insolvency system. [A1]
 - (Refer to criteria under A5.1 for enforcement of unsecured debt.)
 - (Refer to criteria under A5.2 for enforcement of secured debt.)
 - (Refer to the criteria under Part C, "Legal Framework for Insolvency.")

LEGAL FRAMEWORK FOR CREDITOR RIGHTS

SECURITY (IMMOVABLE PROPERTY)

WB Principle

Security (Immovable Property) [A2]

One of the pillars of a modern credit economy is the ability to own and freely transfer ownership interests in land and land-use rights, and to grant a security interest (such as a mortgage or charge) to credit providers with respect to such interests and rights as a means of gaining access to credit at more affordable prices. The typical hallmarks of a modern mortgage system include the following features:

- Clearly defined rules and procedures for granting, by agreement or operation of law, security interests (mortgages, charges, etc.) in all types of interests in immovable assets;
- Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons;
- Clear rules of ownership and priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible;
- Methods of notice, including a system of registry, which will sufficiently publicize the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost.

CRITERIA FOR ASSESSING COMPLIANCE

A2. SECURITY (IMMOVABLE PROPERTY)

9. The system creates the ability for participants to own and freely transfer ownership interests in land and land-use rights. [A2]
10. The system creates the ability for participants to grant a security interest over immovable property to credit providers as a means of gaining access to credit at more affordable prices. [A2]
 - (Refer to criteria #1-#3 under A1 for access to credit in general.)
 - (Refer to the criteria under A4 for recording and registration of security interests.)
 - (Refer to criteria #45-#49 under A5.2 for enforcement of secured debt.)
11. The system for security rights over immovable property provides clearly defined rules and procedures for granting, by agreement or operation of law, security interests). [A2]
 - (Refer to criterion #20 under A3 for rules and procedures supporting security over movable property.)
12. The system for security rights over immovable property provides clearly defined rules and procedures for granting security interests in all types of interests in immovable assets.
 - a. The system provides for security interests to be granted on proceeds, offspring, rents, and other derivatives of immovable assets. [A2]
 - (Refer to criterion #22 under A3 for movable assets available as security.)
13. The system for security rights over immovable property provides for security rights to be granted related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons.
 - (Refer to criterion #23 under A3 for obligations able to be secured by security on movable property.)
14. The system for security rights over immovable property provides clear rules of ownership and priority governing competing claims or interests in the same assets. [A2]

(Refer to criterion #24 under A3 for rules of priority governing competing claims over movable property.)

(Refer to criteria #181-#185 under C12.1 for competing claims and priorities in insolvency.)

15. The system for security rights over immovable property eliminates or reduces priorities over security interests as much as possible. [A2]

(Refer to criterion #25 under A3 for reducing priorities over security rights on movable property.)

(Refer to criteria #188 under C12.2 for reducing priorities over security rights in insolvency.)

16. The system for security rights over immovable property provides methods of notice, including a system of registration that sufficiently publicizes the existence of security interests to creditors, purchasers, and the public generally. [A2] If yes,

- a. The methods of notice that publicize the existence of security interest over immovable property operate at the lowest possible cost. [A2]

(Refer to criteria #29-#32 under A4 for recording and registration of secured rights in general.)

(Refer to criterion #26a under A3 for methods of notice for security rights over movable property.)

17. The systems governing security interests in immovable property and insolvency are procedurally and substantively integrated and harmonized. [A1]

18. (Refer to criteria #27 under A3 for integration of secured rights over movable property and insolvency.)

LEGAL FRAMEWORK FOR CREDITOR RIGHTS

SECURITY (MOVABLE PROPERTY)

WB Principle

Security (Movable Property) [A3]

A modern credit economy should broadly support all manner of modern forms of lending and credit transactions and structures, with respect to utilizing movable assets as a means of providing credit protection to reduce the costs of credit. A mature secured transactions system enables parties to grant a security interest in movable property, with primary features that include:

- Clearly defined rules and procedures to create, recognize, and enforce security interests over movable assets, arising by agreement or operation of law;
- Allowance of security interests in all types of movable assets, whether tangible or intangible (e.g., equipment, inventory, bank accounts, securities, accounts receivables, goods in transit; intellectual property and its proceeds, offspring, and mutations), including and with respect to present, after-acquired, or future assets (including goods to be manufactured or acquired), wherever located and on a global basis, and based on both possessory and non-possessory interests;
- Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons;
- Methods of notice (including a system of registration) that will sufficiently publicize the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost; and
- Clear rules of priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible.

CRITERIA FOR ASSESSING COMPLIANCE

A3. SECURITY (MOVABLE PROPERTY)

19. The system for security interests in movable property enables participants to grant a security interest in movable property to credit providers as a means of gaining access to credit and providing credit protection to reduce the costs of credit. [A3]

(Refer to criteria #10 under A2 for access to secured credit over immovable property.)

(Refer to criteria #1 & 3 under A1 for access to credit in general.)

(Refer to criteria #45-#49 under A5.2 for enforcement of secured debt.)

20. The system for security interests in movable property provides clearly defined rules and procedures supporting modern forms of lending and credit transactions and structures. [A3]

(Refer to essential #45-#49 criteria under A5.2 for enforcement of secured debt.)

(Refer to essential criterion #11 under A2 for rules and procedures supporting security rights over immovable property.)

21. The system for security interests in movable property provides clearly defined rules and procedures to create, recognize, and enforce security interests over movable assets, arising by agreement or operation of law. [A3]

22. The system for security interests in movable property allows security interests in all types of movable assets. [A3]

- a. The system for security interests in movable property allows security interests in both tangible or intangible assets).

- b. The system for security interests in movable property allows security interests with respect to present, after-acquired, or future assets (including goods to be manufactured or acquired).
- c. The system for security interests in movable property allows security interests in assets wherever located and on a global basis.
- d. The system for security interests in movable property allows security interests based on both possessory and non-possessory interests. [A3]

(Refer to criteria #10 under A2 for security interests available over immovable property.)

23. The system for security rights in movable property provides for security interests to be granted related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons. [A3]

(Refer to criteria #13 under A2 for obligations able to be secured by security over immovable property.)

24. The system for security rights in movable property provides clear rules of priority governing competing claims or interests in the same assets. [A3]

(Refer to criterion #13 under A2 for rules of priority governing competing claims over immovable property.)

(Refer to criterion #104-105 under C12.1 for competing claims and priorities in insolvency.)

25. The system for security rights in movable property eliminates or reduces priorities over security interests as much as possible. [A3]

(Refer to criteria #15 under A2 for reducing priorities over security interests on immovable property.)

(Refer to criteria #104b under C12.2 for reducing priorities over security interests in insolvency.)

26. The system for security rights in movable property provides methods of notice, including a system of registration that will sufficiently publicize the existence of security interests to creditors, purchasers, and the public generally. [A3] If yes,

- a. The methods of notice that publicize the existence of security interests in movable property operate at the lowest possible cost. [A3]

(Refer to criteria #29-#32 under A4 for recording and registration of security interests in general.)

(Refer to criterion #16 under A2 for methods of notice for security interests over immovable property.)

27. The systems governing security interests in movable property and insolvency are procedurally and substantively integrated and harmonized. [A1]

(Refer to criterion #17 under A2 for integration of secured rights over immovable property and insolvency.)

28. The systems governing security interests in movable and immovable property are procedurally and substantively integrated and harmonized [A1]

LEGAL FRAMEWORK FOR CREDITOR RIGHTS

REGISTRY SYSTEMS

WB Principle

Registry Systems [A4]

There should be an efficient, transparent, and cost-effective registration system with regard to property rights and security interests in the borrower's immovable assets. There should be an efficient, transparent and cost-effective means of providing notice of the possible existence of security interests in regard to the borrower's movable assets as well, with registration in most cases being the principal and strongly preferred method (with some exceptions). The registration system should be reasonably integrated, easily accessible, and inexpensive with respect to recording requirements and searches of the registry, and it should be secure.

- A4.1 Land and mortgage registries. Registries pertaining to land (or land use rights) and mortgages are typically established solely for recording interests of this nature, although permanent fixtures and attachments to the land may be treated as subject to recordation in the place of the underlying real property. Land and mortgage registries are typically established by jurisdiction, region, or locale where the property is situated; ideally, they should provide for integrated, computerized search features.
- A4.2 Charge registries. Registries pertaining to movable assets of enterprises should be integrated and established nationally, with filings made on the basis of the enterprise or business name, ideally in a centralized, computerized registry situated in the jurisdiction or location where the enterprise or business entity has been incorporated or has its main place of registration.
- A4.3 Specialized registries. Special registries are beneficial in the case of certain kinds of assets, such as aircraft, vessels, vehicles, and certain types of intellectual property (such as trademarks and copyrights).

CRITERIA FOR ASSESSING COMPLIANCE

A4 – A4.3. REGISTRY SYSTEMS

29. There is an efficient, transparent, and cost-effective means of publicizing property rights and security interests (mortgages, charges, pledges and other encumbrances) in regard to the borrower's assets. [A4]
- a. The system provides an efficient, transparent, and cost-effective means of publicizing property rights in both movable and immovable assets. [A4]
 - b. The system provides an efficient, transparent, and cost-effective means of publicizing security interests in both movable and immovable assets. [A4]
30. Registration is provided as a means of publicizing security interests. [A4]
31. The registration system is reasonably integrated, easily accessible, and inexpensive with respect to:
- a. recording requirements, and
 - b. searches of the registry. [A4]
32. The registration system is perceived to be reliable. [A4]
33. Regulations governing recording and searching of security interests are integrated and harmonized with laws and regulations governing credit access, credit protection, credit risk management and recovery, and insolvency. [A1]

(Refer to the criteria under A5 for commercial enforcement systems.)

(Refer to criteria under Part B, "Risk Management and Corporate Workout.")

(Refer to criteria under Part C, "Legal Framework for Insolvency.")

34. Registries are established for recording property rights and security interests over immovable property. [A4.1]
 - (Refer to criteria #9-#18 under A2 on granting security interests on immovable property.)
 - a. Permanent fixtures and attachments to the land are treated as subject to recordation in the place of the underlying immovable property. [A4.1]
35. There are specialized registries for recording property rights and security interests over land and mortgages. [A4.1] If yes,
 - a. Land and mortgage registries are established by jurisdiction, region, or locale where the property is situated. [A4.1]
 - b. Land and mortgage registries provide for computerized search features. [A4.1]
 - (Refer to criterion #34a above on treatment for recording and registration of fixtures and attachments.)
36. Registries are established for recording security rights over movable property. [A4.2]
 - (Refer to criteria #19-#28 under A3 on granting security interests on movable property.)
37. Registries pertaining to movable assets of enterprises are integrated and established nationally. [A4.2]
38. Filings in charge registries are made on the basis of the enterprise or business name. [A4.2]
39. Charge registries are centralized and computerized. [A4.2]
40. Charge registries are situated in the jurisdiction or location where the enterprise or business entity has been incorporated or has its main place of registration. [A4.2]

LEGAL FRAMEWORK FOR CREDITOR RIGHTS

COMMERCIAL ENFORCEMENT SYSTEMS

WB Principle

Commercial Enforcement Systems [A5]

- A5.1 Enforcement of unsecured debt. A functional credit system should be supported by mechanisms and procedures that provide for efficient, transparent, and reliable methods for satisfying creditors' rights by means of court proceedings or nonjudicial dispute resolution procedures. To the extent possible, a country's legal system should provide for executive or abbreviated procedures for debt collection.¹
- A5.2 Enforcement of secured debt. Enforcement systems should provide efficient, cost-effective, transparent, and reliable methods (both nonjudicial and judicial) for enforcing a security interest over assets. Enforcement proceedings should provide for prompt realization of the rights obtained in secured assets, designed to enable maximum recovery according to market-based asset values.

CRITERIA FOR ASSESSING COMPLIANCE

A5.1 ENFORCEMENT OF UNSECURED DEBT

41. The system for commercial enforcement of unsecured debt establishes mechanisms and procedures perceived as providing for efficient, transparent, and reliable methods for satisfying creditors' rights. [A5.1] If yes,
- a. Such mechanisms and procedures include court proceedings as well as nonjudicial dispute resolution procedures. [A5.1]
 (Refer to criterion #239-#250 under D1 for role of courts in commercial enforcement proceedings.)
42. The system for commercial enforcement of unsecured debt provides for executive or abbreviated procedures for debt collection. [A5.1]
43. Laws and regulations governing the commercial enforcement system for unsecured debt are perceived to work in an integrated and harmonized fashion with those governing enforcement for secured debt. [A1]
 (Refer to criteria #45-#49 for enforcement of secured debt.)
44. The commercial enforcement system for unsecured debt is perceived to work in an integrated and harmonized fashion with the insolvency system. [A1]
 (Refer to criteria under Part C, "Legal Framework for Insolvency.")
 (Refer to criteria #45-#49 for enforcement of secured debt.)

¹ Enforcement under this principle aims primarily at the treatment with respect to proceedings to recover against corporate debtors. Where enforcement proceedings involve individuals or persons, reasonable exemptions may need to be adopted to allow individuals or persons to retain those assets indispensable to the subsistence of the debtor and his/her family. Any such exemptions should be clearly defined and narrowly tailored.

A5.2 ENFORCEMENT OF SECURED DEBT

45. The system for commercial enforcement of secured debt provides efficient, cost-effective, transparent, and reliable methods for enforcing a security interest over assets. [A5.2] If yes,
- a. Such methods include both judicial and nonjudicial procedures. [A5.2]
(Refer to criterion #239-#250 under D1 for the role of courts in commercial enforcement proceedings.)
46. Commercial enforcement proceedings for secured debt provide for prompt realization of the rights obtained in secured assets. [A5.2]
47. Commercial enforcement proceedings for secured debt are designed to enable maximum recovery according to market-based asset values. [A5.2]
48. Laws and regulations governing the commercial enforcement system for secured debt are perceived to work in an integrated and harmonized fashion with those governing enforcement for unsecured debt. [A1]
(Refer to criteria #48 and #49 for enforcement of unsecured rights.)
49. The commercial enforcement system for secured debt is perceived to work in an integrated and harmonized fashion with the insolvency system. [A1]
(Refer to criteria under Part C, "Legal Framework for Insolvency.")
(Refer to criteria #41 and #42 above for enforcement of unsecured rights.)

RISK MANAGEMENT AND CORPORATE WORKOUT

CREDIT INFORMATION SYSTEMS

WB Principle

Credit Information Systems [B1]

A modern credit-based economy requires access to complete, accurate, and reliable information concerning borrowers' payment histories. Key features of credit information systems should address the following:

- B1.1 Legal framework. The legal environment should not impede but ideally should provide the framework for the creation and operation of effective credit information systems. Libel laws and similar laws have the potential to constrain good-faith reporting by credit information systems. While the accuracy of information reported is an important value, credit information systems should be afforded legal protection sufficient to encourage their activities without eliminating incentives to maintain high levels of accuracy.
- B1.2 Operations. Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Measures should be employed to safeguard information contained in the credit information systems. Incentives should exist to maintain the integrity of the database. The legal system should create incentives for credit information services in order to collect and maintain a broad range of information on a significant part of the population.
- B1.3 Public policy. Legal controls on the type of information collected and distributed by credit information systems can be used to advance public policies. Legal controls on the type of information collected and distributed by credit information systems may be used to combat certain types of societal discrimination, such as discrimination based on race, gender, national origin, marital status, political affiliation, or union membership. There may be public policy reasons for restricting the ability of credit information services to report negative information beyond a certain period of time, such as five or seven years.
- B1.4 Privacy. Subjects of information in credit information systems should be made aware of the existence of such systems and be able to access information about themselves. In particular, they should be notified when information from such systems is used to make adverse decisions about them. They should be able to dispute inaccurate or incomplete information and mechanisms should exist to have such disputes investigated and have errors corrected.
- B1.5 Enforcement/Supervision. One benefit of the establishment of credit information systems is to permit regulators to assess an institution's risk exposure, thus giving the institution the tools and incentives to assess that exposure itself. Enforcement systems should provide efficient, inexpensive, transparent, and predictable methods for resolving disputes concerning the operation of credit information systems. Both nonjudicial and judicial enforcement methods should be considered. Sanctions for violations of laws regulating credit information systems should be sufficiently stringent to encourage compliance but not so stringent as to discourage the operation of such systems.

CRITERIA FOR ASSESSING COMPLIANCE

B1. CREDIT INFORMATION SYSTEMS

- 50. The credit information systems permit access to complete, accurate, and reliable information concerning borrowers' payment histories. [B1]
- 51. The credit information systems comply with the following key features:
 - a. The legal environment provides the framework for the creation and operation of effective credit information systems. [B1.1]

- (Refer to criterion #53 below on legal framework for credit information systems.)
- b. The legal system clearly circumscribes permissible uses of information from credit information systems. [B1.2]
- (Refer to criteria #54-57 below on operations and permissible uses of credit information systems.)
- c. The legal system provides for legal control over the type of information collected and distributed by credit information systems in order to advance public policies. [B1.3]
- (Refer to additional criteria #61 below on advancement of public policies through credit information systems.)
- d. The legal system provides restrictions on the ability of credit information services to report negative information beyond a certain period of time. [B1.3]
- e. Subjects of information in credit information systems are made aware of the existence of such systems and of the information contained in them. [B1.4]
- (Refer to criteria #57 below on privacy and access to information in credit information systems.)
- f. Enforcement systems provide an efficient, inexpensive, transparent, and predictable method for assessing an institution's risk exposure. [B1.5]
- g. Enforcement systems provide an efficient, inexpensive, transparent, and predictable method for resolving disputes concerning the operation of credit information systems. [B1.5]
- (Refer to criteria #60 below on enforcement of credit information systems.)
52. Credit information systems are afforded legal protection sufficient to encourage their activities. If yes,
- a. Such protection is balanced so as not to eliminate incentives to maintain high levels of accuracy. [B1.1]
- b. Libel and similar laws constrain good-faith reporting by credit information systems. [B1.1]
53. The legal system clearly circumscribes permissible uses of information from credit information systems, especially regarding information about individuals. [B1.2]
54. The legal system provides measures to safeguard information contained in credit information systems. [B1.2]
55. The legal system creates incentives to maintain the integrity of the credit information databases. [B1.2]
56. The legal system creates incentives for credit information services to collect and maintain a broad range of information on a significant part of the country's population. [B1.2]
57. Subjects of information in credit information systems are able:
- a. to access information maintained about them in the credit information systems and be notified when information from such systems is used to make adverse decisions about them; [B1.4]
- b. to dispute inaccurate or incomplete information; [B1.4] and
- c. to access mechanisms to have such disputes investigated and errors corrected. [B1.4]
58. The credit information systems permit regulators to assess an institution's risk exposure. [B1.5]
59. The credit information systems give institutions the tools and incentives to assess their own risk exposure. [B1.5]

60. Both nonjudicial and judicial enforcement methods are considered for resolving disputes concerning the operation of credit information systems. [B1.5]
61. Sanctions for violations of laws regulating credit information systems are sufficiently stringent to encourage compliance but not so stringent as to discourage the operation of such systems. [B1.5]

RISK MANAGEMENT AND CORPORATE WORKOUT

DIRECTOR AND OFFICER ACCOUNTABILITY

WB Principle

Director and Officer Accountability [B2]

Laws governing director and officer liability for decisions detrimental to creditors made when an enterprise is in financial distress or insolvent should promote responsible corporate behavior while fostering reasonable risk taking. At a minimum, standards should hold management accountable for harm to creditors resulting from willful, reckless, or grossly negligent conduct.²

CRITERIA FOR ASSESSING COMPLIANCE

B2. DIRECTOR AND OFFICER ACCOUNTABILITY

62. The legal system addresses accountabilities of directors and officers in the period when a company is facing an imminent risk of insolvency. [B2]
63. The laws governing director and officer liability for decisions detrimental to creditors made when an enterprise is in financial distress or insolvent promote responsible corporate behavior while fostering reasonable risk taking. [B2]
64. Legal standards hold management accountable, at a minimum, for harm to creditors resulting from willful, reckless, or grossly negligent conduct. [B2]

² This principle addresses only accountabilities of directors and officers in the period when a company is facing an imminent risk of insolvency. General principles for corporate governance and officer and director liability to their shareholders are dealt with under the OECD Principles for Corporate Governance.

RISK MANAGEMENT AND CORPORATE WORKOUT

ENABLING LEGISLATIVE FRAMEWORK

WB Principle

Enabling Legislative Framework [B3]

Corporate workouts and restructurings should be supported by an enabling environment, one that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An environment that enables debt and enterprise restructuring includes laws and procedures that:

- B3.1 Require disclosure of or ensure access to timely, reliable, and accurate financial information on the distressed enterprise;
- B3.2 Encourage lending to, investment in, or recapitalization of viable financially distressed enterprises;
- B3.3 Flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges);
- B3.4 Provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction;
- B3.5 Address regulatory impediments that may affect enterprise reorganizations; and
- B3.6 Give creditors reliable recourse to enforcement, as outlined in Section A, and to liquidation and/or reorganization proceedings, as outlined in Section C.

CRITERIA FOR ASSESSING COMPLIANCE

B3. ENABLING LEGISLATIVE FRAMEWORK

65. The legal system provides an enabling environment for informal workout procedures or voluntary restructuring negotiations. [B3]

66. The legal system provides an environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. [B3]

(Refer to criteria #68-70 under B4.1 on enabling legislative framework under insolvency law.)

67. The legal system includes laws and procedures that: [B3]

- a. require the disclosure of or ensure access to timely, reliable, and accurate financial information on the distressed enterprise; [B3.1]
- b. encourage lending to, investment in, or recapitalization of viable financially distressed enterprises; [B3.2]
- c. flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges); [B3.3]
- d. provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction; [B3.4]
- e. address regulatory impediments that may affect enterprise reorganizations; [B3.5] and

(Refer to criteria #78-79 under B5 on the regulation of financial institutions.)

- f. give creditors reliable recourse to enforcement as outlined in the legal framework for creditor rights and to liquidation and/or reorganization proceedings as outlined in the legal framework for insolvency. [B3.6]

(For criteria regarding the legal framework for creditor rights refer to A1 to A5)

(For criteria regarding the legal framework for insolvency refer to C1 to C15)

RISK MANAGEMENT AND CORPORATE WORKOUT

INFORMAL WORKOUT PROCEDURES

WB Principle

Informal workout procedures [B4]

- B4.1 An informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. While a reliable method for timely resolution of inter-creditor differences is important, the financial supervisor should play a facilitating role consistent with its regulatory duties as opposed to actively participating in the resolution of inter-creditor differences.
- B4.2 Where the informal procedure relies on a formal reorganization, the formal proceeding should be able to quickly process the informal, pre-negotiated agreement.
- B4.3 In the context of a systemic crisis, or where levels of corporate insolvency have reached systemic levels, informal rules and procedures may need to be supplemented by interim framework enhancement measures in order to address the special needs and circumstances encountered with a view to encouraging restructuring. Such interim measures are typically designed to cover the crisis and resolution period without undermining the conventional proceedings and systems.

UNCITRAL Recommendations

Expedited reorganization proceedings (Part two, chapter IV, paras. 76-94, pp. 238-243)

Purpose of legislative provisions

The purpose of provisions relating to insolvency procedures which combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the insolvency law for court confirmation of that plan is to:

- (a) Recognize that voluntary restructuring negotiations, which typically involve restructuring of the debt due to lenders and other institutional creditors and major non-institutional creditors where their participation is crucial to the restructuring, but not involving all categories of creditors, is a cost effective, efficient tool for the rescue of financially troubled businesses;
- (b) Encourage and facilitate the use of informal negotiation;
- (c) Develop a procedure under the insolvency law that will:
 - (i) Preserve the benefits of voluntary restructuring negotiations where a majority of each affected class of creditors agree to a plan;
 - (ii) Minimize time delays and expense and ensure that the plan negotiated and agreed in voluntary restructuring negotiations is not lost;
 - (iii) Bind those minority members of each affected class of creditors and equity holders who do not accept the negotiated plan;
 - (iv) Be based upon the same substantive requirements, but shortened time periods, as reorganization proceedings under the insolvency law, including essentially the same safeguards; and
- (d) Suspend, with appropriate safeguards, requirements in other laws that may prevent or inhibit the use of processes which delay the invocation of the insolvency law.³

Commencement of expedited reorganization proceedings

(160) The insolvency law should specify that expedited proceedings can be commenced on the

³ For example, requirements for unanimous consent for adjustment of indebtedness outside of insolvency proceedings, liability for directors where the debtor continues to trade during the period when the out-of-court negotiations are being conducted, that do not recognize obligations for credit extended during such a period, and that restrict conversion of debt to equity.

application of any debtor that:

- (a) Is or 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
- (c) Satisfies the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law.

(160) The insolvency law may additionally specify that an expedited proceeding can be commenced on the application of any debtor if:

- (a) The debtor's liabilities exceed or are likely to exceed its assets; and
- (b) The requirements of recommendation 159(b) and (c) are satisfied.

Application requirements

(162) 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 affect the rights or claims of unaffected creditors without their agreement;
- (d) A report of the votes of affected classes of creditors demonstrating that those classes have accepted the plan by the majorities specified in the insolvency law;
- (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

(163) 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 recommendations 159 or 160 and if so, commence proceedings.

Effect of commencement

(164) 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 modified or not applicable;⁴
- (b) Unless otherwise determined by the court, the effects of commencement should be limited to the debtor, individual creditors and classes of creditors and equity holders whose rights are modified or affected by the plan;

⁴ Provisions of the insolvency law that generally would *not* be applicable or that could be modified 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) Any creditor committee formed during the course of the voluntary restructuring negotiations should be treated as a creditor committee appointed under the insolvency law; and

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

Notice of commencement

(165) The insolvency law should specify that notice of the commencement of expedited proceedings be given to affected creditors and affected equity holders. The notice should specify:

(a) The amount of each affected creditor's claim according to the debtor;

(b) The time period for submitting a claim in a different amount if the affected creditor disagrees with the debtor's statement of the claim, and the place where the claim can be submitted;

(c) The time and procedure for challenging claims submitted by other parties;

(d) The time and place for the hearing on confirmation of the plan, and for the submission of any objection to confirmation; and

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

Confirmation of the plan

(166) 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;

(c) Unaffected creditors are being paid in the ordinary course of business and the plan does not modify or affect the rights or claims of unaffected creditors without their agreement; and

(d) The financial analysis submitted with the application demonstrates that the plan satisfies all applicable requirements for reorganization.

Effect of a confirmed plan

(167) 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

(168) The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

CRITERIA FOR ASSESSING COMPLIANCE

B4.1. INFORMAL WORKOUT PROCEDURES

68. The law encourages and facilitates the use of informal workout procedures . [B4.1]

(Refer to criteria #65-#67 under B3 on enabling legislative framework for informal workout procedures.)

69. The law provides for a reliable method for timely resolution of inter-creditor differences during informal workout procedures. [B4.1]

70. The insolvency system provides that the financial supervisor facilitate the use of informal workout procedures, consistent with its regulatory duties (as opposed to actively participating in the resolution of inter-creditor differences). [B4.1]

(Refer to criterion #77 under B4.3 below on corporate workouts during systemic crisis.)

(Refer to criterion #78 under B5 on regulation of workout and risk management practices.)

B4.2. EXPEDITED REORGANIZATION PROCEEDINGS

71. The insolvency law provides for an expedited proceeding where the court can confirm a plan obtained through informal, voluntary restructuring negotiations. (Expedited reorganization proceedings - Purpose (c)) [B4.2]

72. Expedited proceedings:

(a) Preserve the benefits of informal workouts where a majority of each affected class of creditors agrees to a plan;

(b) Minimize time delays and expense;

(c) Bind those minority members of each affected class of creditors and equity holders who do not accept the negotiated plan;

(d) Are based upon the same substantive requirements, but shortened time periods, as reorganization proceedings under the insolvency law, including essentially the same safeguards. (Expedited reorganization proceedings - Purpose (c)) (164)(a)

(Refer to criteria #204 and #205 under C14.1 on general features of reorganization proceedings.)

73. The insolvency law specifies that a hearing on the confirmation of the plan obtained through voluntary restructuring negotiations by the court should be held as expeditiously as possible. (164 d)

74. The insolvency law suspends, with appropriate safeguards, requirements in other laws that may prevent or inhibit the use of processes which delay the invocation of the insolvency law. (Expedited reorganization proceedings - Purpose (d))

75. The insolvency law specifies that, unless otherwise determined by the court, the effects of commencement of expedited reorganization proceedings are the same as full reorganization proceedings, including notice provisions. (164 b)

76. The insolvency law specifies that the court will confirm the plan if:

a. the plan satisfies the substantive requirements for confirmation of a plan in full reorganization proceedings; (166 a-d)

(Refer to criteria #222 under C14.3 on confirmation of an approved reorganization plan.)

B4.3. INFORMAL WORKOUT PROCEDURES DURING SYSTEMIC CRISIS

77. In the context of a systemic crisis, or where levels of corporate insolvency have reached systemic levels, the insolvency law supplements informal rules and procedures with interim framework enhancement measures to address the special needs and circumstances encountered with a view to encouraging restructuring. [B4.3] If yes,

a. Such interim measures are designed to cover the crisis and resolution period, without undermining the conventional proceedings and legal systems. [B4.3]

RISK MANAGEMENT AND CORPORATE WORKOUT

REGULATION OF WORKOUT AND RISK MANAGEMENT PRACTICES

WB Principle

Regulation of Workout and Risk Management Practices [B5]

- B5.1 A country's financial sector (possibly with the informal endorsement and assistance of the central bank, finance ministry, or bankers' association) should promote the development of a code of conduct on a voluntary, consensual procedure for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where corporate insolvency has reached systemic levels.
- B5.2 In addition, good risk-management practices should be encouraged by regulators of financial institutions and supported by norms that facilitate effective internal procedures and practices supporting the prompt and efficient recovery and resolution of nonperforming loans and distressed assets.

CRITERIA FOR ASSESSING COMPLIANCE

B5. REGULATION OF WORKOUT AND RISK MANAGEMENT PRACTICES

78. The country's financial sector (possibly with the informal endorsement and assistance of the central bank, finance ministry, or bankers' association) promotes the development of a code of conduct on a voluntary, consensual procedure for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where corporate insolvency has reached systemic levels. [B5.1]

(Refer to criteria #77 under B4.3 on informal workout procedures during systemic crisis.)

79. Regulators of financial institutions encourage good risk-management practices. [B5.2]

(Refer to criterion #70 under B4.1 on the financial supervisor's role in informal workout procedures.)

80. Good risk-management practices are supported by norms that facilitate effective internal procedures and by practices that support prompt and efficient recovery and resolution of nonperforming loans and distressed assets. [B5.2]

COMMERCIAL INSOLVENCY

KEY OBJECTIVES AND POLICIES

WB Principle

Key Objectives and Policies [C1]

Though country approaches vary, effective insolvency systems should aim to:

- (i) Integrate with a country's broader legal and commercial systems;
- (ii) Maximize the value of a firm's assets and recoveries by creditors;
- (iii) Provide for the efficient liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;
- (iv) Strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one procedure to another;
- (v) Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;
- (vi) Provide for timely, efficient, and impartial resolution of insolvencies;
- (vii) Prevent the improper use of the insolvency system;
- (viii) Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
- (ix) Provide a transparent procedure that contains, and consistently applies, clear risk allocation rules and incentives for gathering and dispensing information;
- (x) Recognize existing creditor rights and respect the priority of claims with a predictable and established process; and
- (xi) Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

UNCITRAL Recommendations

Designing the key objectives and structure of an effective and efficient insolvency law (Part one, chapter I, paras. 4-27, pp. 10-20)

(1) In order to establish and develop an effective insolvency law, the following key objectives should be considered:

- (a) Provide certainty in the market to promote economic stability and growth;
- (b) Maximize value of assets;
- (c) Strike a balance between liquidation and reorganization;
- (d) Ensure equitable treatment of similarly situated creditors;
- (e) Provide for timely, efficient and impartial resolution of insolvency;
- (f) Preserve the insolvency estate to allow equitable distribution to creditors;
- (g) Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and
- (h) Recognize existing creditors rights and establish clear rules for ranking of priority claims.

(2) The insolvency law should include provisions addressing both reorganization and liquidation of a debtor.

(3) The insolvency law should recognize rights and claims arising under law other than the insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law.

- (4) The insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable.
- (5) The insolvency law should include a modern, harmonized and fair framework to address effectively instances of cross-border insolvency. Enactment of the UNCITRAL Model Law on Cross-Border Insolvency is recommended
- (6) In order to design an effective and efficient insolvency law, the following common features should be considered:
- (a) Identifying the debtors that may be subject to insolvency proceedings, including those debtors that may require a special insolvency regime;
 - (b) Determining when insolvency proceedings may be commenced and the type of proceeding that may be commenced, the party that may request commencement and whether the commencement criteria should differ depending upon the party requesting commencement;
 - (c) The extent to which the debtor should be allowed to retain control of the business once insolvency proceedings commence, or be displaced and an independent party (in the Guide referred to as the insolvency representative) appointed to supervise and manage the debtor, and the distinction to be made between liquidation and reorganization in that regard;
 - (d) Identification of the assets of the debtor that will be subject to the insolvency proceedings and constitute the insolvency estate;
 - (e) Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative, and where the protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings;
 - (f) The manner in which the insolvency representative may deal with contracts entered into by the debtor before the commencement of proceedings and in respect of which both the debtor and its counterparty have not fully performed their respective obligations;
 - (g) The extent to which set-off or netting rights can be enforced or will be protected, notwithstanding the commencement of insolvency proceedings;
 - (h) The manner in which the insolvency representative may use or dispose of assets of the insolvency estate;
 - (i) The extent to which the insolvency representative can avoid certain types of transactions that result in the interests of creditors being prejudiced;
 - (j) In the case of reorganization, preparation of the reorganization plan and the limitations, if any, that will be imposed on the content of the plan, the preparer of the plan and the conditions required for its approval and implementation;
 - (k) Rights and obligations of the debtor;
 - (l) Duties and functions of the insolvency representative;
 - (m) Functions of the creditors and creditor committee;
 - (n) Costs and expenses relating to the insolvency proceedings;
 - (o) The treatment of claims and their ranking for the purposes of distributing the proceeds of liquidation;
 - (p) Distribution of the proceeds of liquidation;
 - (q) Discharge or dissolution of the debtor; and
 - (r) Conclusion of the proceedings.

COMMERCIAL INSOLVENCY

COMMENCEMENT - DUE PROCESS: NOTIFICATION AND INFORMATION

WB Principle

Due process: Notification and Information [C2]

Effectively protecting the rights of parties with an interest in a proceeding requires that such parties have a right to be heard on and to receive proper notice of matters that affect their rights, and that such parties be afforded access to information relevant to protecting their rights or interests and to efficiently resolving disputes. To achieve these objectives, the insolvency system should:

- C2.1 Afford timely and proper notice to interested parties in a proceeding concerning matters that affect their rights. In insolvency proceedings, there should be procedures for appellate review that support timely, efficient, and impartial resolution of disputed matters. As a general rule, appeals do not stay insolvency proceedings, although the court may have power to do so in specific cases.
- C2.2 Require the debtor to disclose relevant information pertaining to its business and financial affairs in detail sufficient to enable the court, creditors, and affected parties to reasonably evaluate the prospects for reorganization. The system should also provide for independent comment on and analysis of that information. Provision should be made for the possible examination of directors, officers and other persons with knowledge of the debtor's financial position and business affairs, who may be compelled to give information to the court, the insolvency representative, and the creditor's committee.
- C2.3 Provide for the retention of professional experts to investigate, evaluate, or develop information that is essential to key decision-making. Professional experts should act with integrity, impartiality, and independence.

UNCITRAL Recommendations General notice (Part two, chapter I, paras. 64-71, pp. 59-61)

(23) The insolvency law should specify that the means of giving notice of the commencement of insolvency proceedings must be appropriate to ensure that the information is likely to come to the attention of parties in interest. The insolvency law should specify the party responsible for giving that notice.

Notice to creditors

(24) The insolvency law should specify that notice of the commencement of proceedings be given to creditors individually, unless the court considers that, under the circumstances, some other form of notice would be more appropriate.

Content of notice

(25) The insolvency law should specify that the notice of commencement of insolvency proceedings include:

- (a) Information concerning submission of claims, including the time and place for submission;
- (b) The procedure and form requirements for the submission of claims;
- (c) The consequences of failure to submit a claim in accordance with paragraphs (a) and (b); and
- (d) Information concerning verification of claims, application of the stay and its effects, and meetings of creditors.

Obligations of the debtor (Part two, chapter III, paras. 22-33, pp. 167-171)

(110) The insolvency law should clearly specify the debtor's obligations in respect of insolvency proceedings. Those obligations should arise on the commencement of, and continue throughout, those proceedings. The obligations should include obligations:

- (a) To cooperate with and assist the insolvency representative to perform its duties;
- (b) To provide accurate, reliable and complete information relating to its financial position and business affairs that might be requested by the court, the insolvency representative, creditors and/or the

creditor committee, including lists of:

- (i) Transactions occurring prior to commencement that involved the debtor or the assets of the debtor;
- (ii) Ongoing court, arbitration or administrative proceedings, including enforcement proceedings;
- (iii) Assets, liabilities, income and disbursements;
- (iv) Debtors and their obligations; and
- (v) Creditors and their claims prepared in cooperation with the insolvency representative and revised and amended by the debtor as claims are verified and admitted or denied;

(c) To cooperate with the insolvency representative to enable the insolvency representative to take effective control of the estate and to facilitate or cooperate in the recovery by the insolvency representative of the assets, or control of the assets of the estate, wherever located and business records; and

(d) Where the debtor is a natural person, to provide notice to the court if it proposes or is forced to leave its habitual place of residence and, where the debtor is a legal person, to obtain the consent of the court or the insolvency representative to the movement of its the headquarters.

Confidentiality (Part two, chapter III, paras. 28 (p. 169), 52 (p. 180) and 115 (p. 202))

(111) The insolvency law should specify protections for information provided by the debtor or concerning the debtor that is commercially sensitive or confidential.

Creditor representation (Part two, chapter III, paras. 75-88, pp. 190-195)

(129) The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation. The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.

Party in interest's right to be heard and to appeal (Part two, chapter III, paras. 116-120, pp. 205-206)

Purpose of legislative provisions

The purpose of legislative provisions on review and appeal is to:

- (a) Ensure that parties in interest have a right to be heard and seek relief from the court when their rights, interests in assets or duties under the insolvency law are affected; and
- (b) Establish procedures for providing relief and for appellate review.

Right to be heard and to request review

(137) The insolvency law should specify that a party in interest have a right to be heard on any issue in the insolvency proceedings that affects its rights, obligations or interests. For example, a party in interest should be entitled to:

- (a) Object to any act that requires court approval;
- (b) Request review by the court of any act for which court approval was not required or not requested; and
- (c) Request any relief available to it in insolvency proceedings.

Right of Appeal

(138) The insolvency law should specify that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests.

CRITERIA FOR ASSESSING COMPLIANCE

C2.1 (1) NOTICE REQUIREMENTS

81. The insolvency law specifies notice requirements for timely and proper notice to be given to parties in interest in a proceeding, concerning any matters that may affect their rights. [C2, C2.1]

(Refer to criteria #104, #106, #107, #108, and #109 under C4 on notice requirements related to commencement.)

(Refer to criteria #111 under C5.1 on notice requirements related to provisional measures.)

(Refer to criteria #143 and #144 under C8.2-C8.3 on notice referring to use and disposal of assets of the estate.)

82. The insolvency law includes clear rules on:

- a. the party responsible for giving notice, (23) and
- b. the content of the notice. (25)

83. The insolvency law specifies the means of giving notice in insolvency proceedings appropriate to ensure that the information is likely to come to the attention of parties in interest. (23) (24)

C2.1 (2) RIGHT TO BE HEARD AND APPELLATE RIGHTS

84. A party in interest has a right to be heard and seek relief on any issue in the insolvency proceedings that affects its rights, obligations, or interests. (137)

85. The law establishes efficient procedures for appellate review that support timely, efficient, and impartial resolution of insolvencies. (Party in interest-Purpose of legislative provisions (b)) [C2.1] (138)

86. As a general rule, appeals do not stay insolvency proceedings although the court may have the power to do so in specific cases. [C2.1]

C2.2 INFORMATION

87. The insolvency law clearly specifies the debtor's obligation to provide accurate and complete information relating to its financial position and business affairs that might be requested by the court, the insolvency representative, creditors and/or a creditor committee. (110 b) [C2.2]

(Refer to criteria #208 and #209 under C14.2 on disclosure statement for reorganization plan.)

88. The insolvency law specifies protections for information provided by the debtor or concerning the debtor that is commercially sensitive or confidential. (111) (120)

89. Creditor interests are safeguarded by appropriate means that enable creditors to actively monitor insolvency proceedings. (129) [C7.1]

(Refer to criteria #128-138 under C7 on creditors and creditor's role in insolvency proceedings)

90. The insolvency law specifies the circumstances in which the debtor is entitled to obtain information relating to the insolvency proceedings. (108) [C2]
91. The legal system provides for the examination of directors, officers, and other persons with knowledge of the debtor's financial position and business affairs. [C2.2]
92. There are mechanisms in place for compelling directors, officers, and other persons to give information related to the debtor's financial position and business affairs. [C2.2]
93. The insolvency system provides for the retention of independent professional experts. [C2.2]
[C2.3]

COMMERCIAL INSOLVENCY

COMMENCEMENT - ELIGIBILITY

WB Principle

Eligibility [C3]

The insolvency proceeding should apply to all enterprises or corporate entities, including state-owned enterprises.⁵ Exceptions should be limited, clearly defined, and should be dealt with through a separate law or through special provisions in the insolvency law.

UNCITRAL Recommendations

Eligibility (Part two, chapter I, paras. 1-11, pp. 38-41)

Purpose of legislative provisions

The purpose of provisions on eligibility and jurisdiction is to establish:

- (a) The types of debtors that are subject to the insolvency law;
- (b) The types of debtors that may be excluded from the insolvency law;
- (c) The debtors that have sufficient connection to a State to be subject to the insolvency law; and
- (d) The courts that have jurisdiction over the commencement and conduct of insolvency proceedings.

(8) The insolvency law should govern insolvency proceedings against all debtors that engage in economic activities, whether natural or legal persons, including state-owned enterprises,⁶ and whether or not those economic activities are conducted for profit.

(9) Exclusions from the application of the insolvency law should be limited and clearly identified in the insolvency law.⁷

CRITERIA FOR ASSESSING COMPLIANCE

- 94. The insolvency law clearly defines the types of debtors that are subject to insolvency proceedings. (Eligibility and Jurisdiction-Purpose of legislative provisions (a))
- 95. The insolvency law provides for the commencement of insolvency proceedings against all enterprises and corporate entities that engage in economic activities, irrespective of whether those activities are conducted for profit.⁸ (8)
- 96. Exceptions to the general rule on inclusion are: [C3] (9)
 - a. Limited;
 - b. Clearly identified in the insolvency law;
 - c. Reasonably tailored to achieve a state⁹ policy objective¹⁰; and

⁵ Ideally, the insolvency process should apply to SOEs, or alternatively, exceptions of SOEs should be clearly defined and based upon compelling state policy.

⁶ It is not intended that the *Guide* would apply to the insolvency of States, sub-national governments, municipalities and other similar types of organization, except to the extent that they are a "state-owned enterprise".

⁷ Highly regulated organizations such as banks and insurance companies may require specialized treatment that can appropriately be provided in a separate insolvency regime or through special provisions in the general insolvency law. Some SOEs, such as those involved in sensitive sectors of the economy, might also be excluded.

⁸ The ROSC aims to assess only the proceedings with respect to enterprises or corporate entities, and does not assess compliance for treatment or inclusion of individuals engaged in economic activities and consumers.

- d. Dealt with through a separate law or through special provisions in the insolvency law.

⁹ Legitimate exceptions often include highly regulated organizations such as financial institutions and insurance companies.

¹⁰ For example, exceptions for policy reasons might, but need not necessarily, include such entities as: [(i) those where the government has given an explicit guarantee of repayment of business liabilities;] (ii) SOEs that are part of a massive macroeconomic policy change; (iii) SOEs or entities that are within sensitive sectors of the economy that pertain to the national security, health or welfare of the citizens; (iv) highly regulated industries that are subject to separate regulatory oversight, where that exists, such as monopolies, financial institutions and insurance companies.

COMMERCIAL INSOLVENCY

COMMENCEMENT - COMMENCEMENT: APPLICABILITY AND ACCESSIBILITY

WB Principle

Commencement: Applicability and Accessibility [C4]

- C4.1 Access to the system should be efficient and cost-effective. Both debtors and creditors should be entitled to apply for insolvency proceedings.
- C4.2 Commencement criteria and presumptions about insolvency should be clearly defined in the law. The preferred test to commence an insolvency proceeding should be the debtor's inability to pay debts as they mature, although insolvency may also exist where the debtor's liabilities exceed the value of its assets, provided that the values of assets and liabilities are measured on the basis of fair-market values.¹¹
- C4.3 Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty).
- C4.4 Where the application for commencement of a proceeding is made by a creditor, the debtor should be entitled to prompt notice of the application, an opportunity to defend against the application, and a prompt decision by the court on the commencement of the case or the dismissal of the creditor's application.

UNCITRAL Recommendations

Commencement of proceedings (Part two, chapter I, paras. 20-79, pp. 45-64)

Purpose of legislative provisions

The purpose of provisions on commencement of insolvency proceedings is to:

- (a) Facilitate access for debtors and creditors to the remedies provided by the law;
- (b) Establish commencement criteria that are transparent and certain;
- (c) Enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and cost effective manner;
- (d) Establish safeguards to protect both debtors and creditors from improper use of the application procedure; and
- (e) Establish requirements for effective notification of commencement of proceedings.

Commencement standard

Persons permitted to apply

(14) The insolvency law should specify the parties permitted to make an application for commencement of insolvency proceedings, which should include the debtor and any of its creditors.

Debtor application

(15) The insolvency law should specify that insolvency proceedings can be commenced on the application of a debtor if the debtor can show either that:

- (a) It is or will be generally unable to pay its debts as they mature; or
- (b) Its liabilities exceed the value of its assets.

Creditor applications

(16) The insolvency law should specify that insolvency proceedings can be commenced on the application of a creditor if it can be shown that either:

¹¹ A single or dual approach may be adopted, although where only a single test is adopted it should be based on the liquidity approach for determining insolvency – that is, the debtor's inability to pay due debts.

- (a) The debtor is generally unable to pay its debts as they mature; or
- (b) The debtor's liabilities exceed the value of its assets.

Presumption that the debtor is unable to pay

(17) The insolvency law may establish a presumption that, if the debtor fails to pay one or more of its mature debts, and the whole of the debt is not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt claimed, the debtor is generally unable to pay its debts.

Commencement on debtor application

(18) The insolvency law should specify that where the application for commencement is made by the debtor:

- (a) The application for commencement will automatically commence the insolvency proceedings; or
- (b) The court will promptly determine its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.

Commencement on creditor application

(19) The law generally should specify that, where a creditor makes the application for commencement:

- (a) Notice of the application promptly is given to the debtor;
- (b) The debtor be given the opportunity to respond to the application, by contesting the application, consenting to the application or, where the application seeks liquidation, requesting the commencement of reorganization proceedings; and
- (c) The court will promptly determine its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.

Denial of an application to commence proceedings

(20) The insolvency law should specify that, where the decision to commence proceedings is to be made by the court, the court may deny the application to commence and, where appropriate, impose costs or sanctions against the applicant, if it determines:

- (a) That it does not have jurisdiction, the debtor is ineligible or does not meet the commencement standard; or
- (b) That the application is an improper use of the law.

(21) Where the application was made by a creditor, the insolvency law should specify that the debtor promptly be given notice of the decision to deny.

Notice of commencement of proceedings

(22) The insolvency law should establish procedures for giving notice of the commencement of insolvency proceedings.

- General notice

(23) The insolvency law should specify that the means of giving notice of the commencement of insolvency proceedings must be appropriate to ensure that the information is likely to come to the attention of parties in interest. The insolvency law should specify the party responsible for giving that notice.

- Notice to creditors

(24) The insolvency law should specify that notice of the commencement of proceedings be given to creditors individually, unless the court considers that, under the circumstances, some other form of notice would be more appropriate.

¹² On mechanisms for appointment, see UNCITRAL Insolvency Guide, part two, chapter III, paras. 44-47, pp 176-177; on remuneration, part two, chapter III, paras. 53-59, pp 180-183.

Debtor with insufficient assets

(26) The insolvency law should specify the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceedings. Different approaches may be taken including:

- (a) Denial of the application, except where the debtor is an individual who would be entitled to a discharge; or
- (b) Commencement of the proceedings, where different mechanisms for appointment and remuneration of the insolvency representative may be available.¹²

Dismissal of insolvency proceedings

(27) The insolvency law should permit the court to dismiss proceedings if, after commencement, the court determines, for example, that:

- (a) The proceedings constitute an improper use of the insolvency law; or
- (b) The debtor was ineligible or did not meet the commencement standard at the time of commencement.

(28) The insolvency law should specify that where proceedings are dismissed, the court may impose costs or sanctions, where appropriate, against the applicant for commencement of the proceedings.

(29) The insolvency law should require notice of a decision to dismiss proceedings to be given.

CRITERIA FOR ASSESSING COMPLIANCE

- 97. The insolvency law provides for efficient and cost-effective access to the insolvency system. [C4.1]
- 98. The insolvency law specifies that the debtor or any creditor is entitled to make an application for commencement of insolvency proceedings. (14) [C4.1]
- 99. The insolvency law clearly defines:
 - a. Commencement criteria (Commencement of proceedings - purpose b); and
 - b. Presumptions of insolvency. [C4.2] (17)
- 100. The insolvency law specifies that insolvency proceedings can be commenced on the application of a debtor if the debtor can show that it is or will be generally unable to pay its debts as they mature. (15) [C4.2]
- 101. The insolvency law specifies that insolvency proceedings can be commenced on the application of a creditor if it can be shown that the debtor is generally unable to pay its debts as they mature. (16) [C4.2]
- 102. If the insolvency law provides that the commencement standard is met where the debtor's liabilities exceed the value of its assets, the following conditions should apply:
 - a. Assets and liabilities are measured on the basis of fair market values; and [C4.2]
 - b. The cessation of payments test (that is, the criteria in 100 and 101) is available as an alternative test.
- 103. The insolvency law specifies that where the application for commencement is made by the debtor:

- a. The application for commencement will automatically commence the insolvency proceedings; or
 - b. The court promptly commences insolvency proceedings on the determination that:
 - It has jurisdiction;
 - The debtor is eligible; and
 - The commencement standard has been met. (18)
104. The insolvency law specifies that, where a creditor makes the application for commencement:
- a. Notice of the application promptly be given to the debtor;
 - b. The debtor be given the opportunity to respond to the application; and
 - c. The court promptly commence insolvency proceedings on the determination that:
 - It has jurisdiction;
 - The debtor is eligible; and
 - The commencement standard has been met. (19) [C4.4]
105. The insolvency law specifies that the court may deny the application to commence or dismiss proceedings that have commenced if it determines that:
- a. It does not have jurisdiction;
 - b. The debtor is ineligible;
 - c. The commencement standard has not been met (20); or
 - d. The application is an improper use of the law. (20) (27) (28)
106. Where the application made by a creditor is denied, the insolvency law specifies that the debtor promptly be given notice of the decision to deny. (21)
107. The insolvency law establishes requirements for effective notification of commencement of proceedings. (Commencement of proceedings - purpose e) (22)
(Refer to criteria #81, #82, and #83 under C2.1 on notification requirements)
108. There is a requirement for notice of the commencement of insolvency proceedings to be given to creditors individually, unless the court considers otherwise appropriate under the circumstances. (24)
109. The insolvency law requires that notice of a decision to dismiss proceedings be given. (29)
110. The insolvency law specifies the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceedings. (26)

COMMERCIAL INSOLVENCY

PROVISIONAL MEASURES AND EFFECTS OF COMMENCEMENT

WB Principle

Provisional Measures and Effects of Commencement [C5]

- C5.1 When an application has been filed, but before the court has rendered a decision, provisional relief or measures should be granted when necessary to protect the debtor's assets and the interests of stakeholders, subject to affording appropriate notice to affected parties.
- C5.2 The commencement of insolvency proceedings should prohibit the unauthorized disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor.
- C5.3 A stay of actions by secured creditors also should be imposed in liquidation proceedings to enable higher recovery of assets by sale of the entire business or its productive units, and in reorganization proceedings where the collateral is needed for the reorganization. The stay should be of limited, specified duration, strike a proper balance between creditor protection and insolvency proceeding objectives, and provide for relief from the stay by application to the court based on clearly established grounds when the insolvency proceeding objectives or the protection of the secured creditor's interests in its collateral are not achieved. Exceptions to the general rule on a stay of enforcement actions should be limited and clearly defined.

UNCITRAL Recommendations

Protection and preservation of the insolvency estate (Part two, chapter II, paras. 25-73, pp. 83-99)

Purpose of legislative provisions

The purpose of provisions on the protection and preservation of the estate is to:

- (a) Establish measures to ensure the value of the estate is not diminished by the actions of the debtor, creditors or third parties;
- (b) Determine the scope of those measures and the actions and parties to which they apply;
- (c) Establish the method, time and duration of application of those measures; and
- (d) Establish the grounds for relief from those measures.

Provisional measures

(39) The insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings, including:

- (a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;
- (b) Entrusting the administration or supervision of the debtor's business, which may include the power to use and dispose of assets in the ordinary course of business, to an insolvency representative or other person designated by the court;
- (c) Entrusting the realization of all or part of the assets of the debtor to an insolvency representative or other person designated by the court, in order to protect and preserve the value of assets of the debtor that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and
- (d) Any other relief of the type applicable or available on commencement of proceedings under recommendations 46 and 48.

Indemnification in connection with provisional measures (40) The insolvency law may provide the

court with the power to:

- (a) Require the applicant for provisional measures to provide indemnification and, where appropriate, to pay costs or fees; or
- (b) Impose sanctions in connection with an application for provisional measures.

Balance of rights between the debtor and insolvency representative

(41) The insolvency law should clearly specify the balance of the rights and obligations between the debtor and any insolvency representative appointed as a provisional measure. Between the time an application for commencement of insolvency proceedings is made and commencement of those proceedings, the debtor is entitled to continue to operate its business and to use and dispose of assets in the ordinary course of business, except to the extent restricted by the court.

Notice (42) The insolvency law should specify that, unless the court limits or dispenses with the need to provide notice, appropriate notice be given to those parties in interest affected by:

- (a) An application or court order for provisional measures (including an application for review and modification or termination); and
- (b) A court order for additional measures applicable on commencement, unless the court limits or dispenses with the need to provide notice.

Ex parte provisional measures

(43) The insolvency law should specify that, where the debtor or other party in interest affected by a provisional measure is not given notice of the application for that provisional measure, the debtor or other party in interest affected by the provisional measures has the right, upon urgent application, to be heard promptly on whether the relief should be continued.

Modification or termination of provisional measures (44) The insolvency law should specify that the court, at its own motion or at the request of the insolvency representative, the debtor, a creditor or any other person affected by the provisional measures, may review and modify or terminate those measures.

Termination of provisional measures

- (45) The insolvency law should specify that provisional measures terminate when:
- (a) An application for commencement is denied;
 - (b) An order for provisional measures is successfully challenged under recommendation 43; and
 - (c) The measures applicable on commencement take effect, unless the court continues the effect of the provisional measures.

Measures applicable on commencement (46) The insolvency law should specify that, on commencement of insolvency proceedings:

- (a) Commencement or continuation of individual actions or proceedings concerning the assets of the debtor, and the rights, obligations or liabilities of the debtor are stayed;
- (b) Actions to make security interests effective against third parties and to enforce security interests are stayed;
- (c) Execution or other enforcement against the assets of the estate is stayed;
- (d) The right of a counterparty to terminate any contract with the debtor is suspended; and
- (e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.

Exceptions to the application of the stay (47) The insolvency law may permit exceptions to the application of the stay or suspension under recommendation 46 and, where it does so, those exceptions should be clearly stated. Paragraph (a) of recommendation 46 should not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.

Additional measures available on commencement

(48) The insolvency law should specify that the court may grant relief additional to the measures applicable on commencement.

Duration of measures automatically applicable on commencement (49) The insolvency law should specify that the measures applicable on commencement of insolvency proceedings remain effective throughout those proceedings until:

- (a) The court grants relief from the measures;
- (b) In reorganization proceedings, a reorganization plan becomes effective; or
- (c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires, unless it is extended by the court for a further period on a showing that:
 - (i) An extension is necessary to maximize the value of assets for the benefit of creditors; and
 - (ii) The secured creditor will be protected against diminution of the value of the encumbered asset in which it has a security interest.

Protection from diminution of the value of encumbered assets (50) The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the assets in which it has a security interest. The court may grant appropriate measures of protection that may include:

- (a) Cash payments by the estate;
- (b) Provision of additional security interests; or
- (c) Such other means as the court determines.

Relief from measures applicable on commencement

(51) The insolvency law should specify that a secured creditor may request the court to grant relief from the measures applicable on commencement of insolvency proceedings on grounds that may include that:

- (a) The encumbered asset is not necessary to a prospective reorganization or sale of the debtor's business;
- (b) The value of the encumbered asset is diminishing as a result of the commencement of insolvency proceedings and the secured creditor is not protected against that diminution of value; and
- (c) In reorganization, a plan is not approved within any applicable time limits.

Financial contracts and netting (Part two, chapter II, paras. 208-215, pp. 156-158)

(102) Once the financial contracts of the debtor have been terminated by a counterparty, the insolvency law should permit the counterparty to net or set-off obligations under those terminated financial contracts to establish a net exposure position relative to the debtor. This termination and set-off to establish a net exposure should be permitted regardless of whether the termination of the contracts occurs prior to or after the commencement of insolvency proceedings. Where the insolvency law limits or stays the exercise of set-off rights upon commencement of insolvency proceedings, set-off and netting of financial contracts should be exempt from such limitations.

(103) Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

C5. CRITERIA FOR ASSESSING COMPLIANCE

C5.1 PROVISIONAL MEASURES

111. The insolvency law provides that provisional relief may be granted by the court, when necessary to preserve the value of the debtor's assets, prior to commencement of insolvency proceedings, upon application of: (39) [C5.1]

- a. The debtor, (39)

- b. A creditor, (39) or
 - c. A third party; (39) and
 - d. Subject to affording appropriate notice to affected parties. (42) (43) [C5.1]
- (Refer to criteria #81-#82 under C2.1 on notice requirements)
112. The insolvency law specifies that the court may review, modify, or terminate provisional measures. (44) (45)
113. When the insolvency law allows the appointment of an interim insolvency representative, the debtor is entitled to continue its business and to use and dispose of assets in the ordinary course of business, except to the extent restricted by the court. (41)

C5.2 – C5.3 – EFFECTS OF COMMENCEMENT

114. On commencement of insolvency proceedings, the insolvency law establishes a stay on:
- (Refer to criteria #115-#117 below on exceptions to application of the stay)
- a. Commencement or continuation of individual actions or proceedings concerning the assets, rights, obligations, or liabilities of the debtor; (46 a) [C5.2]
 - b. Actions to make security interests effective against third parties and to enforce security interests; (46 b)
 - c. Execution or other enforcement against the assets of the estate; (46 c) [C5.2]
 - d. The right of a counterparty to terminate any contract with the debtor (46 d); and
 - e. The right to transfer, encumber, or otherwise dispose of any assets of the estate. (46 e) [C5.2]
115. Exceptions to the general rule on stay are limited and clearly defined. (47) [C5.3]
116. The insolvency law provides that financial contracts are exempted from application of the stay. (102) (103)
117. The stay should not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor. (47)
118. The insolvency law determines that the stay remains effective throughout the insolvency proceedings until:
- a. The court grants relief from those measures; (49)
 - b. A reorganization plan becomes effective; (49) or
 - c. In the case of secured creditors in liquidation proceedings, a limited time period specified in the law expires unless extended by the court. (49) [C5.3]
119. The insolvency law specifies that a secured creditor:
- a. May request the court to grant relief from the measures applicable on commencement of insolvency proceedings (51) [C5.2]; and
 - b. Is entitled to protection of the value of the assets in which it has a security interest. (50)
- (Refer to criteria #147 under C8.2 and criteria #185 to #188 under C12.2 on secured creditors in insolvency proceedings)
120. In reorganization proceedings, the court may grant relief from the stay on enforcement actions by secured creditors where the collateral is not needed for the reorganization. [C5.3]

121. The measures applicable on commencement of insolvency proceedings strike a proper balance between creditor protection and insolvency proceeding objectives. [C5.3]

C6. COMMERCIAL INSOLVENCY

MANAGEMENT

WB Principle

Management [C6]

- C6.1 In liquidation proceedings, management should be replaced by an insolvency representative with authority to administer the estate in the interest of creditors. Control of the estate should be surrendered immediately to the insolvency representative. In creditor-initiated filings, where circumstances warrant, an interim administrator with limited functions should be appointed to monitor the business to ensure that creditor interests are protected.
- C6.2 There are typically three preferred approaches in reorganization proceedings: (i) exclusive control of the proceeding is entrusted to an independent insolvency representative; or (ii) governance responsibilities remain invested in management; or (iii) supervision of management is undertaken by an impartial and independent insolvency representative or supervisor. Under the second and third approaches, complete administrative power should be shifted to the insolvency representative if management proves incompetent or negligent or has engaged in fraud or other misbehavior.

UNCITRAL Recommendations

The Debtor (Part two, chapter III, paras. 1-34, pp. 161-171)

The purpose of provisions concerning the debtor is to:

- (a) Establish the rights and obligations of the debtor during the insolvency proceedings;
- (b) Address the remedies for failure of the debtor to meet its obligations; and
- (c) Address issues relating to management of the debtor in insolvency proceedings.

Rights

Right to be heard See recommendation 137.

Right to participate and request information (108) The insolvency law should specify that the debtor is entitled to participate in the insolvency proceedings, and to obtain information relating to those proceedings from the insolvency representative and the court.

Right to retain property to preserve the personal rights of the debtor

(109) Where the debtor is a natural person, the insolvency law should specify that the debtor is entitled to retain those assets excluded from the estate by the law.

Obligations of the debtor (110) The insolvency law should clearly specify the debtor's obligations in respect of insolvency proceedings. Those obligations should arise on the commencement of, and continue throughout, those proceedings. The obligations should include obligations:

- (a) To cooperate with and assist the insolvency representative to perform its duties;
- (b) To provide accurate, reliable and complete information relating to its financial position and business affairs that might be requested by the court, the insolvency representative, creditors and/or the creditor committee, including lists of:
 - (i) Transactions occurring prior to commencement that involved the debtor or the assets of the debtor;
 - (ii) Ongoing court, arbitration or administrative proceedings, including enforcement proceedings;
 - (iii) Assets, liabilities, income and disbursements;
 - (iv) Debtors and their obligations; and
 - (v) Creditors and their claims prepared in cooperation with the insolvency representative and

<p>revised and amended by the debtor as claims are verified and admitted or denied;</p> <p>(c) To cooperate with the insolvency representative to enable the insolvency representative to take effective control of the estate and to facilitate or cooperate in the recovery by the insolvency representative of the assets, or control of the assets of the estate, wherever located and business records; and</p> <p>(d) Where the debtor is a natural person, to provide notice to the court if it proposes or is forced to leave its habitual place of residence and, where the debtor is a legal person, to obtain the consent of the court or the insolvency representative to the movement of its the headquarters.</p> <p>Confidentiality</p> <p>(111) The insolvency law should specify protections for information provided by the debtor or concerning the debtor that is commercially sensitive or confidential.</p> <p>The debtor's role in continuation of the business</p> <p>(112) The insolvency law should specify the role of the debtor in the continuing operation of the business during insolvency proceedings. Different approaches may be taken, including:</p> <p>(a) Retention of full control of the business (debtor-in-possession), with appropriate protections including varying levels of control of the debtor and provision for displacement of the debtor in specified circumstances;</p> <p>(b) Limited displacement, where the debtor may continue to operate the business on a day-to-day basis, subject to the supervision of an insolvency representative, in which event the division of responsibilities between the debtor and the insolvency representative should be specified in the law; or</p> <p>(c) Total displacement of the debtor from any role in the business and the appointment of an insolvency representative.</p> <p>(113) The insolvency law should specify, where the debtor is a debtor-in-possession, those functions of the insolvency representative that may be performed by the debtor-in-possession.</p> <p>Sanctions for the debtor's failure to comply with its obligations</p> <p>(114) The insolvency law should permit the imposition of sanctions for the debtor's failure to comply with its obligations under the insolvency law.</p>

CRITERIA FOR ASSESSING COMPLIANCE

122. The debtor is entitled to participate in insolvency proceedings. (108) [C2]
123. The insolvency law specifies the debtor's obligations in respect of insolvency proceedings to include the following:
- a. To cooperate with and assist the insolvency representative (110 a) (110 c); and
 - b. To provide accurate and complete information relating to its financial position and business affairs. (110b)
- (Refer to criterion #87 under C2.2 referring to protection of commercially sensitive or confidential information)
124. The insolvency law specifies the debtor's role in the continuing operation of the business in both liquidation and reorganization proceedings. (112) [C6.2]
125. Upon commencement of liquidation proceedings, management is replaced by an insolvency representative with authority to administer the insolvency estate. [C6.1]
126. Upon commencement of liquidation proceedings, control of the estate is immediately surrendered to the insolvency representative. [C6.1]

127. The insolvency law provides that, in reorganization proceedings where governance remains with incumbent management, if management proves incompetent or negligent or has engaged in fraud, governance may be shifted to the insolvency representative by order of the court. [C6.2]

COMMERCIAL INSOLVENCY

CREDITORS AND THE CREDITORS' COMMITTEE

WB Principle

Creditors and the Creditors' Committee [C7]

- C7.1 The role, rights, and governance of creditors in proceedings should be clearly defined. Creditor interests should be safeguarded by appropriate means that enable creditors to effectively monitor and participate in insolvency proceedings to ensure fairness and integrity, including by creation of a creditors' committee as a preferred mechanism, especially in cases involving numerous creditors.
- C7.2 Where a committee is established, its duties and functions, and the rules for the committee's membership, quorum and voting, and the conduct of meetings should all be specified by the law. The committee should be consulted on non-routine matters in the case and have the ability to be heard on key decisions in the proceeding. The committee should have the right to request relevant and necessary information from the debtor. It should serve as a conduit for processing and distributing that information to other creditors and for organizing creditors to decide on critical issues. In reorganization proceedings, creditors should be entitled to participate in the selection of the insolvency representative.

UNCITRAL Recommendations

Creditors – participation in insolvency proceedings (Part two, chapter III, 75-115, pp. 190-202)

The purpose of provisions on participation of creditors in insolvency proceedings is to:

- (a) Facilitate participation of creditors in insolvency proceedings;
- (b) Provide a mechanism for the appointment of a creditor committee or other creditor representative where to do so would facilitate the participation of creditors in the insolvency proceedings;
- (c) Ensure the right of creditors to access information on the insolvency proceedings; and
- (d) Specify the functions and responsibilities of the creditor committee or other representative.

Right to be heard

See recommendation 111.

Confidentiality

See recommendation 111.

Participation by creditors

(126) The insolvency law should specify that creditors, both secured and unsecured, are entitled to participate in insolvency proceedings and identify what that participation may involve in terms of the functions that may be performed.

Voting by creditors

(127) The insolvency law should specify the matters on which a vote of creditors is required and establish the relevant eligibility and voting requirements. In particular, the insolvency law should require creditors to vote on approval or rejection of a reorganization plan.

Convening meetings of creditors (128) The insolvency law may require a first meeting of creditors to be convened within a specified period of time after commencement to discuss matters specified in the insolvency law. The insolvency law may also permit the court, the insolvency representative or creditors holding a specific percentage of the total value of unsecured claims to request the convening of any other meeting of creditors and specify the circumstances in which such a meeting may be convened. The insolvency law should specify the party responsible for giving notice to creditors of such a meeting.

Creditor representation

(129) The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation. The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.

(130) Where the insolvency law permits a creditor committee or representative to be appointed, the relationship between the creditors and the creditor committee or representative should be clearly specified. The insolvency law should specify how the costs of the creditor committee would be paid.

Creditors that may be appointed to a creditor committee

(131) The insolvency law should specify the creditors that are eligible to be appointed to a committee. Creditors who may not be appointed to a creditor committee would include related persons and others who for any reason might not be impartial. The insolvency law should specify whether or not a creditor's claim must be admitted before the creditor is entitled to be appointed to a committee.

Mechanism for appointment to a creditor committee

(132) The insolvency law should establish a mechanism for appointment of a creditor committee. Different approaches may include selection of the creditor committee by creditors or appointment by the court or other administrative body.

Rights and functions of a creditor committee

(133) The insolvency law should specify the rights and functions of the creditor committee in insolvency proceedings, which may include:

- (a) Providing advice and assistance to the insolvency representative or the debtor-in-possession;
- (b) Participating in development of the reorganization plan;
- (c) Receiving notice of and being consulted on matters in which their class has an interest, including the sale of assets outside the ordinary course of business;
- (d) The right to hear the insolvency representative at any time; and
- (e) The right to be heard in the proceedings.

Employment and remuneration of professionals by a creditor committee

(134) The insolvency law should permit a creditor committee, subject to approval by the court, to select, employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions. The insolvency law should specify how the costs and remuneration of those professionals would be paid.

Liability of members of a creditor committee (135) The insolvency law should specify that members of a creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found to have acted fraudulently or to be guilty of willful misconduct.

Removal and replacement of members of a creditor committee

(136) The insolvency law should specify the grounds for removal of members of a creditor committee and provide for their replacement.

Insolvency representative- appointment

(118) The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.

CRITERIA FOR ASSESSING COMPLIANCE

128. The role and obligations of creditors in insolvency proceedings are clearly defined. [C7.1]
129. The insolvency law entitles both secured and unsecured creditors to participate in insolvency proceedings and determines the manner of their participation. (126) [C2] [C7.1]
- (Refer to criteria #84-#86 under C2.1(2) on right to be heard and appellate rights in insolvency proceedings.)
130. The insolvency law facilitates active creditor participation through mechanisms such as:
- Creditor committees (129) [C7.1], or
(Refer to criteria #134-#137 below on the different issues of creditor committees.)
 - A special representative. (129)
131. The insolvency law requires a meeting of creditors to be convened within a specified period of time after commencement. (128)
132. The insolvency law provides for other meetings of creditors to be convened at the request of the insolvency representative or creditors holding a specific percentage of the total value of unsecured claims. (128)
133. The insolvency law specifies the matters on which a vote of creditors is required. (127)
- The insolvency law establishes the relevant eligibility and voting requirements. (127)
(Refer to criteria #207-#208 under C14.2 on voting of the plan.)
134. The insolvency law establishes a mechanism for appointment of a creditor committee. (132) [C7.2]
- The insolvency law specifies the creditors eligible to be appointed to the creditor committee. (131) [C7.2]
 - The creditor committee is selected by creditors or appointed by the court or other administrative body. (132)
 - The relationship between the creditors and the creditor committee or representative is clearly specified. (130)
135. The insolvency law specifies the rights and functions of the creditor committee in insolvency proceedings, (133) including
- Providing advice and assistance; (133a) (133c) [C7.2]
 - Participating in the development of the reorganization plan; (133b)
 - Having the right to obtain information from the insolvency representative and the debtor; (133d) [C7.2]
 - Having the right to be heard in the proceedings (133e) [C7.2]; and
 - Serving as a conduit for processing and distributing information to the creditors. [C7.2]
(Refer to criteria #88 above under C2.2 on protection of confidential information.)
136. When a creditor committee is established, the insolvency law specifies how the rules for the committee's membership, quorum and voting, the conduct of meetings and payment of costs are to be determined. (130) [C7.2]

137. Where a creditor committee is established, the insolvency law specifies the grounds for removal and procedures for replacement of creditor committee members. (136)
138. In reorganization proceedings, creditors are entitled to participate in the selection of the insolvency representative. (118) [C7.2]

(Refer to D8, "Competence and Integrity of Insolvency Representatives.")

COMMERCIAL INSOLVENCY

COLLECTION, PRESERVATION, ADMINISTRATION AND DISPOSITION OF ASSETS

WB Principle

Collection, Preservation, Administration, and Disposition of Assets [C8]

- C8.1 The insolvency estate should include all of the debtor's assets, including encumbered assets and assets obtained after the commencement of the case. Assets excluded from the insolvency estate should be strictly limited and clearly defined by the law.
- C8.2 After the commencement of the insolvency proceedings, the court or the insolvency representative should be allowed to take prompt measures to preserve and protect the insolvency estate and the debtor's business. The system for administering the insolvency estate should be flexible and transparent and enable disposal of assets efficiently and at the maximum values reasonably attainable. Where necessary, the system should allow assets to be sold free and clear of security interests, charges, or other encumbrances, subject to preserving the priority of interests in the proceeds from the assets disposed.
- C8.3 The rights and interests of a third-party owner of assets should be protected where its assets are used during the insolvency proceedings by the insolvency representative and/or the debtor in possession.

UNCITRAL Recommendations

Assets constituting the insolvency estate (Part two, chapter II, paras. 1-24, pp. 75-82)

Purpose of legislative provisions

The purpose of provisions relating to the insolvency estate is to:

- (a) Identify those assets that will be included in the estate, including the debtor's interests in encumbered assets and in third party-owned assets; and
- (b) Identify the assets, if any, which will be excluded from the estate.

Assets constituting the estate

(35) The insolvency law should specify that the estate should include:

- (a) Assets of the debtor, including the debtor's interest in encumbered assets and in third party-owned assets;
- (b) Assets acquired after commencement of the insolvency proceedings; and
- (c) Assets recovered through avoidance and other actions.

(36) In the case of insolvency proceedings commenced where the debtor has its centre of main interests, the insolvency law should specify that the estate include all assets of the debtor wherever located.

Time of constitution of the estate

(37) The insolvency law should specify the date from which the estate is to be constituted, being either the date of application for commencement or the effective date of commencement of insolvency proceedings.

Assets excluded from the estate where the debtor is a natural person (38) The insolvency law should specify the assets, if any, that are excluded from the estate where the debtor is a natural person.

Use and disposal of assets (Part two, chapter II, paras. 74-93, pp. 104-111)

Purpose of legislative provisions

The purpose of provisions on use and disposal of assets is to:

- (a) Permit the use and disposal of assets, including encumbered assets in the insolvency proceedings

<p>and specify the conditions for their use and disposal;</p> <p>(b) Permit and specify the conditions for the use of third party owned assets;</p> <p>(c) Establish the limits to powers of use and disposal;</p> <p>(d) Notify creditors of proposed use and disposal, where appropriate; and</p> <p>(e) Provide for the treatment of burdensome assets.</p> <p>Power to use and dispose of assets of the estate</p> <p>(52) The insolvency law should permit:</p> <p>(a) The use and disposal of assets of the estate (including encumbered assets) in the ordinary course of business, except cash proceeds; and</p> <p>(b) The use and disposal of assets of the estate (including encumbered assets) outside the ordinary course of business, subject to the requirements of recommendations 55 and 58.</p> <p>Further encumbrance of encumbered assets</p> <p>(53) The insolvency law should specify that encumbered assets may be further encumbered, subject to the requirements of recommendations 65, 66 and 67.</p> <p>Use of third party owned assets (54) The insolvency law should specify that the insolvency representative may use assets owned by third parties and in the possession of the debtor provided specified conditions are satisfied, including:</p> <p>(a) The interests of the third party will be protected against diminution in the value of the assets; and</p> <p>(b) The costs under the contract of continued performance of the contract and use of the assets will be paid as an administrative expense.</p> <p>Procedure for notification of disposal</p> <p>(55) The insolvency law should specify that adequate notice of any disposal conducted outside the ordinary course of business be given to creditors and that they have the opportunity to be heard by the court.</p> <p>(56) The insolvency law should specify that notification of public auctions be provided in a manner that will ensure the information is likely to come to the attention of interested parties.</p> <p>General methods of sale</p> <p>(57) The insolvency law should specify methods of sale for sales conducted outside the ordinary course of business that will maximize the price obtained for assets being sold in insolvency proceedings, and permit both public auctions and private sales.</p> <p>Ability to sell assets of the estate free and clear of encumbrances and other interests (58) The insolvency law should permit the insolvency representative to sell assets that are encumbered or subject to other interests free and clear of those encumbrances and other interests, outside the ordinary course of business, provided that:</p> <p>(a) The insolvency representative gives notice of the proposed sale to the holders of encumbrances or other interests;</p> <p>(b) The holders are given the opportunity to be heard by the court where they object to the proposed sale;</p> <p>(c) Relief from the stay has not been granted; and</p> <p>(d) The priority of interests in the proceeds of sale of the asset is preserved.</p> <p>Use of cash proceeds (59) The insolvency law should permit the insolvency representative to use and dispose of cash proceeds if:</p> <p>(a) The secured creditor with a security interest in those cash proceeds consents to such use or disposal; or</p> <p>(b) The secured creditor was given notice of the proposed use or disposal and an opportunity to be</p>
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- heard by the court; and
- (c) The interests of the secured creditor will be protected against diminution in the value of the cash proceeds.

Urgent sales

(60) The insolvency law should permit urgent sales of assets to be conducted outside the ordinary course of business, where the assets by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy. The insolvency law may provide that prior approval of the court or of creditors is not required in such circumstances.

Disposal of assets to related persons

(61) The insolvency law should require any proposed disposal of assets to related persons to be carefully scrutinised before being allowed to proceed.

Burdensome assets

(62) The insolvency law should permit the insolvency representative to determine the treatment of any assets that are burdensome to the estate. In particular, the insolvency law may permit the insolvency representative to relinquish burdensome assets following the provision of notice to creditors and the opportunity for creditors to object to the proposed action, except that where a secured claim exceeds the value of the encumbered asset, and the asset is not required for a reorganization or sale of the business as going concern, the insolvency law may permit the insolvency representative to relinquish the asset to the secured creditor without notice to other creditors.

Security for post-commencement finance (Part two, chapter II, paras. 94-107, pp. 113-118)

(66) The law should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation 67.

(67) The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

- (a) The existing secured creditor was given the opportunity to be heard by the court;
- (b) The debtor can prove that it cannot obtain the finance in any other way; and
- (c) The interests of the existing secured creditor will be protected.

Performance of a contract prior to continuation or rejection (Part two, chapter II, paras. 131, pp. 126-7)

(80) The insolvency law should specify that the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:

- (a) If the counterparty has performed the contract the amount of the administrative expense should be the contractual price of the performance; or
- (b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with paragraph (a).

CRITERIA FOR ASSESSING COMPLIANCE

C8.1 DEFINING THE INSOLVENCY ESTATE

139. The insolvency estate comprises all the debtor's assets¹³, wherever located, including:
- a. Assets obtained after commencement;
 - b. Assets recovered through avoidance and other actions; and (35) [C8.1]
 - c. Encumbered assets and the debtor's interests in third party-owned-assets. (35) (36)
140. The insolvency law specifies the date on which the estate is constituted. (37)

C8.2 – C8.3 ADMINISTRATION AND DISPOSITION OF ASSETS (AFTER COMMENCEMENT)

141. The system for administering the estate enables the timely preservation, protection, and disposal of assets at maximum value. [C8.2]
142. The insolvency law permits the use and disposal of assets of the estate in the ordinary course of business where the continued operation of the business is authorized. (52 a) (46 e)¹⁴
143. The insolvency law permits the use or disposal of assets of the estate outside the ordinary course of business, subject to:
- a. Priority rules being observed; and (52 b)
 - b. Creditors being given notice and having the right to be heard by the court, (52 b) (55)
- (Refer to criteria #81-#83 under C2.1(1) on notice requirements.)
- (Refer to criteria #84-#85 under C2.1(2) on right to be heard and appellate rights in insolvency proceedings.)
144. Where relief from the stay has not been granted, the insolvency law permits the insolvency representative to sell assets that are encumbered or subject to other interests free and clear of those encumbrances and other interests, outside the ordinary course of business, provided that: (58) [C8.2]
- a. Notice of the proposed sale is given to the holders of encumbrances or other interests; (58)
 - b. The holders are given the opportunity to be heard by the court where they object to the proposed sale; (58)
 - c. The priority of interests in the proceeds of sale of the asset is preserved. (58) [C8.2]
145. The insolvency law includes the possibility of assets being disposed of both by auctions open to the public and by private sales. (57)

¹³ From UNCITRAL's *Legislative Guide's* glossary: "assets of the debtor: property, rights and interests of the debtor, including rights and interests in property, whether or not in the possession of the debtor, tangible or intangible, movable or immovable, including the debtor's interests in encumbered assets or in third party-owned assets".

¹⁴ **Note:** footnote 23 to rec. (46 e) reads: "The limitation on the right to transfer, encumber or otherwise dispose of assets of the estate may be subject to an exception in those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business."

146. If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to a contract, that party: (80 b) [C8.3]
 - a. Is protected against diminution of the value of those assets; and
 - b. Has an administrative claim for the continued performance of the contract and use of the asset. (54) (80 b)
147. The insolvency law permits the insolvency representative to use and dispose of cash proceeds in which the secured creditor has a secured interest if the secured creditor is adequately protected against diminution in the value. (59)
148. The insolvency law permits urgent sales of assets that are perishable, susceptible to devaluation, or otherwise in jeopardy. (60)
149. The insolvency law permits the insolvency representative to determine the treatment of assets that are burdensome to the estate. (62)
150. When the insolvency law permits sales to related parties, it provides adequate safeguards. (61)

COMMERCIAL INSOLVENCY

STABILIZING AND SUSTAINING BUSINESS OPERATIONS

WB Principle

Stabilizing and Sustaining Business Operations [C9]

- C9.1 The business should be permitted to operate in the ordinary course. Transactions that are not part of the debtor's ordinary course of business activities should be subject to court review.
- C9.2 Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its ongoing business needs.

UNCITRAL Recommendations

Use and Disposal of Assets (Part two, chapter II, para. 83-4, pp. 107-108)

Further encumbrance of encumbered assets

(53) The insolvency law should specify that encumbered assets may be further encumbered, subject to the requirements of recommendations 65, 66, and 67.

Post-commencement finance (Part two, chapter II, paras. 94-107, pp. 113-118)

Purpose of legislative provisions

The purpose of provisions on post-commencement finance is to:

- (a) Facilitate finance to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate;
- (b) Ensure appropriate protection for the providers of post-commencement finance; and
- (c) Ensure appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance.

Contents of legislative provisions

Attracting and authorizing post-commencement finance

(63) The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the estate. The insolvency law may require the court to authorize or creditors to consent to the provision of post-commencement finance.

Priority for post-commencement finance

(64) The insolvency law should establish the priority that may be accorded to post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of ordinary unsecured creditors, including those unsecured creditors with administrative priority.

Security for post-commencement finance

(65) The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on unencumbered assets, including after-acquired assets, or a junior or lower- priority security interest on already encumbered assets of the estate.

(66) The law¹⁵ should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured

¹⁵ This rule may be in a law other than the insolvency law, in which case the insolvency law should note the existence of the provision.

creditor(s) or follows the procedure in recommendation 67.

(67) The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

- (a) The existing secured creditor was given the opportunity to be heard by the court;
- (b) The debtor can prove that it cannot obtain the finance in any other way; and
- (c) The interests of the existing secured creditor will be protected.¹⁶

Effect of conversion on post-commencement finance

(68) The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation.¹⁷

CRITERIA FOR ASSESSING COMPLIANCE

- 151. Under the insolvency law, commencement of insolvency proceedings does not automatically cease the operation of the debtor's business. [C9.1]
- 152. The insolvency law allows access to post-commencement financing. [C9.2] (Post-commencement finance – purpose (a)) (63)
- 153. The insolvency law makes provision for appropriate protection to be given to the providers of post-commencement finance. (Post-commencement finance - purpose b) (65) (68) [C9.2]
- 154. The insolvency law establishes the priority that may be accorded to post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of ordinary unsecured creditors, including those with administrative priority. (64) [C9.2]
- 155. The insolvency law specifies that encumbered assets may be further encumbered, subject to: (53)
 - a. The consent of the secured creditor, or (66)
 - b. Where the existing secured creditor does not agree, the provision of other adequate safeguards. (67)

¹⁶ See UNCITRAL *Insolvency Guide*, part two, chapter II paras. 63-69, pp 96-98.

¹⁷ The same order of priority may not necessarily be recognized. For example, post-commencement finance may rank in priority after administrative claims relating to the costs of the liquidation.

COMMERCIAL INSOLVENCY

TREATMENT OF CONTRACTUAL OBLIGATIONS

WB Principle

Treatment of Contractual Obligations¹⁸ [C10]

- C10.1 To achieve the objectives of insolvency proceedings, the system should allow interference with the performance of contracts where both parties have not fully performed their obligations. Interference may imply continuation, rejection, or assignment of contracts.
- C10.2 To gain the benefit of contracts that have value, the insolvency representative should have the option of performing and assuming the obligations under those contracts. Contract provisions that provide for termination of a contract upon either an application for commencement or the commencement of insolvency proceedings should be unenforceable subject to special exceptions.
- C10.3 Where the contract constitutes a net burden to the estate, the insolvency representative should be entitled to reject or cancel the contract, subject to any consequences that may arise from rejection.
- C10.4 Exceptions to the general rule of contract treatment in insolvency proceedings should be limited, clearly defined, and allowed only for compelling commercial, public, or social interests, such as in the following cases: (i) upholding general setoff rights, subject to rules of avoidance; (ii) upholding automatic termination, netting, and close-out provisions contained in financial contracts; (iii) preventing the continuation and assignment of contracts for irreplaceable and personal services where the law would not require acceptance of performance by another party; and (iv) establishing special rules for treating employment contracts and collective bargaining agreements.

UNCITRAL Recommendations

Treatment of Contracts (Part two, chapter II, paras. 108-147, pp. 119-131)

Purpose of legislative provisions

The purpose of provisions on treatment of contracts is to:

- (a) Establish the manner in which contracts, under which both the debtor and its counterparty have not yet fully performed their respective obligations, should be addressed in the insolvency law, including the relationship between the insolvency law and applicable law, with the objective of maximizing the value and reducing the liabilities of the estate;
- (b) Define the scope of the powers to deal with these contracts and the situations in which and by whom these powers may be exercised;
- (c) Identify the types of contracts that should be excepted from the exercise of these powers; and
- (d) Identify the kinds of protection that will be available to counterparties to continued contracts.

Treatment of contracts not fully performed

(69) The insolvency law should specify the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations.

Automatic termination and acceleration clauses

(70) The insolvency law should specify that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:

- (a) An application for commencement, or commencement, of insolvency proceedings;
- (b) The appointment of an insolvency representative.¹⁹

¹⁸ Treatment of contracts typically also includes leases.

¹⁹ This recommendation would apply only to those contracts where such clauses could be overridden (see commentary above at paras. 143-145 on exceptions) and is not intended to be exclusive, but to establish a minimum: the court should

(71) The insolvency law should specify the contracts that are exempt from the operation of recommendation 70, such as financial contracts, or subject to special rules, such as labour contracts.

Continuation or rejection

(72) The insolvency law should specify that the insolvency representative may decide to continue the performance of a contract of which it is aware where continuation would be beneficial to the insolvency estate.²⁰ The insolvency law should specify that:

- (a) The right to continue applies to the contract as a whole; and
- (b) The effect of continuation is that all terms of the contract are enforceable.

(73) The insolvency law may permit the insolvency representative to decide to reject a contract.²¹ The insolvency law should specify that the right to reject applies to the contract as a whole.

Timing and notice of decision to continue or reject

(74) The insolvency law should specify a time period within which the insolvency representative is required to make a decision to continue or reject a contract, which time period may be extended by the court.

(75) The insolvency law should specify the time at which the rejection will be effective.

(76) The insolvency law should specify that where a contract is continued or rejected, the counterparty be given notice of the continuation or rejection, including its rights in respect to submitting a claim and the time in which the claim should be submitted, and permit the counterparty to be heard by the court.

Counterparty's right to request a decision

(77) Notwithstanding recommendation 74, the insolvency law should permit a counterparty to request the insolvency representative (within any specified time limit) to make a prompt decision and, in the event that the insolvency representative fails to act, to request the court to direct the insolvency representative to make a decision to continue or reject a contract.

Consequences of failure to make a decision

(78) The insolvency law should specify the consequences of the failure of the insolvency representative to make a decision within the specified time period with respect to contracts of which it is aware. Failure by the insolvency representative to act within the specified time period

be able to examine other contractual clauses that would have the effect of terminating a contract on the occurrence of similar events.

²⁰ Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation, unless the contract has a termination date which happens to fall after the commencement of insolvency proceedings.

²¹ An alternative to providing a power to reject contracts is the approach of those jurisdictions that provide that performance of a contract simply ceases unless the insolvency representative decides to continue its performance.

²² See UNCITRAL Insolvency Guide, part two, chapter III, para. 24 p168, which refers to the debtor's obligation to provide information, including a list of contracts not fully performed.

²³ This will allow market participants to extend credit based on "net" positions and make it impossible for the debtor to "cherry pick" contracts by performing some and breaching others, which is especially important with regard to financial contracts because of systemic risk.

²⁴ Margin is the process of posting additional cash or securities as a security for the transactions in accordance with a contractual formula that accounts for fluctuations in the market value of the contract and the existing security. For example, on a swap, a margin of 105 per cent might be required to maintain the termination value of the contract. If the security position falls to 100 per cent, an additional margin might have to be posted.

²⁵ In some circumstances, a settlement payment might be viewed as a preference. In the example of a swap, settlement payments are to be made monthly or upon termination of the contract based on the market value of the contract. These payments are not value for value transfers, but rather payment of an accrued debt obligation that has matured. In countries that have a fixed suspect period for all transactions occurring before commencement, such a payment might also be subject to avoidance.

²⁶ Even if a given financial contract does not involve a financial institution, the impact of the insolvency of a counterparty could entail systemic risk.

should not operate to continue a contract of which the insolvency representative was not aware.²²

Continuation of contracts where the debtor is in breach

(79) The insolvency law should specify that where the debtor is in breach of a contract the insolvency representative can continue the performance of that contract, provided the breach is cured, the non-breaching counterparty is substantially returned to the economic position it was in before the breach, and the estate is able to perform under the continued contract.

Performance prior to continuation or rejection

(80) The insolvency law should specify that the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:

- (a) If the counterparty has performed the contract the amount of the administrative expense should be the contractual price of the performance; or
- (b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with paragraph (a).

Damages for subsequent breach of a continued contract

(81) The insolvency law should specify that where a decision is made to continue performance of a contract, damages for the subsequent breach of that contract should be payable as an administrative expense.

Damages arising from rejection

(82) The insolvency law should specify that any damages arising from the rejection of a pre-commencement contract would be determined in accordance with applicable law and should be treated as an ordinary unsecured claim. The insolvency law may limit claims relating to the rejection of a long-term contract.

Assignment of contracts

(83) The insolvency law may specify that the insolvency representative can decide to assign a contract, notwithstanding restrictions in the contract, provided the assignment would be beneficial to the estate.

(84) Where the counterparty objects to assignment of a contract, the insolvency law may permit the court to nonetheless approve the assignment provided:

- (a) The insolvency representative continues the contract;
- (b) The assignee can perform the assigned contractual obligations;
- (c) The counterparty is not substantially disadvantaged by the assignment; and
- (d) The debtor's breach under the contract is cured before assignment.

(85) The insolvency law may specify that where the contract is assigned, the assignee will be substituted for the debtor as the contracting party with effect from the date of the assignment and the estate will have no further liability under the contract.

Post-commencement contracts

(86) The insolvency law should specify that contracts entered into after the commencement of insolvency proceedings are post-commencement obligations of the estate. Claims arising from those contracts should be payable as an administrative expense.

Rights of set-off (Part two, chapter II, paras. 204-207, pp. 155-156)

Purpose of legislative provisions

The purpose of provisions on set-off is to:

- (a) Provide certainty with respect to the effect of the commencement of insolvency

proceedings upon the exercise of set-off rights;

(b) Specify the types of obligations that may be set-off after commencement of insolvency proceedings; and

(c) Specify the effect of other provisions of the law (e.g. avoidance provisions and the stay) on the exercise of rights of set-off.

Contents of legislative provisions

(100) The insolvency law should protect a general right of set-off existing under law other than the insolvency law that arose prior to the commencement of insolvency proceedings, subject to the application of avoidance provisions.

Financial contracts and netting (Part two, chapter II, paras. 208-215, pp. 156-158)

Purpose of legislative provisions

The purpose of provisions on netting and set-off in the context of financial transactions on financial markets is to reduce the potential for systemic risk that could threaten the stability of financial markets by providing certainty with respect to the rights of parties to a financial contract when one of those parties fails to perform for reasons of insolvency. These recommendations are not intended to apply to transactions that are not financial contracts and they would remain subject to the law applicable to set-off and netting.

Contents of legislative provisions

(101) The insolvency law should recognize contractual termination rights associated with financial contracts that permit the termination of those contracts and the set-off and netting of outstanding obligations under those contracts promptly after the commencement of insolvency proceedings. Where the insolvency law stays the termination of contracts or limits the enforceability of automatic termination clauses on commencement of insolvency proceedings, financial contracts should be exempt from such limitations.²³

(102) Once the financial contracts of the debtor have been terminated by a counterparty, the insolvency law should permit the counterparty to net or set-off obligations under those terminated financial contracts to establish a net exposure position relative to the debtor. This termination and set-off to establish a net exposure should be permitted regardless of whether the termination of contracts occurs prior to or after the commencement of insolvency proceedings. Where the insolvency law limits or stays the exercise of set-off rights upon commencement of insolvency proceedings, set-off and netting of financial contracts should be exempt from such limitations.

(103) Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

(104) The insolvency law should specify that routine pre-bankruptcy transfers consistent with market practice, such as the putting up of margin for financial contracts²⁴ and transfers to settle financial contract obligations²⁵ should be exempt from avoidance.

(105) The insolvency law should recognize and protect the finality of the netting, clearing and settlement of financial contracts through payment and settlement systems upon the insolvency of a participant in the system.

(106) Recommendations 101 to 105 should apply to all transactions that are considered to be "financial contracts," whether or not one of the counterparties is a financial institution.²⁶

(107) Financial contracts should be defined broadly enough to encompass existing varieties of financial contracts and to accommodate new types of financial contracts as they appear.

CRITERIA FOR ASSESSING COMPLIANCE

C10.1 - C10.3 GENERAL TREATMENT OF CONTRACTUAL OBLIGATIONS

156. The insolvency law specifies the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations. (69)
- a. To achieve the objectives of insolvency proceedings, the insolvency system allows the possibility of continuation, rejection, or assignment of the performance of contracts where both parties have not fully performed their obligations. [C10.1] (72) (73) (83)
157. The insolvency law specifies that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:
- a. An application for commencement or commencement of insolvency proceedings;
 - b. The appointment of an insolvency representative. (70) [C10.2]
158. The insolvency representative may decide to continue the performance of a contract of which it is aware where continuation would be beneficial to the insolvency estate. (72) [C10.2]
- a. The right to continue applies to the contract as a whole (72); and
 - b. The time in which the decision to continue is to be made is specified in the insolvency law. (74)
159. The insolvency law permits the insolvency representative to decide to reject a contract. (73) [C10.3]
- a. The right to reject applies to the contract as a whole (73)
 - b. The time in which the decision to reject is to be made (74); and
 - c. The time in which the rejection will be effective are specified in the insolvency law. (75)
160. The insolvency law specifies that any damages arising from the rejection of a contract are determined in accordance with applicable law and treated as an ordinary unsecured claim. (82)
161. The insolvency law specifies that where a contract is to be continued or rejected, the counterparty be given notice of the continuation or rejection. (76)
- (Refer to criteria #81-#83 under C2.1(1) on notice requirements in insolvency proceedings.)
162. Where the debtor is in breach under a contract, the insolvency law specifies the conditions under which the insolvency representative can continue the performance of that contract. (79)
163. The insolvency law specifies the conditions under which the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. (80)
- a. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract are payable as an administrative expense. (80)
164. The insolvency law specifies that damages for the subsequent breach of a continued contract are payable as an administrative expense. (81)

165. The insolvency law allows assignment of a contract, provided the assignment would be beneficial to the estate. (83)
166. The insolvency law specifies that contracts entered into after the commencement of insolvency proceedings are post-commencement obligations of the estate. (86)
- a. Claims arising from post-commencement contracts are payable as an administrative expense. (86)

C10.4 EXCEPTIONS FOR SPECIAL CONTRACTUAL RELATIONS: RIGHTS OF SET-OFF, FINANCIAL CONTRACTS AND NETTING

167. Exceptions to the general rule of contract treatment in insolvency proceedings are limited, clearly defined, and permitted for compelling commercial, public or social interests, such as in the following cases: [C10.4]
- a. Upholding general set-off rights that arose prior to the commencement of insolvency proceedings, (100) [C10.4]
 - subject to the application of avoidance provisions; (100)
 - b. Preventing continuation and assignment of contracts for irreplaceable and personal services where the law would not require acceptance of performance by another party; [C10.4]
 - c. Establishing special rules for treating employment contracts and collective bargaining agreements. (71) [C10.4]
168. The insolvency law upholds contractual termination rights associated with financial contracts that permit the termination of those contracts and the set-off and netting of outstanding obligations under those contracts promptly after the commencement of insolvency proceedings. (70) (101) (102) [C10.4]
169. Financial contracts are defined broadly (to encompass existing varieties of financial contracts and to accommodate new types of financial contracts as they appear). (107)

COMMERCIAL INSOLVENCY

ADMINISTRATION: AVOIDABLE TRANSACTIONS

WB Principle

Administration: Avoidable Transactions [11]

- C11.1 After the commencement of an insolvency proceeding, transactions by the debtor that are not consistent with the debtor's ordinary course of business or engaged in as part of an approved administration should be avoided (cancelled), with narrow exceptions protecting parties who lacked notice.
- C11.2 Certain transactions prior to the application for or the date of commencement of the insolvency proceeding should be avoidable (cancelable), including fraudulent and preferential transfers made when the enterprise was insolvent or that rendered the enterprise insolvent.
- C11.3 The suspect period, during which payments are presumed to be preferential and may be set aside, should be reasonably short in respect to general creditors to avoid disrupting normal commercial and credit relations, but the period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.

UNCITRAL Recommendations

Avoidance Proceedings (Part two, chapter II, paras. 148-203, pp. 135-152)

Purpose of legislative provisions

The purpose of avoidance provisions is to:

- (a) Reconstitute the integrity of the estate and ensure the equitable treatment of creditors;
- (b) Provide certainty for third parties by establishing clear rules for the circumstances in which transactions occurring prior to the commencement of insolvency proceedings involving the debtor or the debtor's property may be considered injurious and therefore subject to avoidance;
- (c) Enable the commencement of proceedings to avoid those transactions; and
- (d) Facilitate the recovery of money or assets from persons involved in transactions that have been avoided.

Avoidable transactions²⁷

(87) The insolvency law should include provisions that apply retroactively and are designed to overturn transactions, involving the debtor or assets of the estate and that have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors. The insolvency law should specify the following types of transactions as avoidable:

- (a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors;
- (b) Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was a gift or was made in exchange for a nominal or less than equivalent value or for inadequate value which occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); and
- (c) Transactions involving creditors where a creditor obtained, or received the benefit of, more than its pro rata share of the debtor's assets which occurred at a time when the debtor was insolvent (preferential transactions).

²⁷ The use of the word "transaction" in this section is intended to refer generally to the wide range of legal acts by which assets may be disposed of or obligations incurred including by way of a transfer, a payment, granting of a security interest, a guarantee, a loan or a release or an action to make a security interest effective against third parties, and may include a composite series of transactions.

Security interests

(88) The insolvency law should specify that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of insolvency law on the same grounds as other transactions.

Establishing the suspect period

(89) The insolvency law should specify that the transactions described in recommendation 87(a)-(c) may be avoided if they occurred within a specified period (the suspect period) calculated retroactively from a specified date, being either the date of application for or commencement of the insolvency proceedings. The insolvency law may specify different suspect periods for different types of transactions.

Transactions with related persons

(90) The insolvency law may specify that the suspect period for avoidable transactions involving related persons is longer than for transactions with unrelated persons.

(91) The insolvency law should specify the categories of persons with sufficient connection to the debtor to be treated as related persons.²⁸

Transactions exempt from avoidance actions

(92) The insolvency law should specify the transactions that are exempt from avoidance, including financial contracts.

Conduct of avoidance proceedings

(93) The insolvency law should specify that the insolvency representative has the principal responsibility to commence avoidance proceedings.²⁹ The insolvency law may also permit any creditor to commence avoidance proceedings with the agreement of the insolvency representative and where, the insolvency representative does not agree, the creditor may seek leave of the court to commence such proceedings.

Funding of avoidance proceedings

(94) The insolvency law should specify that the costs of avoidance proceedings be paid as administrative expenses.

(95) The insolvency law may provide alternative approaches to address the pursuit and funding of avoidance proceedings.

Time limits for commencement of avoidance proceedings

(96) The insolvency law or applicable procedural law should specify the time period within which an avoidance proceeding may be commenced. That time period should begin to run on the commencement of insolvency proceedings. In respect of transactions referred to in recommendation 87 which have been concealed and which the insolvency representative could not be expected to discover, the insolvency law may provide that the time period commences at the time of discovery.

Elements of avoidance and defences

(97) The insolvency law should specify the elements to be proved in order to avoid a particular transaction, the party responsible for proving those elements and specific defences to avoidance. Those defences may include that the transaction was entered into in the ordinary course of business prior to commencement of insolvency proceedings. The law may also establish presumptions and permit shifts in the burden of proof to facilitate the conduct of avoidance proceedings.

Liability of counterparties to avoided transactions

(98) The insolvency law should specify that a counterparty to a transaction that has been avoided must return to the estate the assets obtained or, if the court so orders, make a cash payment to the estate for the value of the transaction. The insolvency law should determine whether the counterparty to an avoided transaction would have an ordinary unsecured claim.

(99) The insolvency law may specify that where the counterparty does not comply with the court order

²⁸ "Related person" is defined in the Glossary to the UNCITRAL Insolvency Guide.

²⁹ Issues relevant to avoidance may also arise in proceedings commenced by a person other than the insolvency representative, where the insolvency representative raises avoidance by way of defence against enforcement.

avoiding the transaction, in addition to avoidance and any other remedy, a claim by the counterparty may be disallowed.

CRITERIA FOR ASSESSING COMPLIANCE

C11.1 - C11.3 AVOIDABLE TRANSACTIONS

170. The insolvency law provides that transactions by the debtor after the commencement of an insolvency proceeding that are not entered into in the ordinary course of business or as part of an approved administration should be avoided or are unenforceable as against the estate. [C11.1]
- a. If the insolvency law provides exceptions limiting the general rule, they are limited, narrowly construed, and aimed at protecting third parties' rights in good faith. [C11.1]
171. The insolvency law establishes clear rules for the circumstances in which transactions occurring prior to the commencement of insolvency proceedings involving the debtor or the debtor's assets may be subject to avoidance. (Avoidance proceedings - purpose b)
- a. The insolvency law specifies the types of transactions occurring prior to the commencement of insolvency proceedings that may be avoidable or are exempt from avoidance. (87) [C11.2]
172. The insolvency law specifies the following types of pre-commencement transactions as avoidable: (87)
- a. Transactions through which the debtor intended to defeat, delay, or hinder the ability of creditors to collect claims and where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors (intentionally prejudicial transactions or fraudulent transactions); (87 a) [C11.2]
- b. Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was a gift or was made in exchange for inadequate value, which occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); (87 b) [C11.2] and,
- c. Transactions involving creditors where a creditor obtained, or received the benefit of, more than its *pro rata* share of the debtor's assets which occurred at a time when the debtor was insolvent (preferential transactions). (87 c) [C11.2]
173. The insolvency law specifies that transactions referred to in 93 may be avoided if they occurred within a specified period (the suspect period) calculated retroactively from a specified date, being either the date of application for or commencement of the insolvency proceedings. (89) [C11.2]
174. The suspect period is reasonably short, relative to each type of transaction. (89) (90) [C11.3]
175. The insolvency law specifies that financial contracts are exempt from avoidance. (92) (104)
176. The insolvency law specifies that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of insolvency law on the same grounds as other transactions. (88)
177. The insolvency law specifies who may commence avoidance proceedings. (93)

178. The insolvency law addresses the funding of avoidance proceedings. (94) (95)
179. The insolvency law or applicable procedural law specifies:
 - a. The time period within which an avoidance proceeding may be commenced; (96)
 - b. The elements to be proved in order to avoid a particular transaction;
 - c. The party responsible for proving those elements; and
 - d. The specific defenses to avoidance. (97)
180. The law addresses the consequences of avoidance, including whether a counterparty has an unsecured claim. (98) (99)

COMMERCIAL INSOLVENCY

TREATMENT OF STAKEHOLDER RIGHTS AND PRIORITIES

WB Principle

Treatment of Stakeholder Rights and Priorities [C12]

- C12.1 The rights of creditors and the priorities of claims established prior to insolvency proceedings under commercial or other applicable laws should be upheld in an insolvency proceeding to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships. Deviations from this general rule should occur only where necessary to promote other compelling policies, such as the policy supporting reorganization, or to maximize the insolvency estate's value. Rules of priority should enable creditors to manage credit efficiently, consistent with the following additional principles:
- C12.2 The priority of secured creditors in their collateral should be upheld and, absent the secured creditor's consent, its interest in the collateral should not be subordinated to other priorities granted in the course of the insolvency proceeding. Distributions to secured creditors should be made as promptly as possible.
- C12.3 Following distributions to secured creditors from their collateral and the payment of claims related to the costs and expenses of administration, proceeds available for distribution should be distributed *pari passu* to the remaining general unsecured creditors,³⁰ unless there are compelling reasons to justify giving priority status to a particular class of claims. Public interests generally should not be given precedence over private rights. The number of priority classes should be kept to a minimum.
- C12.4 Workers are a vital part of an enterprise, and careful consideration should be given to balancing the rights of employees with those of other creditors.
- C12.5 In liquidation, equity interests or the owners of the business are not entitled to a distribution of the proceeds of assets until the creditors have been fully repaid. The same rule should apply in reorganization, although limited exceptions may be made under carefully stated circumstances that respect rules of fairness entitling equity interests to retain a stake in the enterprise.

UNCITRAL Recommendations

Priorities and distribution of proceeds (Part two, chapter V, paras. 51-81, pp. 266-274)

Purpose of legislative provisions

The purpose of provisions on priority and distribution is to:

- (a) Establish the order in which claims should be satisfied from the estate;
- (b) Ensure that similarly ranked creditors are satisfied proportionately out of the assets of the estate; and
- (c) Specify limited circumstances in which priority in distribution is permitted.

Classes and treatment of creditors affected by commencement of insolvency proceedings

(185) The insolvency law should specify the classes of creditors that will be affected by the commencement of insolvency proceedings and the treatment of those classes in terms of priority and distribution.

Establishing an order for satisfaction of claims

(186) The insolvency law should establish the order in which claims are to be satisfied from the estate.

Priority claims

³⁰ Subject to any intercreditor agreements and contractual subordination provisions or where equitable subordination of a creditors claim may be appropriate.

(187) The insolvency law should minimize the priorities accorded to unsecured claims. The law should set out clearly the classes of claims, if any, that will be entitled to be satisfied in priority in insolvency proceedings.

Secured claims

(188) The insolvency law should specify that secured claims should be satisfied from the encumbered asset in liquidation or pursuant to a reorganization plan, subject to claims that are superior in priority to the secured claim, if any. Claims superior in priority to secured claims should be minimized and clearly set forth in the insolvency law. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor.

Ranking of claims other than secured claims

(189) The insolvency law should specify that claims other than secured claims, are ranked in the following order:³¹

- (a) Administrative costs and expenses;
- (b) Claims with priority;
- (c) Ordinary unsecured claims;
- (d) Deferred claims or claims subordinated under the law.

(190) The insolvency law should specify that in the event there is a surplus after all claims have been satisfied in full, the surplus is to be returned to the debtor.

Distribution in liquidation

(191) The insolvency law should provide, as a general principle, that similarly ranked claims are paid *pari passu*. All similarly ranked claims in a particular class should be paid in full before the next rank is paid.

(192) The insolvency law should specify that in making a distribution the insolvency representative be required to make provision for submitted claims that are not yet finally admitted.

(193) The insolvency law should specify that, in liquidation proceedings, distributions be made promptly and that interim distributions may be made.

CRITERIA FOR ASSESSING COMPLIANCE

C12.1. PRIORITIES AMONG CREDITORS

181. Creditor rights and priorities of claims established prior to insolvency under commercial or other applicable laws are upheld in insolvency proceedings. (1h) [C12.1]
 - a. Exceptions are limited and only occur where necessary to promote key objectives and policies of the insolvency system. [C12.1]
182. The insolvency law specifies the classes of creditors that will be affected by the commencement of insolvency proceedings. (185)
183. The insolvency law specifies the treatment of the classes of creditors affected by insolvency proceedings in terms of priority and distribution. (185) (186)
 - a. The number of priority classes is kept to a minimum. (187) [C12.3]
 - b. Claims superior in priority to secured claims are minimized and clearly set forth in the insolvency law. (188)

³¹ The insolvency law may provide for further ranking of claims within each of the ranks set forth in paras. (a), (b) and (d). Where all creditors within a rank cannot be paid in full, the order of payment should reflect any further ranking specified in the insolvency law for claims of the same rank.

184. The insolvency law sets out clearly the classes of claims, if any, that will be entitled to be satisfied in priority in insolvency proceedings. (187)

C12.2. TREATMENT OF SECURED CREDITORS

185. The priority of secured creditors is upheld in the course of the insolvency proceeding. (188) [C12.2]
186. A secured creditor's priority is not subordinated to other priorities granted in the course of the insolvency proceeding without its consent. [C12.2]
187. In liquidation, distributions to secured creditors are made as promptly as possible. [C12.2]
188. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor. (187)

C12.3. TREATMENT OF UNSECURED CREDITORS

189. Following distributions to secured creditors from their collateral and payment of claims related to costs and expenses of administration, proceeds are available for distribution *pari passu* to the remaining general unsecured creditors unless there are compelling reasons to justify giving priority status to a particular class of claims. [C12.3]
190. The insolvency law specifies that claims other than secured claims are ranked in the following order:
- a. Administrative costs and expenses;
 - b. Claims with priority;
 - c. Ordinary unsecured claims; and
 - d. Deferred claims or claims subordinated under the law. (189)
191. In liquidation proceedings, the insolvency law provides that all similarly ranked claims in a particular class should be paid in full before the next rank is paid. (191)

C12.4 – C12.5 TREATMENT OF OTHER STAKEHOLDERS

192. In liquidation, equity interests or interests of the business' owners are not entitled to a distribution of the proceeds of assets until the creditors have been fully repaid. [C12.5]
193. In reorganization, the same rule on priorities applies, although limited exceptions may be made that entitle equity interests to retain a stake in the enterprise under carefully stated circumstances that respect rules of fairness. [C12.5] A question was raised as to whether this meant that equity holders could retain a stake if creditors consent? If so, should we perhaps state it that way?

COMMERCIAL INSOLVENCY

COMMENCEMENT – CLAIMS AND CLAIMS RESOLUTION

WB Principle

Claims and Claims Resolution: Claims Filing and Resolution [C13]

Procedures for notifying creditors and permitting them to file claims should be cost effective, efficient, and timely. While there must be a rigorous system of examining claims to ensure validity and resolve disputes, the delays inherent in resolving disputed claims should not be permitted to delay insolvency proceedings.

UNCITRAL Recommendations

Treatment of Creditor Claims (Part two, chapter V, paras. 1-50, pp. 249-263)

Purpose of legislative provisions

The purpose of provisions on creditor claims is to:

- (a) Define the claims that can or are required to be submitted and the treatment to be accorded to those claims;
- (b) Enable persons who have a claim against a debtor to submit claims against the estate;
- (c) Establish a mechanism for verification and admission of claims;
- (d) Provide for review of disputed claims; and
- (e) Ensure that similarly ranked creditors are treated equally.

Requirement to submit

(169) The insolvency law should require creditors who wish to participate in the proceedings to submit a claim, which should specify the basis and amount of the claim. The law should minimize the formalities associated with submission of claims. The insolvency law should permit claims to be submitted using different means, including mail and electronic means.

Undisputed claims

(170) The insolvency law may permit claims that are undisputed to be admitted by reference to the list of creditors and claims prepared by the debtor in cooperation with the insolvency representative³² or the court or the insolvency representative may require a creditor to provide evidence of its claim. The insolvency law should not require that in all cases a creditor must appear in person to prove its claim.

Claims that may be submitted (para. 1)

(171) The insolvency law should specify that claims that may be submitted include all rights to payment which arise from acts or omissions of the debtor³³ prior to commencement of the insolvency proceedings, whether mature or not, whether liquidated or unliquidated, whether fixed or contingent. The law should identify claims that will not be affected by the insolvency proceedings.³⁴

Secured claims

(172) The insolvency law should specify whether secured creditors are required to submit claims.

³² See recommendation 110.

³³ This would include claims by third parties or a guarantor for payment arising from acts or omissions of the debtor.

³⁴ Some insolvency laws provide, for example, that claims such as fines and penalties and taxes will not be affected by the insolvency proceedings. Where a claim is to be unaffected by the insolvency proceedings it would continue to exist and would not be included in any discharge.

Equal treatment of similarly ranked creditors

(173) The insolvency law should specify that all similarly ranked creditors, regardless of whether they are domestic or foreign creditors, are to be treated equally with respect to the submission and processing of their claims.

Timing of submission of claims

(174) The insolvency law should specify the period of time after the effective date of commencement of proceedings within which claims may be submitted. That time period should be adequate to allow creditors to submit their claims.³⁵

Consequences of failure to submit a claim

(175) Where the insolvency law requires a creditor to submit a claim, the insolvency law should specify the consequences of failure to submit a claim within any period of time specified for submission.

Foreign currency claims

(176) Where claims are denoted in foreign currency, the insolvency law should specify the circumstances in which those claims must be converted and the reasons for conversion. Where conversion is required, the insolvency law should specify that the claim will be converted into local currency by reference to a specified date, such as the effective date of commencement of insolvency proceedings.

Admission or denial of claims

(177) The insolvency law should permit the insolvency representative to admit or deny any claim, in full or in part.³⁶ Where the claim is to be denied or subjected to treatment under recommendation 183 as a claim by a related person, whether in full or in part, notice of the reasons for the decision should be given to the creditor.

Unliquidated claims

(178) The insolvency law should permit unliquidated claims to be admitted provisionally, pending determination of the amount of the claim by the insolvency representative.

Valuation of secured claims

(179) The insolvency law should provide that the insolvency representative may determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset.

Disputing a claim

(180) The insolvency law should permit a party in interest to dispute any submitted claim, either before or after admission, and request review of that claim by the court.

Review of claims denied or subjected to special treatment

(181) The insolvency law should permit creditors whose claims have been denied or subjected to treatment under recommendation 183 as a claim by a related person, whether in full or in part, to request the court to review their claim. The insolvency law may specify a period of time after notification of the decision within which that request may be made.

Provisional admission of disputed claims

³⁵ Where proceedings involve foreign creditors, longer time periods may be required to facilitate submission of claims. Also, it is desirable that claims be submitted at an early stage of the proceedings so that the insolvency representative will be aware of the claims involved, of the encumbered assets affected and of the value of those assets and claims.

³⁶ In some jurisdictions, the court may be required to ratify the decision of the insolvency representative.

³⁷ However, when making a distribution, the insolvency representative may be required to take account of claims that have been provisionally admitted, or submitted but not yet admitted.

³⁸ Sufficient justification may involve situations where the debtor is undercapitalized or there has been self-dealing, UNCITRAL *Insolvency Guide*, part two, chapter V, para. 48, pp 262-63.

³⁹ On subordination, see below, UNCITRAL *Insolvency Guide*, part two, chapter V, paras. 55-61, pp 267-269.

(182) The insolvency law should specify that, claims disputed in the insolvency proceedings could be admitted provisionally by the insolvency representative pending resolution of the dispute by the court.

Effects of admission

(183) The insolvency law should specify the effects of admission, including provisional admission, of a claim. These effects may include:

- (a) Entitling the creditor to participate in the proceedings and to be heard;
- (b) Permitting the creditor to vote at a meeting of creditors, including on approval of a plan;
- (c) Determining the priority to which the creditor's claim is entitled;
- (d) Determining the amount for which the creditor is entitled to vote;
- (e) Except in the case of provisional admission of a claim, permitting the creditor to participate in a distribution.³⁷

Claims by related persons

(184) The insolvency law should specify that claims by related persons should be subject to scrutiny and, where justified:³⁸

- (a) The voting rights of the related person may be restricted;
- (b) The amount of the claim of the related person may be reduced; or
- (c) The claim may be subordinated.³⁹

CRITERIA FOR ASSESSING COMPLIANCE

194. The insolvency law defines eligible claims and the treatment to be accorded to those claims. (purpose a)
- a. The insolvency law specifies that eligible claims include all rights to payment that arise from acts or omissions of the debtor prior to commencement of the insolvency proceedings, whether mature or not, whether liquidated or unliquidated, and whether fixed or contingent. (171)
 - b. The insolvency law identifies claims that are not affected by insolvency proceedings. (171)
195. The insolvency law establishes a mechanism for submission, verification, and admission of claims. (Treatment of creditor claims - purpose c) [C13]
- a. The insolvency law enables persons who have a claim against a debtor to submit claims; (Treatment of creditor claims - purpose b)
 - b. The insolvency law requires creditors who wish to participate in the proceedings to submit a claim; (169) unless,
 - c. The insolvency law permits claims that are undisputed to be admitted by reference to a list of creditors and claims; (170)
 - d. The insolvency law specifies whether secured creditors are required to submit claims; (172)
 - e. The basis and amount of the claim should be specified in the claim; (169)
 - f. Procedures for permitting creditors to file claims are cost-effective, efficient, and timely, and permit claims to be submitted using different means, including mail and electronic means (169) [C13]; and

- g. The insolvency law does not require that in all cases a creditor must appear in person to prove its claim. (170)
- 196. The insolvency law specifies the period of time after the effective date of commencement of proceedings within which claims may be submitted.
 - a. The time period is adequate to allow creditors to submit their claims. (174)
 - b. Where the insolvency law requires a creditor to submit a claim, it specifies the consequences of failure to submit a claim within any period of time specified for submission. (175)
- 197. The insolvency law provides for the admission or denial of any claim, in full or in part. (177)
- 198. The insolvency law provides for all claims by foreign or domestic creditors to be treated equally. (173)
- 199. The insolvency law specifies the effects of admission, including provisional admission, of a claim. (182) (183)
- 200. The insolvency law permits a party in interest to dispute any submitted claim, either before or after admission, and request review of that claim by the court. (180) [C13]
- 201. Where claims are denoted in foreign currency, the insolvency law specifies the circumstances in which those claims are to be converted and the effects of conversion.
 - a. Where conversion is required, the insolvency law specifies that the claim will be converted into local currency by reference to a specified date. (176)
- 202. The insolvency law provides for the determination of the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset. (179)
- 203. The insolvency law addresses the treatment of claims for related persons. (184)

COMMERCIAL INSOLVENCY

REORGANIZATION PROCEEDINGS

WB Principle

Reorganization Proceedings [C14]

- C14.1 The system should promote quick and easy access to the proceeding; assure timely and efficient administration of the proceeding; afford sufficient protection for all those involved in the proceeding; provide a structure that encourages fair negotiation of a commercial plan; and provide for approval of the plan by an appropriate majority of creditors. Key features and principles of a modern reorganization proceeding include the following:
- C14.2 Plan Formulation and Consideration. There should be a flexible approach for developing the plan consistent with fundamental requirements designed to promote fairness and prevent commercial abuse.
- C14.3 Plan Voting and Approval. For voting purposes, classes of creditors may be provided with voting rights weighted according to the amount of a creditor's claim. Claims and voting rights of insiders should be subject to special scrutiny and treated in a manner that will ensure fairness. Plan approval should be based on clear criteria aimed at achieving fairness among similar creditors, recognition of relative priorities, and majority acceptance, while offering opposing creditors or classes a dividend equal to or greater than they would likely receive in a liquidation proceeding. Where court confirmation is required, the court should normally defer to the decision of the creditors based on a majority vote. Failure to approve a plan within the stated time period, or any extended periods, is typically grounds for placing the debtor into a liquidation proceeding.
- C14.4 Plan Implementation and Amendment. Effective implementation of the plan should be independently supervised. A plan should be capable of amendment (by vote of the creditors) if it is in the interests of the creditors. Where a debtor fails or is incapable of implementing the plan, this should be grounds for terminating the plan and liquidating the insolvency estate.
- C14.5 Discharge and Binding Effects. The system should provide for plan effects to be binding with respect to forgiveness and to cancellation or alteration of debts. The effect of approval of the plan by a majority vote should bind all creditors, including dissenting minorities.
- C14.6 Plan revocation and closure. Where approval of the plan has been procured by fraud, the plan should be reconsidered or set aside. Upon consummation and completion of the plan, provision should be made to swiftly close the proceedings and enable the enterprise to carry on its business under normal conditions and governance.

UNCITRAL Recommendations

Reorganization Plan (Part two, chapter IV, paras. 1-75, pp. 209-233)

Purpose of legislative provisions

The purpose of provisions relating to the reorganization plan is to:

- (a) Facilitate the rescue of businesses subject to the insolvency law, thereby preserving employment and, in appropriate cases, protecting investment;
- (b) Identify those businesses that are capable of reorganization;
- (c) Maximize the value of the estate;
- (d) Facilitate the negotiation and approval of a reorganization plan and establish the effects of approval, including that the plan should bind the debtor, creditors and other parties in interest;
- (e) Address the consequences of a failure to propose an acceptable reorganization plan or to secure approval of the plan, including conversion of the proceedings to liquidation in certain circumstances; and
- (f) Provide for the implementation of the reorganization plan and the consequences of failure of implementation.

Contents of legislative provisions

Proposal of a reorganization plan

(139) 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 period of time after commencement of the insolvency proceedings:

- (i) The time period should be fixed by the insolvency law;
- (ii) The court should be authorized to extend the time period in appropriate circumstances;

(140) Where liquidation proceedings are converted to reorganization proceedings, the insolvency law should also address the impact of conversion on time limits for proposal of a plan.

Preparation of a disclosure statement

(141) The insolvency law should require a plan to be accompanied by a disclosure statement that will enable those entitled to vote on approval of the plan to make an informed decision about the plan. The party that prepares the plan should also prepare the disclosure statement.

Submission of the plan and disclosure statement

(142) The insolvency law should provide a mechanism for submission of the plan and disclosure statement to creditors and equity holders.

Contents of a disclosure statement

(143) The insolvency law should specify that the disclosure statement include:⁴⁰

- (a) A summary 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;
- (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, adequate provision has been made for satisfaction of all obligations included in the plan; and
- (g) Information on the voting mechanisms applicable to approval of the plan.

Contents of a plan

(144) 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 terms and conditions of the plan;
- (d) Identify the debtor's role in implementation of the plan;
- (e) 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

⁴⁰ 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 chapter III, recommendation 111, and paras. 28, 52 and 115.

remuneration; and

(f) Indicate how the plan will be implemented.

Voting mechanisms

(145) The insolvency law should establish a mechanism for voting on approval of the plan. The mechanism should address the creditors and equity holders who are entitled to vote on the plan; the manner in which the vote will be conducted, either at a meeting convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether or not creditors and equity holders should vote in classes according to their respective rights.

(146) The insolvency law should specify that a creditor or equity holder whose rights are modified or affected by the plan should not be bound to the terms of the plan unless that creditor or equity holder has been given the opportunity to vote on approval of the plan.

(147) The insolvency law should specify that where the plan provides that the rights of a creditor or equity holder or class of creditors or equity holders are not modified or affected by a plan, that creditor or equity holder or class of creditors or equity holders is not entitled to vote on approval of the plan.

(148) The insolvency law should specify that creditors entitled to vote on approval of the plan should be separately classified according to their respective rights and that each class should vote separately.

(149) The insolvency law should specify that all creditors and equity holders in a class should be offered the same treatment.

Approval by classes

(150) Where voting on approval of the plan is conducted by reference to classes, 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 classes or approval by a specified majority of the classes, but at least one class of creditors whose rights are modified or affected by the plan must approve the plan.

(151) Where the insolvency law does not require a plan to be approved by all classes, the insolvency law should address the treatment of those classes that do not vote to approve a plan that is otherwise approved by the requisite classes. That treatment should be consistent with the grounds set forth in recommendation 151.

Confirmation of an approved plan

(152) Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to 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 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 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 classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

⁴¹ Where the proceedings involve a debtor-in-possession, or where the proceedings conclude on approval of the plan, it may not be necessary to appoint a supervisor.

⁴² This course of action is only available where the proceedings remain open during implementation – see chapter VI, paras. 18-19.

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

(153) Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit parties in interest, 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 151 are satisfied; and
- (b) Fraud, in which case the requirements of recommendation 153 should apply.

Challenges to a confirmed plan

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

- (a) A time limit for bringing such a challenge calculated by reference to the time the fraud is discovered;
- (b) The party that may bring such a challenge; and
- (c) That the challenge should be heard by the court.

Amendment of a plan

(155) 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

(156) The insolvency law should establish the mechanism for approval of amendments to a plan that has been approved by creditors. That mechanism should: require notice to be given to the creditors and other parties affected by the proposed modification; specify the party required to give notice; require the approval of creditors and other parties affected by the modification; and require the rules for confirmation (where confirmation is required) to be satisfied. The insolvency law should also specify the consequences of failure to secure approval of proposed amendments.

Supervision of implementation

(157) The law may establish a mechanism for supervising implementation of the plan, which may include supervision by the court, by a court-appointed supervisor, by the insolvency representative, or by a creditor-appointed supervisor.⁴¹

Conversion to liquidation

(158) 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 the court does not grant an extension of time;
- (b) A proposed plan is not approved;
- (c) An approved plan is not confirmed (where the insolvency law requires confirmation);
- (d) An approved or a confirmed plan is successfully challenged; or
- (e) There is substantial breach by the debtor of the terms of the plan or an inability to implement the plan.⁴²

Failure of implementation of a plan

(159) The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

Discharge (Part two, chapter VI, paras. 1-15, pp. 281-284)

Purpose of legislative provisions

The purpose of provisions on discharge is to:

- (a) Enable an a natural person debtor to be finally discharged from liabilities for pre-commencement debts, thus providing a fresh start;
- (b) Establish the circumstances under which discharge will be granted and the terms of that discharge.

Discharge of a natural person debtor in liquidation

(194) Where natural persons are eligible as debtors under the insolvency law, the issue of discharge of those debtors from liability for pre-commencement debts should be addressed. The insolvency law may specify that the discharge may not apply until after the expiration of a specified period of time following commencement, during which period the debtor is expected to cooperate with the insolvency representative. Upon the expiration of such time period, the debtor may be discharged where the debtor has not acted fraudulently and has cooperated with the insolvency representative in performing its obligations under the insolvency law. The insolvency law may specify that the discharge be revoked where it was obtained fraudulently.

(194) Where the insolvency law provides that certain debts are excluded from a discharge, those debts should be kept to a minimum to facilitate the debtor's fresh start and be clearly set forth in the insolvency law.

(195) Where the insolvency law provides that conditions may be attached to a debtor's discharge, those conditions should be kept to a minimum to facilitate the debtor's fresh start and should be clearly set forth in the insolvency law.

Conclusion of Proceedings (Part two, chapter VI, paras. 16-19, pp. 285-286)

Purpose of legislative provisions

The purpose of provisions on conclusion of insolvency proceedings is to determine a procedure for closing the proceedings once their goal has been achieved.

Reorganization

(197) The insolvency law should specify the procedures by which reorganization proceedings should be closed.

Liquidation

(198) The insolvency law should specify the procedures by which liquidation proceedings should be closed following final distribution or a determination that no distribution can be made.

CRITERIA FOR ASSESSING COMPLIANCE

C14.1. GENERAL FEATURES

204. The insolvency law facilitates the reorganization of viable businesses that are subject to insolvency law. (Reorganization Plan – purpose a)

205. The insolvency system:

- a. Promotes quick and easy access to the reorganization proceeding; [C14.1]
- b. Assures timely and efficient administration of the reorganization proceeding; [C14.1]
- c. Maximizes the value of the estate; (Reorganization Plan – purpose c)
- d. Affords sufficient protection for all parties in interest; [C14.1]
- e. Provides a structure that facilitates the fair negotiation of a reorganization plan; (Reorganization Plan – purpose d) [C14.1] and,
- f. Provides for approval of the plan by an appropriate majority of creditors. [C14.1]

C14.2. PLAN FORMULATION AND CONSIDERATION

206. Reorganization proceedings provide a flexible approach for developing a plan consistent with fundamental requirements designed to promote fairness and prevent commercial abuse. [C14.2]

(Refer to criterion #205 above for fundamental requirements for reorganization proceedings.)

207. The insolvency law specifies that a plan may be proposed on or after the making of an application to commence insolvency proceedings, or within a specified period of time after commencement of the insolvency proceedings. (139)

208. The insolvency law requires a plan to be accompanied by a disclosure statement by the proponent of the plan that will enable those entitled to vote on approval of the plan to make an informed decision about the plan. (141)

209. The insolvency law specifies the minimum contents of the disclosure statement. (143)

210. The insolvency law specifies the minimum contents of a plan. (144)

211. The insolvency law provides a mechanism for submission of the plan and disclosure statement to creditors and equity holders. (142)

C14.3. PLAN VOTING AND APPROVAL

212. The insolvency law establishes a mechanism for voting on approval of the plan. (145)

213. The mechanism for voting on approval of a plan addresses:

- a. The creditors and equity holders who are entitled to vote on the plan; (145) [C14.2]
- b. The manner in which the vote will be conducted (145); and
- c. Whether or not creditors and equity holders should vote in classes according to their respective rights. (145) [C14.2]

214. Negotiation and approval are facilitated by entitling creditors to vote in separate classes according to their respective rights, at least as between secured and unsecured creditors. (Reorganization Plan – purpose d) (148) [C14.2]

215. The insolvency law requires that all members of a class be offered the same treatment under the plan. (149)

216. The insolvency law specifies that where the plan provides that the rights of a creditor or equity holder or class of creditors or equity holders are not modified or affected by a plan, that creditor or equity holder or class of creditors or equity holders is not entitled to vote on approval of the plan. (147)

217. The insolvency law provides that plan approval should be based on clear criteria, aimed at achieving fairness among similar creditors, recognition of relative priorities, and majority acceptance. [C14.3]

218. Where voting on approval of the plan is conducted by reference to classes, the insolvency law specifies how the vote achieved in each class should be treated for the purposes of approval of the plan. (150)

219. The insolvency law provides for approval of the plan by an appropriate majority of creditors. [C14.1]
220. The insolvency law addresses the treatment of those classes that do not vote to approve a plan. (151)
221. Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law permits parties in interest, including the debtor, to challenge the approval of the plan. (153)
- a. The insolvency law specifies criteria against which a challenge to approval can be assessed. (152) (153)
222. Where the insolvency law requires court confirmation of an approved plan, the insolvency law requires the court to confirm the plan if the following conditions are satisfied:
- a. The requisite approvals have been obtained and the approval process was properly conducted; (152) [C14.3]
 - b. Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment; (152) [C14.3]
 - c. The plan does not contain provisions contrary to 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 classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking. (152) [C14.3]
223. The insolvency law permits a confirmed plan to be challenged on the basis of fraud. (153) The insolvency law specifies:
- a. A time limit for bringing such a challenge, calculated by reference to the time the fraud is discovered;
 - b. The party that may bring such a challenge; and
 - c. That the challenge should be heard by the court. (154)
224. The insolvency law provides 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 the court does not grant an extension of time;
 - b. A proposed plan is not approved;
 - c. An approved plan is not confirmed (where the insolvency law requires confirmation); or
 - d. An approved or a confirmed plan is successfully challenged. (158) [C14.3]

C14.4 PLAN IMPLEMENTATION AND AMENDMENT

225. The insolvency law establishes a mechanism for supervising implementation of the plan. (157) [C14.4]
226. The insolvency law specifies that where there is substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the proceedings may be:

- a. Converted to liquidation; (158) [C14.4] or
 - b. Closed, and parties in interest may exercise their rights at law. (159) [C14.4]
227. The insolvency law permits amendment of an approved plan. (155) [C14.4]
- a. The insolvency law specifies the parties that may propose amendments. (155)
 - b. The insolvency law specifies the time at which the plan may be amended. (156)
 - c. The insolvency law specifies the mechanism for approval by affected creditors. (156)
 - d. The insolvency law specifies the consequences of failure to secure approval of proposed amendments. (156)

C14.5 DISCHARGE AND BINDING EFFECTS

228. The insolvency law gives binding effect to the forgiveness, cancellation, or alteration of debts in accordance with the approved plan. [C14.5].
229. The effect of approval of the plan is to bind all affected creditors, including dissenting creditors, provided they have been given the opportunity to vote on approval. (146) [C14.5]

C14.6 PLAN REVOCATION AND CLOSURE

230. The law specifies the procedures for closure of reorganization proceedings. (197) [C14.5]

COMMERCIAL INSOLVENCY

INTERNATIONAL CONSIDERATIONS

WB Principle

International Considerations [C15]

Insolvency proceedings may have international aspects, and a country's legal system should establish clear rules pertaining to jurisdiction, recognition of foreign judgments, cooperation among courts in different countries, and choice of law. Key factors to effective handling of cross-border matters typically include:

- (i) A clear and speedy process for obtaining recognition of foreign insolvency proceedings;
- (ii) Relief to be granted upon recognition of foreign insolvency proceedings;
- (iii) Foreign insolvency representatives to have access to courts and other relevant authorities;
- (iv) Courts and insolvency representatives to cooperate in international insolvency proceedings; and
- (v) Non-discrimination between foreign and domestic creditors.

UNCITRAL Recommendations

Jurisdiction (Part two, chapter I, paras. 12-19, pp. 41-43)

(10) The insolvency law should specify which debtors have sufficient connection to the State to be subject to its insolvency law. Different approaches may be taken to identifying appropriate connecting factors, but the grounds upon which a debtor can be subject to the insolvency law should include:⁴³

- (a) That the debtor has its centre of main interests in the State; or
- (b) That the debtor has an establishment in the State.

(11) The insolvency law should establish a presumption that, in the absence of proof to the contrary, a legal person's centre of main interests is in the State in which it has its registered office, and a natural person's centre of main interests is in the State in which that person has their habitual residence.

(12) The insolvency law should define "establishment" to mean "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services".

Applicable law in insolvency proceedings (Part two, chapter I, paras. 80-91, pp. 67-72)

Purpose of legislative provisions

The purpose of provisions on the applicable law in insolvency proceedings is to:

- (a) Facilitate commerce by recognizing, in insolvency proceedings, the rights and claims that arise before commencement of insolvency proceedings and the law that will apply to the validity and effectiveness of those rights and claims; and
- (b) Establish the law applicable in insolvency proceedings and exceptions, if any, to the application of that law.

Law applicable to validity and effectiveness of rights and claims

(30) The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

⁴³This recommendation is intended to indicate minimum and non-exclusive grounds for commencing insolvency proceedings. Other grounds, such as presence of assets, are used in some jurisdictions, but are not recommended: see above, UNCITRAL Insolvency Guide, part two, chapter I, paras. 17-18, pp 42-43 and the Guide to Enactment of the UNCITRAL Model Law, paras. 184-187, UNCITRAL Insolvency Guide, pp 355-56.

Law applicable in insolvency proceedings

(31) The insolvency law of the State in which insolvency proceedings are commenced (lex fori concursus) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

- (a) Identification of the debtors that may be subject to insolvency proceedings;
- (b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement;
- (c) Constitution and scope of the insolvency estate;
- (d) Protection and preservation of the insolvency estate;
- (e) Use or disposal of assets;
- (f) Proposal, approval, confirmation and implementation of a plan of reorganization;
- (g) Avoidance of certain transactions that could be prejudicial to certain parties;
- (h) Treatment of contracts;
- (i) Set-off;
- (j) Treatment of secured creditors;
- (k) Rights and obligations of the debtor;
- (l) Duties and functions of the insolvency representative;
- (m) Functions of the creditors and creditor committee;
- (n) Treatment of claims;
- (o) Ranking of claims;
- (p) Costs and expenses relating to the insolvency proceedings;
- (q) Distribution of proceeds;
- (r) Conclusion of the proceedings; and
- (s) Discharge.

Exceptions to the application of the law of the insolvency proceedings

(32) Notwithstanding recommendation 31, the effects of insolvency proceedings on the rights and obligations of the participants in a payment or settlement system or in a regulated financial market should be governed solely by the law applicable to that system or market.

(33) Notwithstanding recommendation 31, the effects of insolvency proceedings on rejection, continuation and modification of labour contracts may be governed by the law applicable to the contract.

(34) Any exceptions additional to recommendations 32 and 33 should be limited in number and be clearly set forth or noted in the insolvency law

Treatment of creditor claims (Part two, chapter V, paras. 10 (p. 251), 21-22 (pp. 254-255)),

Equal treatment of similarly ranked creditors

(172) The insolvency law should specify that all similarly ranked creditors, regardless of whether they are domestic or foreign creditors, are to be treated equally with respect to the submission and processing of their claims.

Foreign currency claims

(175) Where claims are denoted in foreign currency, the insolvency law should specify the circumstances in which those claims must be converted and the reasons for conversion. Where conversion is required, the insolvency law should specify that the claim will be converted into local currency by reference to a specified date, such as the effective date of commencement of insolvency proceedings.

CRITERIA FOR ASSESSING COMPLIANCE

C15. INTERNATIONAL CONSIDERATIONS

231. The UNCITRAL Model Law on Cross-Border Insolvency has been adopted in domestic legislation (ML, *Legislative Guide on Insolvency Law*, Annex III).
232. The law establishes clear rules pertaining to jurisdiction. (10) (11) (12) [C15]
233. The law allows foreign insolvency representatives to have access to courts and other relevant authorities. [C15 iii] (ML arts 9, 11, 12, 15)
234. The law establishes clear rules pertaining to recognition of foreign judgments. [C15]
235. The law establishes clear rules pertaining to recognition of foreign insolvency proceedings. [C15] (ML art 15)
236. The law allows relief to be granted upon recognition of foreign insolvency proceedings. [C15 ii] (ML arts 20-21)
237. The law establishes clear rules for cooperation among insolvency representatives and/or courts in cross-border insolvency proceedings. [C15 iv] (ML arts 25-26)
238. There are clear conflict-of-laws rules that apply in cross-boarder insolvency proceedings. (30) (31) (34) [C15]

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

ROLE OF COURTS

WB Principle

Role of Courts [D1]

- D1.1 Independence, Impartiality and Effectiveness. The system should guarantee the independence of the judiciary. Judicial decisions should be impartial. Courts should act in a competent manner and effectively.
- D1.2 Role of Courts in Insolvency Proceedings. Insolvency proceedings should be overseen and impartially disposed of by an independent court and assigned, where practical, to judges with specialized insolvency expertise. Nonjudicial institutions playing judicial roles in insolvency proceedings should be subject to the same principles and standards applied to the judiciary.
- D1.3 Jurisdiction of the Insolvency Court. The court's jurisdiction should be defined and clear with respect to insolvency proceedings and matters arising in the conduct of these proceedings.
- D1.4 Exercise of Judgment by the Court in Insolvency Proceedings. The court should have sufficient supervisory powers to efficiently render decisions in proceedings in line with the legislation without inappropriately assuming a governance or business management role for the debtor, which would typically be assigned to management or an insolvency representative.
- D1.5 Role of Courts in Commercial Enforcement Proceedings. The general court system must include components that effectively enforce the rights of both secured and unsecured creditors outside of insolvency proceedings. If possible, these components should be staffed by specialists in commercial matters. Alternatively, specialized administrative agencies with that expertise may be established.

UNCITRAL Recommendations

Competent courts (Part two, chapter I, para. 19, p. 43)

- (13) The insolvency law should clearly indicate (or include a reference to the relevant law which establishes) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings.

CRITERIA FOR ASSESSING COMPLIANCE

D1. ROLE OF COURTS

239. The legal system guarantees the independence of the judiciary. [D1.1]
240. Judicial decisions are generally perceived as being impartial. [D1.1]
 (Refer to criteria #267-#273 under D6 on integrity of the court system.)
241. Courts are perceived as acting in a competent manner and effectively. [D1.1]
 (Refer to criteria #251-#260 under D2 on criteria for judicial selection, training, and performance.)
242. Insolvency proceedings are overseen and impartially disposed of by an independent court. [D1.2]
243. Insolvency proceedings are assigned, where practical, to judges with specialized insolvency expertise. [D1.2]

244. There are nonjudicial institutions that play judicial roles in insolvency proceedings. [D1.2] If yes,
- a. Nonjudicial institutions that play judicial roles in insolvency proceedings are subject to the same principles and standards as are applied to the judiciary. [D1.2]
245. The jurisdiction of the insolvency court is defined and clear with respect to:
- a. Insolvency proceedings; and
 - b. Matters arising in the conduct of these proceedings. [D1.3] (13)
(Refer to criteria #231-238 under C15 on jurisdiction of the insolvency court in cross-border cases.)
(Refer to criteria #71-#76 under B4.2 on expedited reorganization proceedings.)
246. The insolvency court has sufficient supervisory role to efficiently render decisions in proceedings in line with the legislation. [D1.4]
247. The insolvency court renders decisions without assuming a corporate governance or business management role for the debtor, which would typically be assigned to management or an insolvency representative. [D1.4]
(Refer to criteria #125-#126 under C6 on management of the estate during insolvency proceedings.)
248. The general court system includes components that effectively enforce the rights of both secured and unsecured creditors outside of insolvency proceedings. [D1.5]
(Refer to criteria #41-#44 under A5.1 on the commercial enforcement system for unsecured debt.)
(Refer to criteria #45-#49 under A5.2 on the commercial enforcement system for secured debt.)
249. The components of the general court system that enforce rights of both secured and unsecured creditors are staffed by specialists in commercial matters. [D1.5]
(Refer to criteria #41-#44 under A5.1 on enforcement for unsecured debt.)
(Refer to criteria #45-#49 under A5.2 on enforcement for secured debt.)
250. Specialized administrative agencies with expertise in commercial matters are established for the enforcement of both secured and unsecured rights. [D1.5]

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

JUDICIAL SELECTION, QUALIFICATION, TRAINING, AND PERFORMANCE

WB Principle

Judicial Selection, Qualification, Training, and Performance [D2]

- D2.1 Judicial Selection and Appointment. Adequate and objective criteria should govern the process for selection and appointment of judges.
- D2.2 Judicial Training. Judicial education and training should be provided to judges.
- D2.3 Judicial Performance. Procedures should be adopted to ensure the competence of the judiciary and efficiency in the performance of court proceedings. These procedures serve as a basis for evaluating court efficiency and for improving the administration of the process.

CRITERIA FOR ASSESSING COMPLIANCE

D2. JUDICIAL SELECTION, QUALIFICATION, TRAINING, AND PERFORMANCE

251. Adequate and objective criteria govern the process for selection and appointment of judges. [D2.1]

252. Judicial education and training are provided to judges. [D2.2]

253. Procedures are adopted to ensure:

- a. The competence of the judiciary; and
- b. Efficiency in the performance of court proceedings? [D2.2]

If yes,

- a. The procedures adopted to ensure competence of the judiciary and efficiency of court proceedings serve as a basis for:
 - evaluating court efficiency, and
 - improving the administration of the process. [D2.3]

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

COURT ORGANIZATION

WB Principle

Court Organization [D3]

The court should be organized so that all interested parties—including the attorneys, the insolvency representative, the debtor, the creditors, the public, and the media—are dealt with fairly, in a timely manner, objectively, and as part of an efficient, transparent system. Implicit in that structure are firm and recognized lines of authority, clear allocation of tasks and responsibilities, and orderly operations in the courtroom and case management.

CRITERIA FOR ASSESSING COMPLIANCE

D3. COURT ORGANIZATION

254. The court is organized so that all interested parties—including the attorneys, the administrator, the debtor, the creditors, the public, and the media—are dealt with fairly, objectively, in a timely manner, and as part of an efficient, transparent court system. [D3]
 (Refer to criteria #259-#261 under D4 on transparency and accountability of the court system.)
255. There are firm and recognized lines of authority implicit in the structure of the court. [D3]
256. There are clear rules for allocation of tasks and responsibilities within the structure of the court. [D3]
257. There are clear rules for orderly operations in the courtroom. [D3]
258. There are clear rules pertaining to case management within the structure of the court. [D3]

IMPLEMENTATION: INSTITUTIONAL & REGULATORY FRAMEWORK

TRANSPARENCY AND ACCOUNTABILITY

WB Principle

Transparency and Accountability [D4]

An insolvency and creditor rights system should be based upon transparency and accountability. Rules should ensure ready access to relevant court records, court hearings, debtor and financial data, and other public information.

CRITERIA FOR ASSESSING COMPLIANCE

D4. TRANSPARENCY AND ACCOUNTABILITY

259. The insolvency and creditor rights system is based upon transparency and accountability. [D4]

260. There are rules that ensure ready access to relevant:

- a. Court records;
- b. Court hearings;
- c. Debtor and financial data; and
- d. Other public information. [D4]

261. There are rules that ensure ready access, when appropriate, to relevant information to all interested parties –including the attorneys, the administrator, the debtor, the creditors, the public, and the media. [D4] [D3]

(Refer to criteria #254 under D3 on treatment to interested parties by the court organization.)

(Refer to criteria #87 - #88 under C2.2 on creditors and debtors' right to access information regarding insolvency proceedings.)

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

JUDICIAL DECISION MAKING AND ENFORCEMENT OF ORDERS

WB Principle

Judicial decision making and enforcement of orders [D5]

- D5.1 Judicial Decision Making. Judicial decision making should encourage consensual resolution among parties where possible, and should otherwise undertake timely adjudication of issues with a view to reinforcing predictability in the system through consistent application of the law.
- D5.2 Enforcement of Orders. The court must have clear authority and effective methods of enforcing its judgments.
- D5.3 Creating a Body of Jurisprudence. A body of jurisprudence should be developed by means of consistent publication of important and novel judicial decisions, especially by higher courts, using publication methods that are both conventional and electronic (where possible).

CRITERIA FOR ASSESSING COMPLIANCE

D5.1 – D5.2 JUDICIAL DECISION MAKING AND ENFORCEMENT OF ORDERS

262. Judicial decision making encourages consensual resolution among parties where possible. [D5.1]
263. When consensual resolution among parties is not possible, judicial decision making undertakes timely adjudication of issues. [D5.1]
264. When consensual resolution among parties is not possible, adjudication of issues by the court is undertaken with a view to reinforcing predictability in the court system through consistent application of the law. [D5.1]
265. Courts have clear authority and effective methods to enforce their judgments. [D5.2]
 (Refer to criteria #273 under D6 on enforcement of court orders pertaining to integrity of the court system.)

D5.3 CREATING A BODY OF JURISPRUDENCE

266. A body of jurisprudence has been developed by means of consistent publication of important and novel judicial decisions, especially by higher courts. If yes,
- a. In the development of such body of jurisprudence, conventional and electronic (where possible) publication methods are used. [D5.3]

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

INTEGRITY OF THE SYSTEM

WB Principle

Integrity of the System [D6]

- D6.1 Integrity of the court. The system should guarantee security of tenure and adequate remuneration of judges, personal security for judicial officers, and the security of court buildings. Court operations and decisions should be based on firm rules and regulations to avoid corruption and undue influence.
- D6.2 Conflict of interest and bias. The court must be free of conflicts of interest, bias, and lapses in judicial ethics, objectivity, and impartiality.
- D6.3 Integrity of participants. Persons involved in a proceeding must be subject to rules and court orders designed to prevent fraud, other illegal activity, and abuse of the insolvency and creditor rights system. In addition, the court must be vested with appropriate powers to enforce its orders and address matters of improper or illegal activity by parties or persons appearing before the court with respect to court proceedings.

CRITERIA FOR ASSESSING COMPLIANCE

D6. INTEGRITY OF THE SYSTEM

267. The legal system guarantees security of tenure for judges. [D6.1]
268. The legal system guarantees adequate remuneration of judges. [D6.1]
269. The legal system guarantees personal security for judicial officers and court buildings. [D6.1]
270. Court operations and decisions are based on firm rules and regulations to avoid corruption and undue influence. [D6.1]
 (Refer to criteria #254-#258 under D3 on criteria for court organization and operations.)
 (Refer to criteria #262-#265 under D5 on judicial decision making and enforcement of court orders.)
271. Courts are generally perceived as acting free of conflicts of interest, bias, and lapses in judicial ethics, objectivity, and impartiality. [D6.2]
 (Refer to criteria #240 under D1 on impartiality in judicial decisions.)
 (Refer to criteria #259-#261 under D4 on transparency and accountability of the courts.)
272. Participants in a proceeding are subject to rules and court orders designed to prevent fraud, other illegal activity, and abuse of the insolvency and creditor rights system. [D6.3]
273. The court is vested with appropriate powers to enforce its orders and address matters of improper or illegal activity by parties or persons appearing before the court with respect to court proceedings. [D6.3]
 (Refer to criteria #265 under D5 on court authority to enforce its judgments in general.)

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

ROLE OF REGULATORY OR SUPERVISORY BODIES

WB Principle

Role of regulatory or supervisory bodies [D7]

The bodies responsible for regulating or supervising insolvency representatives should:

- Be independent of individual representatives;
- Set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency, and accountability; and
- Have appropriate powers and resources to enable them to discharge their functions, duties, and responsibilities effectively.

CRITERIA FOR ASSESSING COMPLIANCE

D7. ROLE OF REGULATORY OR SUPERVISORY BODIES

274. The bodies responsible for regulating or supervising insolvency representatives are independent of individual representatives. [D7]

275. The bodies responsible for regulating or supervising insolvency representatives set standards for the performance of insolvency representatives. If yes,

(Refer to criterion #277 under D8 on standards of qualifications and qualities for insolvency representatives.)

- a. The standards for the performance of insolvency representatives set by their regulatory or supervisory bodies reflect the requirements of the legislation.
- b. The standards for the performance of insolvency representatives set by their regulatory or supervisory bodies reflect public expectations of fairness, impartiality, transparency, and accountability. [D7]

276. The bodies responsible for regulating or supervising insolvency representatives have appropriate powers and resources to enable them to discharge their functions, duties, and responsibilities effectively. [D7]

IMPLEMENTATION: INSTITUTIONAL AND REGULATORY FRAMEWORK

COMPETENCE AND INTEGRITY OF INSOLVENCY REPRESENTATIVES

WB Principle

Competence and Integrity of Insolvency Representatives [D8]

The system should ensure that:

- Criteria as to who may be an insolvency representative should be objective, clearly established, and publicly available;
- Insolvency representatives be competent to undertake the work to which they are appointed and to exercise the powers given to them;
- Insolvency representatives act with integrity, impartiality, and independence; and
- Insolvency representatives, where acting as managers, be held to director and officer standards of accountability, and be subject to removal for incompetence, negligence, fraud, or other wrongful conduct.⁴⁴

UNCITRAL Recommendations

The insolvency representative (Part two, chapter III, paras. 35-74, pp. 174-187)

Purpose of legislative provisions

The purpose of provisions concerning the insolvency representative is to:

- (a) Specify qualifications required for appointment;
- (b) Establish a mechanism for selection and appointment;
- (c) Specify powers and functions; and
- (d) Provide for remuneration, liability, removal and replacement.

Qualifications

(115) The insolvency law should specify the qualifications and qualities required for appointment as an insolvency representative, including integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters. The insolvency law should also specify the grounds upon which a proposed insolvency representative may be disqualified from appointment.

Conflict of interest

(116) The insolvency law should require the disclosure of a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence by:

- (a) A person proposed for appointment as an insolvency representative or a person appointed as an insolvency representative where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings; and
- (b) Persons proposed for employment by the insolvency representative or the estate including professionals or a person employed by the insolvency representative or the estate where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings.

(117) The insolvency law should specify that the obligation to disclose set forth in recommendation 116 should continue throughout the insolvency proceedings. The insolvency law should specify the consequences of a conflict of interest or lack of independence.

Appointment (118) The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including

⁴⁴ See Principle B2.

appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.

Remuneration (119) The insolvency law should establish a mechanism for fixing the remuneration of the insolvency representative and establish priority for payment of that remuneration.

Duties and functions of the insolvency representative

(120) The insolvency law should specify that the insolvency representative have an obligation to protect and preserve the assets of the estate. The insolvency law should specify the insolvency representative's duties and functions with respect to the administration of the proceedings and preservation and protection of the estate, including continued operation of the debtor's business.

Right to be heard

See recommendation 137.

Confidentiality

See recommendation 111.

Liability

(121) The insolvency law should specify the consequences of the insolvency representative's failure to perform, or to properly perform, its duties and functions under the law and any related standard of liability imposed.

Removal and replacement (122) The insolvency law should establish the grounds and procedure for removal of the insolvency representative. The grounds may include:

- (a) Incompetence, failure to perform or failure to exercise the proper degree of care in the performance of its powers and functions;
- (b) Inability to perform;
- (c) Lack of a particular or specialized qualification required by a specific case;
- (d) Engaging in illegal acts or conduct;
- (e) Conflict of interest or a lack of independence that would justify removal; or
- (f) Where the function of the insolvency representative changes.⁴⁵

(123) The insolvency law should establish a mechanism for removal of the insolvency representative that reflects the manner in which the insolvency representative was appointed and provides a right for the insolvency representative to be heard.

(124) In the event of the death, resignation, or removal of the insolvency representative, the insolvency law should establish a mechanism for appointment of a replacement and specify whether or not court approval of the replacement is necessary.

Estates with insufficient assets to meet the costs of administration

(125) Where the insolvency law provides for an insolvency representative to be appointed to administer an estate with insufficient assets to meet the costs of administration, the insolvency law should also establish a mechanism for appointment and remuneration of that representative.

⁴⁵ Such as where the proceedings are converted from liquidation to reorganization.

CRITERIA FOR ASSESSING COMPLIANCE

D8. COMPETENCE AND INTEGRITY OF INSOLVENCY REPRESENTATIVES

277. The insolvency law specifies the qualifications and qualities required for appointment as an insolvency representative. (115) [D8]
- a. The insolvency law includes a requirement for integrity, independence, and impartiality. (115)
 - b. The insolvency law includes a requirement for knowledge of relevant commercial law and experience in commercial and business matters. (115)
278. The insolvency law specifies the obligation for the insolvency representative to disclose a conflict of interest, a lack of independence, or circumstances that may lead to a conflict of interest or lack of independence and that the obligation continues throughout the proceedings. (116) (117)
279. The insolvency law establishes a mechanism for selection and appointment of an insolvency representative. (118)
280. The legal system ensures that the requirements of 277 and 279 are clearly and transparently established. [D8]
281. The insolvency law specifies the grounds upon which a proposed insolvency representative may be disqualified from appointment. (115)
- (Refer to criteria #287 below on grounds for removal of an appointed insolvency representative.)
282. Insolvency administrators are generally perceived as being competent to undertake the work to which they are appointed and to exercise the powers given to them [D8]
283. The insolvency law establishes a mechanism for fixing the basis of the remuneration of the insolvency representative. (119)
284. The insolvency law establishes the priority for payment of the remuneration of the insolvency representative. (119)
285. The insolvency law specifies the insolvency representative's duties, powers, and functions in insolvency proceedings. (111) (120)
286. The insolvency law specifies the consequences of the insolvency representative's failure to perform or to properly perform, its duties and functions under the law and any related standard of liability imposed. (121)
287. The insolvency law establishes the grounds and mechanism for removal of the insolvency representative. (122) (123)
- (Refer to criteria #281 above on disqualification from appointment as insolvency representative.)
- a. The insolvency law establishes a mechanism for appointment of a replacement. (124)