



General Assembly

Distr.: General
April 2005

Original: English

United Nations Commission on International Trade Law

Thirty-eighth session
Vienna, 4-15 July 2005

Insolvency law

Possible future work in the area of insolvency law

Proposal by the International Insolvency Institute (III), Committee on Debtor in Possession Financing in International Reorganizations

Post-commencement financing in international reorganizations

Background

1. The International Insolvency Institute (III) proposes that the United Nations Commission on International Trade Law (UNCITRAL) undertake further work in the area of the law concerning financing in cross-border insolvency cases. The work could take the form initially of a colloquium to discuss the nature of the work or could involve a detailed study of available mechanisms, their shortcomings and the possible approaches to addressing the problems in the area. Ultimately, UNCITRAL should consider establishing a Working Group to address this topic, perhaps in combination with additional work that UNCITRAL might undertake in the areas of finance and insolvency law.

2. The work that UNCITRAL has successfully completed in the area of insolvency law recognizes the need for effective and efficient domestic insolvency regimes which include a framework for cross-border insolvency. Preserving and maximizing the value of a debtor's estate often requires that credit, loans or other financial accommodations be available to a debtor or an insolvency representative to enable continued operation of a debtor's business. Continued business operation, in turn, is necessary to permit realization of value through reorganization or sale as a going concern, both of which foster continued economic benefits including employment.

3. The UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide) elaborates the key objectives which an insolvency regime should aim to achieve and recommends consideration of the following key objectives:

“(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” (UNCITRAL Legislative Guide on Insolvency Law, part one, chapter I, section A).

4. The purpose of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) complements and reinforces the key objectives of the Legislative Guide, extending them to multinational situations. The purpose of the Model Law “is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- (a) Cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency;
- (b) Greater legal certainty for trade and investment;
- (c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- (d) Protection and maximization of the value of the debtor’s assets; and

(e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment” (Preamble to the UNCITRAL Model Law on Cross-Border Insolvency).

5. Fulfillment of the purposes of the Model Law and the key objectives of the Legislative Guide will often require that the business operations of a debtor continue to be operated subsequent to the filing of an application to commence insolvency proceedings and then subsequent to the commencement of insolvency proceedings. The Legislative Guide, at paragraph 94 (part two, chapter II, section D), explains the need for post-commencement finance of continuing business operations in language that would apply as well to the period between application and commencement:

“94. The continued operation of the debtor’s business after the commencement of insolvency proceedings is critical to reorganization and, to a lesser extent, liquidation where the business is to be sold as a going concern. To maintain its business activities, the debtor must have access to funds to enable it to continue to pay for crucial supplies of goods and services, including labour costs, insurance, rent, maintenance of contracts and other operating expenses, as well as costs associated with maintaining the value of assets. In some insolvency cases, the debtor may already have sufficient liquid assets to fund the ongoing business expenses in the form of cash or other assets that can be converted to cash (such as anticipated proceeds of receivables). Alternatively, those expenses can be funded out of the debtor’s existing cash flow through operation of the stay and cessation of payments on pre-commencement liabilities. Where the debtor has no available funds to meet its immediate cash flow needs, it will have to seek financing from third parties. This financing may take the form of trade credit extended to the debtor by vendors of goods and services, or loans or other forms of finance extended by lenders.”

6. A full discussion of post-commencement finance is contained in paragraphs 94-107 and recommendations 63-68 of the Legislative Guide (part two, chapter II, section D). Augmenting the direct treatment of the subject are: (a) the discussion and recommendations concerning “protection of value” at paragraphs 63-69 and recommendation 50; and (b) the discussion and recommendations concerning “provisional measures” (between the time of application and the time of commencement of insolvency proceedings) at paragraphs 47-53 and recommendations 39-45 (part two, chapter II, section B). These references are extracted in A/CN.9/582/Add.5.

7. What the Legislative Guide implicitly recognizes is that many insolvency regimes do not currently contain effective mechanisms for post-application or post-commencement financing at the domestic law level. In addition, some States have laws that discourage or penalize lending to businesses that are the subject of insolvency proceedings. Neither the Legislative Guide nor the Model Law address the additional complications to post-petition and post-commencement finance in a cross-border case.

8. As the world economy continues its integration, the number of insolvency cases that involve debtors with establishments and operations in multiple States increases. The need for financing in those cases is as acute as in the domestic cases addressed by the Guide. The III believes that further work by UNCITRAL could enhance both

the improvement and harmonization of domestic laws affecting finance in insolvency cases and the effectiveness of those laws in cross-border cases.

9. For example, in addition to considering how to promote enhanced domestic laws on finance, UNCITRAL could consider the following questions raised by cross-border cases: Should the court in which a “main” proceeding is filed, located in the State where the debtor has its centre of main interests, be able to authorize finance for the operations of the debtor in other States? How will the issues of priority and security be addressed in light of likely variations in treatment of these issues by existing domestic laws among States? Will a lender in a main case be protected against exposure in those States which create liability to creditors for lending to an insolvent? How can cash management systems employed to consolidate cash of large businesses across State borders continue to function effectively after the commencement of insolvency proceedings? How will finance be effected when there is an affiliated group of debtors (or even debtors with non-debtor affiliates) with different, but related entities in different States as opposed to a single debtor with branches in different States? What rights will a lender have in each affected State when a reorganization case is dismissed or converted to a liquidation case? Do the coordination and cooperation provisions of the Model Law suffice to address these issues or must there be additional model provisions?

10. UNCITRAL’s excellent prior work in the insolvency area and its ongoing work in the area of secured transactions provides a solid platform on which to build this necessary additional structure. The III believes that further work on financing of insolvency proceedings would be enhanced by involvement of States, representatives of international financial organizations, development banks and non-governmental organizations, including representatives of commercial banks and other financial organizations.

11. Finance for insolvency cases is essential to realization of the goals and objectives of the Model Law and Legislative Guide. Currently, finance is often unavailable or uncertain due to shortcomings in applicable law. UNCITRAL is ideally and uniquely suited to develop recommendations for enhancements in this critical area of insolvency law by applying the type of skilled collaborative effort that its Secretariat, members and observers brought to the Model Law and Legislative Guide. Work on post-application and post-commencement finance would be complementary to any work that UNCITRAL might undertake on the development of cross-border protocols and corporate groups and could be combined with such work.