International Insolvency Institute

Supplementary Submissions to the Senate of Canada Banking, Trade and Commerce Committee

Reform Issues Relating to International Aspects of Reorganizations and Insolvencies

Presented by E. Bruce Leonard Chairman, International Insolvency Institute

Ottawa, Ontario October, 2003
This is a Supplementary Report to the Report submitted to this Committee on June 4, 2003 in connection with the Committee’s consideration of the adoption by Canada of the UNCITRAL Model Law on Cross-Border Insolvency.

Subsequent to the original Report, it has been confirmed that Poland and Romania have adopted the UNCITRAL Model Law. In summary, the current status of the adoption of the Model Law is as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>Adopted and enacted.</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Adopted and enacted.</td>
</tr>
<tr>
<td>(Yugoslavia)</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Adopted and enacted with variations.</td>
</tr>
<tr>
<td>Poland</td>
<td>Adopted and enacted.</td>
</tr>
<tr>
<td>Romania</td>
<td>Adopted and enacted.</td>
</tr>
<tr>
<td>South Africa</td>
<td>Adopted and enacted but not yet proclaimed in force.</td>
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<tr>
<td>Spain</td>
<td>Legislation passed to come into force in 2004 with international insolvency provisions that parallel (and may be more extensive than those in) the Model Law and also reflect the European Union Regulation on Insolvency Proceedings.</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Enabling legislation for adoption passed and enacted. Adoption expected.</td>
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Argentina  Bill submitted to Congress with a modified reciprocity clause.
United States  Passed by both Houses of Congress several times but not enacted. No significant variations. Adoption expected.
Australia  Studied and adoption recommended.
New Zealand  Studied and adoption recommended.

The Issue of Reciprocity:

The question has been raised as to whether Canadian adoption of the Model Law should contain a provision restricting assistance to foreign insolvency representatives and denying the co-operation mandated in the Model Law to foreign insolvency administrations in countries that have not adopted the Model Law.

In fact, there are only a limited number of examples of reciprocity requirements in countries that have considered the Model Law. South Africa has a reciprocity requirement in its Act and Argentina has a modified reciprocity requirement in its draft Bill. On the other hand, the United States does not have a reciprocity requirement. Japan does not have a reciprocity requirement and none of Mexico, Poland, Romania or Montenegro appear to have a reciprocity requirement. The first case in which the Model Law was applied (Xacur) occurred in Mexico and the Mexican Court recognized bankruptcy proceedings in the United States, despite the United States not having adopted the Model Law. The South African and Argentine reciprocity requirements were, in fact, adopted against the recommendations of the studies that were done in those countries. Consequently, to date, the weight of international opinion seems to be against the concept of a reciprocity requirement.

Adopting a reciprocity requirement would be contrary to Canada’s long-standing position of leadership in international insolvency issues. It would also be inconsistent with the international insolvency provisions that were enacted by Parliament in 1997 into the BIA and the CCAA. As previously reported, the UNCITRAL Model Law was still under development when the Canadian international insolvency provisions were enacted by Parliament in 1997. The international insolvency provisions of 1997, however, were based on the formulation of the Model Law that was current at that time. In a sense, Canada was the first country to adopt the provisions of the Model Law.
In the deliberations that preceded the enactment of the 1997 amendments, no requirement of reciprocity for Canadian recognition and assistance to foreign insolvency representatives and foreign insolvency administrations was even considered. Adopting a reciprocity requirement at this stage of the evolution of Model Law, where most countries are proceeding without one, would be a retrograde step from a policy point of view and would be inconsistent with Canada’s approach to increased and enhanced co-operation in international insolvency issues as illustrated by the 1997 amendments and Canada’s participation through all aspects of UNCITRAL’s very valuable work in this area.

The consequences of adopting a reciprocity requirement are also problematical from a practical point of view. The reciprocity provision does not seem to be a major issue for most countries and Canada, in fact, could be creating unnecessary legislative and judicial problems and issues if it adopted the Model Law with a reciprocity provision. If Canada adopts the Model Law before the United States and the United Kingdom adopt it and if Canada requires reciprocity, would this mean that Canadian Courts would be unable to cooperate with foreign insolvency representatives from the U.S. and the U.K.? We would hope not and we might reasonably expect that our enlightened judiciary would continue to find ways to cooperate with proceedings in other countries despite such a legislative impediment. On that basis, a reciprocity clause in the Canadian legislation would be a useless distraction in the context of international cooperation in the international insolvency area which Canada has helped to pioneer.

A reciprocity requirement would also explicitly convey the message that Canadian legislators believe that Canada should not cooperate with foreign administrations in countries that have not adopted the Model Law. As noted above, this would, technically, bar cooperation with most countries including the United States and the U.K. until they pass the Model Law and, surely, this cannot be the intended expression of Canada’s international policy on these issues.

**Assessing Variations in the Adoption of the Model Law:**

It is difficult to measure the adaptations that have been made in the legislation of countries that have enacted the Model Law or countries that have produced Bills that would enact the Model Law. Apart from the language issue (five languages not including English are involved at this point), UNCITRAL does not, at least as yet, keep records of this kind although they are considering doing so. The texts of the legislation and draft legislation from all of the countries that have proceeded with the Model Law are all on the website of the International Insolvency Institute on the respective Country Pages to which the legislation relates (see [http://www.iiiglobal.org/country/index.html](http://www.iiiglobal.org/country/index.html)).
With regard to some of the major countries that have adopted or proposed legislation based on the Model Law, the International Insolvency Institute surveyed senior Members who were involved in and knowledgeable about the domestic adoption of the Model Law in these countries for reports on the adoption of the Model Law. Those reports were prepared in a compressed time frame because of the Committee’s tight schedule for hearings and they are attached as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Report By</th>
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<tbody>
<tr>
<td>South Africa</td>
<td>Mr. Justice R. H. Zulman, Supreme Court of Appeal of South Africa and Commissioner on South Africa’s study on the adoption of the Model Law.</td>
</tr>
<tr>
<td>Argentina</td>
<td>Mr. Justice Adolfo Rouillon, Court of Appeal for the Province of Rosario and Chair of the Argentine Committee on adoption of the Model Law.</td>
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<tr>
<td>Mexico</td>
<td>Josefina Fernandez-McEvoy, Los Angeles, Chair of the III Committee on Latin America.</td>
</tr>
<tr>
<td>Japan</td>
<td>Professor Junichi Matsushita, Gakushuin University, Tokyo, co-author of the most authoritative analysis/translation of the adoption of the Model Law.</td>
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To this point, it has been confirmed that apart from the reciprocity provisions in South Africa and Argentina, there are no material distinctions between the Model Law and the legislation in South Africa and Mexico and the draft legislation in the United States and Argentina. There are some distinctions in the Japanese legislation which are described in a paper on the Japanese legislation (“The New Japanese Legislation on Cross-Border Insolvency compared with the UNCITRAL Model Law”) on the International Insolvency Institute website at www.iiiglobal.org/country/japan/legislation.pdf which is enclosed with this Report.

**Domestic Creditors Under the Model Law:**

Inevitably, some concerns are expressed that entering into the Model Law is likely to be prejudicial to individual domestic creditors. These concerns, however, are in fact addressed in the Model Law itself.
The Model Law is intended to put in place a system that will aid and assist trade and commerce between nations and enhance and facilitate investment and credit availability to less-developed countries. Greater certainty in matters of trade and investment will inevitably increase cross-border trade and investment and improve international commerce for the benefit of everyone who participates in it. If parties to international agreements and treaties each insisted that preference be given to their own investors or creditors over others or that their investors and creditors should not be prejudiced while those in other countries could be, there would be no international progress in the economic and commercial spheres and the international economy would go back to the “beggar my neighbour” regimes of the 1930’s.

The Model Law on Cross-Border Insolvency is an attempt to improve the world-wide regime for trade and commerce and investment for the benefit of everyone involved in the global economy. Concerns relating to issues that are particularly local or domestic were addressed in the development of the Model Law. Consequently:

1. The Model Law contemplates that a domestic court may decline to act where doing so would be contrary to domestic public policy: Article 6.

2. The Model Law provides that it is to be interpreted having regard to its international origin and the need to promote uniformity in its application and the observance of good faith: Article 8.

3. The Model Law does not affect the ranking of claims in a proceeding under domestic law except that the claims of foreign creditors must not be ranked lower than the claims of general domestic creditors: Article 13(2).

4. Subsequent to a foreign insolvency representative’s application for recognition, it must inform the domestic court promptly of any change in the status of the foreign proceeding or in its appointment: Article 18(8).

5. The recognition of a foreign proceeding does not affect the rights of domestic creditors to commence proceedings under domestic insolvency law or the right to file claims in such a proceeding: Article 20(4).

6. In granting, denying or modifying relief under the Model Law, the domestic court “must be satisfied that the interests of creditors and other interested persons including the debtor are adequately protected”: Article 22(1).

7. The domestic court is entitled to communicate with or request information or assistance directly from foreign courts or foreign representatives: Article 25(2).
8. Where a domestic proceeding and a foreign proceeding are both taking place, the domestic and foreign court are obliged to cooperate with each other. If the domestic insolvency proceeding began before an application for recognition of the foreign proceeding was filed, the relief granted to the foreign representative must be consistent with the domestic proceeding: Article 29(a)(i).

9. Where a domestic proceeding is commenced after an application for recognition for a foreign proceeding is filed, the relief in effect in favour of the foreign representative must be reviewed by the domestic court and must be modified or terminated if it is inconsistent with the domestic insolvency proceeding: Article 29(b).

10. In determining whether relief should be granted to a foreign insolvency representative from a non-main proceeding, the domestic court must be satisfied that the relief relates to assets that, under domestic law, should be administered in that foreign proceeding: Article 29(c).

The recognition of a foreign proceeding under the Model Law therefore does not bar domestic creditors from commencing a domestic insolvency proceeding under domestic law: Article 20(4). If a domestic proceeding is commenced after an application for recognition of the foreign proceeding, the domestic court must review the relief sought by the foreign representative and must modify that relief if it is inconsistent with the domestic proceedings: Article 29(b)(i). As a consequence, the Model Law permits domestic insolvency proceedings to be commenced and continued and directs that relief granted to a foreign insolvency representative or a foreign insolvency administration be modified if it is inconsistent with domestic insolvency law. These measures ensure that domestic creditors will not be unfairly treated by the recognition of foreign proceedings under the Model Law because the domestic insolvency proceedings would take precedence over the recognition accorded to the foreign insolvency proceedings by the domestic court.

Structurally and logically, if the procedures that are provided in this Model Law for the recognition and access of foreign insolvency administrations and foreign insolvency representatives would be unfair to Canadian creditors if Canada adopted the Model Law, they must also be unfair to the domestic creditors of the other countries that adopt the Model Law. This cannot be. It is impossible to visualize a situation in which the domestic creditors of every country that adopts the Model Law are all prejudiced as a result. The international consensus on which the Model Law was developed was that domestic creditors would not be prejudiced by the Model Law and the structure of the Model Law itself bears this out.
Over 70 countries and international organizations participated in the development of the Model Law and, at each stage of the way, there was a consensus on each of the provisions of the Model Law. Consequently, the Model Law is a much broader expression of international co-operation in an important commercial area than is currently reflected by the number of countries that have passed the Model Law. A number of countries seem to be waiting for the United States to pass the Model Law and the expectation is that, once the Model Law is passed by the United States, a number of other countries will almost certainly pass the Model Law themselves. It is also worth remembering Canada’s important participation in and contribution to the development of the Model Law. Canada’s refusal to enact legislation based on the Model Law at this stage would be a significant international embarrassment for Canada.

Consequently, all of the indications based on international co-operation and the development of international trade and commerce favour the adoption of the Model Law. Concerns that Canadian creditors would somehow be treated unfairly in an international system of insolvency treaties seem to be without much foundation in substance. In keeping with Canada’s proud tradition of leadership which is based, at least in part, on Canada’s adoption of the precursor to the Model Law in 1997, it would behoove Canada to adopt the Model Law at an early opportunity rather than waiting to be among the last countries to do so.

Respectfully submitted on behalf of the International Insolvency Institute this 1st day of October, 2003.

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