



# General Assembly

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## **Possible future work in the area of insolvency law**

Proposal by the International Insolvency Institute (III), Committee on  
Corporate and Professional Responsibilities

**Study and Recommendations in the area of Directors' and Officers' Responsibilities  
and Liabilities in Insolvency and Pre-Insolvency Cases**

### **Background**

1. The benefits of effective insolvency laws are widely recognized and accepted by most nations, as evidenced by the efforts of many nations in recent years to update their insolvency laws to take into account modern finance and business. In addition to providing the primary means for maintaining financial discipline and ensuring efficient resource allocation in an economy, providing a predictable legal process for addressing the financial difficulties of troubled firms before their accumulated financial difficulties and the necessary framework for the efficient restructuring or orderly liquidation of troubled firms, effective insolvency laws also permit an examination to be made of the circumstances giving rise to insolvency and the conduct of officers of a company in its failure, perhaps revealing culpable behaviour on the part of those responsible for that failure and unfair dispositions of assets or property that are potentially recoverable.

2. Recently there has been an increased focus on director and officer responsibilities and liabilities in insolvency and pre-insolvency proceedings, fuelled in part by the widely publicized cases of WorldCom, Parmalat and Enron, highlighting alleged corporate fraud and self-dealing. The substantial increase in actions being brought against officers and directors for alleged breaches of various obligations points to an urgent need to create uniform and clear guidelines setting forth the responsibilities of officers and directors when

a company approaches insolvency or becomes insolvent. Uniform guidelines would provide a means of crisis prevention as well as crisis management. The need for such guidelines is not limited to large insolvency cases. It is equally present in much smaller cases—any time a company has assets in more than one country, there is a risk that managers will face competing laws or regulations as to how to use those assets to repay creditors, or which creditors are senior, or on many other issues.

3. The soundness and credibility of insolvency laws and director and officer practices are central to the efforts of governments and regulators to enhance the operation of the global financial system. Inefficient, antiquated and inconsistent existing guidelines on director and officer obligations as a company approaches insolvency have the potential to undermine the benefits that the UNCITRAL Legislative Guide on Insolvency is intended to produce. Furthermore, poorly designed or developed laws on director and officer responsibilities and liabilities, with outcomes that are uncertain, capricious, unfair or parochial, threaten the benefits of globalization. They have the potential to seriously impede trade liberalization and deter the international flow of capital.

4. The harmonization of officer and director responsibilities is problematic for several reasons. Officer and director responsibilities and liabilities are generally imbedded in corporate and insolvency laws which often interact with other national laws and policies. The application of laws addressing officer and director responsibilities and liabilities are closely related to a country's other legal rules and statutory provisions on corporate governance. In some jurisdictions they form a key part of other policy frameworks, such as protecting depositors in financial institutions, revenue collection, favouring certain categories of creditors over others (such as employees), and so on. They must be in harmony with the relevant legal, business and cultural frameworks in the local context.

5. Nevertheless, it should be possible to crystallize, from effective insolvency regimes, basic principles that should be reflected in officer and director duties in insolvency. The III believes it is possible to go further and outline the particular features that best give effect to the public and international policy objectives that countries seek to achieve through such laws. The development of a set of guidelines on director and officer responsibilities and liabilities which is flexible in its application could be a valuable supplement to other forces driving nations to progress reforms in this area.

#### **Features of Proposed Guidelines**

6. A set of guidelines would not seek to harmonize officers and director laws across countries or establish uniform approaches or a "firm" set of provisions. Rather, it would contain a menu of suggested guidelines on various matters (such as to whom duties are owed prior to and after insolvency, what actions might create personal liabilities, etc.) which countries could select from and modify to suit their individual circumstances. A starting point for the development of a model framework could be the key principles and features identified in the survey of legal counsel from over fifty countries conducted by III in 2004 of officer and director responsibilities and liabilities, as well as the work of other

organizations in this field, such as the OECD and INSOL. UNCITRAL could assist in further developing those principles and features. Ultimately, the III would propose having specific options for legislative and other measures which, if adopted, would be likely to contribute to effective guidelines for director and officer obligations when a company is approaching insolvency.

#### **Role of UNCITRAL in Developing Uniform Guidelines**

7. III considers UNCITRAL well-suited to becoming involved in a project of this complexity and wide-ranging significance, given UNCITRAL's proven record with respect to the UNCITRAL Model Law on Cross-Border Insolvency and the subsequent UNCITRAL Legislative Guide on Insolvency. The timing of a project to develop such guidelines is ripe given the recent completion of the Legislative Guide. Clear and uniform guidelines by which officers and directors should conduct themselves are essential for the meaningful use and application of the principles contained in the Legislative Guide on Insolvency.

8. In the course of developing these texts, UNCITRAL formed links with other key participants in the insolvency community, consulting widely with practitioners and holding joint colloquia with judges and State officials. Participants represented a broad cross-section of nations with different cultures and legal systems. The UNCITRAL Secretariat and members are therefore already familiar with many of the national policy issues connected with director and officer responsibilities and liabilities. These factors would tend to support UNCITRAL in developing a framework of standards for directors and officers when a company approaches insolvency.

9. UNCITRAL involvement in this area would also give useful international prominence to director and officer responsibilities and liabilities in conjunction with the implementation of insolvency laws based upon the Legislative Guide on Insolvency. These items together could become the benchmark for multilateral transparency reporting and surveillance and thus assist the international progress toward better insolvency practice.

10. The III urges UNCITRAL to develop model guidelines on director and officer responsibilities and liabilities in insolvency and pre-insolvency cases.