# UNCITRAL-World Bank Group Judicial Capacity-Building Initiative on International Best Practices in Insolvency Law

## First session (avoidance proceedings)

## Reference materials

| **27 October 2021, 12 pm to 3 pm (CET)** | **28 October 2021, 3 pm to 6 pm (CET)** |
|---|---|
| Suggested for judges from Africa and Asia and the Pacific. | Suggested for judges from other regions |

## Online, Zoom

## Case study

**Counsel for the liquidator is opening the case to you and explains the facts in this way:**

1. Albert and Beatrice were business colleagues and property developers. They carried on their business through their company Tumbledown Ltd. In January 2020, they decided to take on bigger projects. This worried Albert's wife a little; she worried that the family future would be at risk and asked Albert to transfer his interest in the matrimonial home to her so that the family would be sure of a home in the event that anything went wrong. In February 2020, he did so, and registered the change in the property register.
2. In March 2020, a development site became available at an asking price of $300,000. Albert and Beatrice each lent Tumbledown $100,000. To cover the rest, they persuaded the bank to grant them an overdraft of up to $100,000 repayable on demand and secured by personal guarantees from Albert and from Beatrice. The bank said that any further money would have to be lent on a fixed term loan supported by a security right over the site by Tumbledown. Albert and Beatrice began negotiating this long-term loan with the bank.
3. By clever negotiation with the seller, they managed to get the development site for $225,000 in April 2020. They used the remainder of the free cash, i.e. $75,000, to buy a corporate yacht, which they thought would be good for entertaining guests for marketing purposes.
4. In May 2020, they persuaded a contractor to start on the preparatory works on the site by saying that they were in the course of negotiating bank funding and should be able to pay his invoice (estimated at $65,000) within two months of its delivery.
5. After one month, the contractor said that to add value to the site, Tumbledown should lay pipes and wires in the trenches that he had dug so as to turn it into a fully serviced and marketable bare site worth about 50% more at open market value. The pipe supplier said that because it had no

record of trading with Tumbledown, it would only supply the pipes on a "cash on delivery" basis and that the pipes would cost $50,000.

6. Tumbledown ordered the pipes on that basis in June 2020 because Albert and Beatrice predicted that the bank would increase the overdraft (pending the entry of the long-term loan arrangements) to cover both the pipe supply and the contractor's bill (because of the uplift in value that would happen as a result of the fully serviced site). But the bank got tough. It said it would advance only another $75,000, and for that, it wanted a first priority security right over the development site to cover the whole of its $175,000 overdraft advance. Albert and Beatrice thought they had no alternative but to take that money and grant the security right. They did so in June 2020.

7. At that point, Albert desperately needed money for a tax bill and demanded repayment of $50,000 of his original investment. Beatrice said that she would leave in her original $100,000 investment, but if the bank was getting the security right over the site, then she wanted a second priority security right over the site. So, during June 2020, Tumbledown repaid Albert and granted the security right Beatrice wanted.

8. Because Albert demanded repayment there was only $25,000 of the new advance remaining, which was not enough to cover the pipe supplier and the contractor. Albert said that the corporate yacht had to be sold. He said that, rather than selling it at the next boat auction in August 2020 or via a yacht broker (which would take time and incur commission charges), his son-in-law would buy it for $55,000 of which he would pay $35,000 the next day and the balance of $20,000 within six weeks. This arrangement was put into effect at the beginning of June 2020.

9. The pipes were supplied at the beginning of July 2020. The supplier was paid $50,000 on delivery. The contractor fitted the pipes straightaway and at the same time, presented his $65,000 invoice for all the work he had done, expecting payment within the promised two months. He was not paid when the two months expired in mid-September 2020 because Tumbledown only had available $25,000, which the company kept. After fruitless demands over the next couple of months, in January 2021, the contractor applied for the commencement of an insolvency proceeding against Tumbledown, which was actually commenced at the beginning of February 2021 when the liquidator was appointed.

10. Meanwhile, in December 2020, and in exercise of its security rights, the bank sold the site for $300,000 and repaid itself $175,000 plus interest of $25,000 (the agreed reasonable commercial rate). This meant the bank did not have to call on the personal guarantees. Beatrice was repaid her $100,000 from the proceeds of sale. Albert and the contractor went unpaid.

**What transactions do you expect Counsel for the liquidator to ask you to examine? Do you think any transaction can be successfully challenged?**

# Extracts from the UNCITRAL and World Bank insolvency texts related to avoidance

## A. ICR Principle C11 of the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes:

https://openknowledge.worldbank.org/bitstream/handle/10986/35506/Principles-for-Effective-Insolvency-and-Creditor-and-Debtor-Regimes.pdf?sequence=1&isAllowed=y

C11 Avoidable Transactions

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.

B. **Recommendations 87-99 and accompanying commentary of part two of the UNCITRAL Legislative Guide on Insolvency Proceedings (see pages 135-155 of the English version of the Guide, available at** https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf**)**

***Recommendations 87-99***

**Purpose of legislative provisions**

The purpose of avoidance provisions is:
*(a)* To reconstitute the integrity of the estate and ensure the equitable treatment of creditors;
*(b)* To 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)* To enable the commencement of proceedings to avoid those transactions; and
*(d)* To facilitate the recovery of money or assets from persons involved in transactions that have been avoided.

**Contents of legislative provisions**

*Avoidable transactions*[44] *(paras. 170-179)*

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 transaction 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 that 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 that occurred at a time when the debtor was insolvent (preferential transactions).

[44]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 (para. 180)*

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 (paras. 188-191)*

89. The insolvency law should specify that the transactions described in recommendation 87, subparagraphs *(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 transaction.

*Transactions with related persons (paras. 182-184)*

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.[45]

[45]"Related person" is defined in the glossary (see Introduction, para. 12 *(jj)*).

*Transactions exempt from avoidance actions (para. 185)*

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

*Conduct of avoidance proceedings (paras. 192-195)*

93. The insolvency law should specify that the insolvency representative has the principal responsibility to commence avoidance proceedings.[46] 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.

[46]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.

*Funding of avoidance proceedings (para. 196)*

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 (para. 197)*

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 that have been concealed and that 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 (paras. 198-201)*

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 (para. 202)*

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

***Commentary to recommendations 87-99***

**F. Avoidance proceedings**

*1. Introduction*

148. Insolvency proceedings (both liquidation and reorganization) may commence long after a debtor first becomes aware that such an outcome cannot be avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations or gifts to relatives and friends or pay certain creditors to the exclusion of others. There may also be opportunities for creditors to initiate strategic action to place themselves in an advantageous position. The result of such activities, in terms of the eventual insolvency proceedings, generally disadvantages ordinary unsecured creditors who were not party to such actions and do not have the protection of a security interest.

149. 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 transfer, payment, encumbrance, guarantee, loan or release, and may include a composite series of such transactions.

150. Many insolvency laws include provisions that apply retroactively from a particular date (such as the date of application for, or commencement of, insolvency proceedings) for a specified period of time (often referred to as the

"suspect" period[1]) and are designed to overturn those past transactions to which the insolvent debtor was a party or which involved the debtor's assets where they have certain effects. These effects include reducing the net worth of the debtor (e.g. by gifting of its assets or transferring or selling assets for less than their fair commercial value); or upsetting the principle of equal sharing between creditors of the same rank (e.g. by payment of a debt to a particular unsecured creditor or granting a security interest to a creditor who is otherwise unsecured when other unsecured creditors remain unpaid and unsecured). Many non-insolvency laws also address these types of transaction as being detrimental to creditors outside insolvency. In some cases, the insolvency representative will be able to use those non-insolvency laws in addition to the provisions of the insolvency law.

151. It is a generally accepted principle of insolvency law that collective action is more efficient in maximizing the assets available to creditors than a system that leaves creditors free to pursue their individual remedies and that it requires all like creditors to receive the same treatment. Provisions dealing with avoidance powers are designed to support these collective goals, ensuring that creditors receive a fair allocation of an insolvent debtor's assets consistent with established priorities and preserving the integrity of the insolvency estate. Avoidance provisions may also have a deterrent effect, discouraging creditors from pursuing individual remedies in the period leading up to insolvency if they know that these may be reversed or their effects nullified on commencement. Transactions are typically made avoidable in insolvency to prevent fraud (e.g. transactions designed to hide assets for the later benefit of the debtor or to benefit the officers, owners or directors of the debtor); to uphold the general enforcement of creditors' rights; to ensure equitable treatment of all creditors by preventing favouritism where the debtor wishes to advantage certain creditors at the expense of the rest; to prevent a sudden loss of value from the business entity just before the supervision of the insolvency proceedings is imposed; and, in some States, to create a framework for encouraging out-of-court settlement—creditors will know that last-minute transactions or seizures of assets can be set aside and therefore will be more likely to work with debtors to arrive at workable settlements without court intervention.

[1] Defined in the Glossary of the Guide, term *(ss)* as: "Suspect period": the period of time by reference to which certain transactions may be subject to avoidance. The period is generally calculated retroactively from the date of the application for commencement of insolvency proceedings or from the date of commencement.

152. Avoidance provisions can be important to an insolvency law not only because the policy upon which they are based is sound, but also because they may result in recovery of assets or their value for the benefit of creditors generally and because provisions of this nature help to create a code of fair commercial conduct that is part of appropriate standards for the governance of commercial entities. It should be noted that, in the cross-border context, jurisdictions with insolvency laws that do not provide for avoidance of certain types of transaction, may encounter difficulties with recognition of proceedings and cooperation with courts and insolvency officials of jurisdictions where those transactions are subject to avoidance.

153. Notwithstanding the generally accepted rationale of avoidance provisions, it is important to bear in mind that many of the transactions that may be subject to avoidance in insolvency are perfectly normal and acceptable when they occur outside that context, but become suspect only when they occur in proximity to the commencement of insolvency proceedings. Avoidance powers are not intended to replace or otherwise affect other devices for the protection of the interests of creditors that would be available under general civil or commercial law.

154. Avoidance rules are much discussed, principally as to their effectiveness in practice and the somewhat arbitrary rules that are necessary to define, for example, relevant time periods and the types of transaction that may be avoided. As is the case with a number of the core provisions of an insolvency law, the design of avoidance provisions requires a balance to be reached between competing social benefits such as, on the one hand, the need for strong powers to maximize the value of the estate for the benefit of all creditors and, on the other, the possible undermining of contractual predictability and certainty. It may also require a balance to be reached between avoidance criteria that are easily proven and will result in a number of transactions being avoided and narrower avoidance criteria that are difficult to prove but more restricted in the number of transactions that will be avoided successfully. To minimize the potentially negative effects of avoidance powers on contractual predictability and certainty, it is desirable that as far as possible the categories of transactions to be avoidable (irrespective of whether they are broadly or narrowly defined) and the exercise of avoidance powers be subject to clear criteria that will enable business and commercial risks to be ascertained.

155. The decision whether or not to commence avoidance proceedings with respect to a particular transaction requires a number of different considerations to

be weighed. In the case of actions to restore assets to the insolvency estate, these considerations will include whether avoidance of the transaction will be beneficial to the estate (such as where the taking of an avoidance action may disrupt reorganization proposals, especially where the action can be taken by creditors without the consent of the insolvency representative); the likely cost of avoidance proceedings to the estate; the likelihood of recovering value for the estate; possible delays in recovery; and the difficulties associated with proving the elements necessary to avoid a particular transaction.

*2. Avoidance criteria*

156. Approaches to establishing the criteria for avoidance actions vary considerably between insolvency laws both in terms of specific criteria and the manner in which they are combined in each law. In terms of the specific criteria, they can be grouped broadly as objective and subjective criteria.

*(a) Objective criteria*

157. One approach emphasizes the reliance on generalized, objective criteria for determining whether transactions are avoidable. The question would be, for example, whether the transaction took place within the suspect period or whether the transaction evidenced any of a number of general characteristics set forth in the law (e.g. whether appropriate value was given for the assets transferred or the obligation incurred, whether the debt was mature or the obligation due or whether there was a special relationship between the parties to the transaction). While such generalized criteria may be easier to apply than criteria that rely upon proof, for example, of intent, they can also have arbitrary results if relied upon exclusively. So, for example, legitimate and useful transactions that fall within the specified suspect period might be avoided, while fraudulent or preferential transactions that fall outside the period are protected.

*(b) Subjective criteria*

158. Another approach emphasizes case-specific, subjective criteria such as whether there is evidence of intention to hide assets from creditors, whether the debtor was insolvent when the transaction took place or became insolvent as a result of the transaction, whether the transaction was unfair in relation to certain creditors and whether the counterparty knew that the debtor was insolvent at the time the transaction took place or would become insolvent as a result of the transaction. This individualized approach may require detailed consideration of

the intent of the parties to the transaction and of other factors such as the debtor's financial circumstances at the time the transaction occurred, the financial effect of the transaction on the debtor's assets and what might constitute the normal course of business between the debtor and particular creditors.

*(c) Combining the elements*

159. Very few insolvency laws rely solely on subjective criteria as the basis of avoidance provisions; they are generally combined with time periods within which the transactions must have occurred. In some States, a heavy reliance upon subjective criteria has led to considerable litigation and the imposition of extensive costs on insolvency estates. In order to avoid these costs, some laws have recently adopted a strictly objective approach of a short suspect period, such as three to four months, which in some cases is combined with an arbitrary rule that all transactions occurring within that period would be suspect unless there was a roughly contemporaneous exchange of value between the parties to the transaction. Additionally, the short suspect period may be used to create a presumption of necessary intent or knowledge, especially of insolvency, on the part of the debtor or the counterparty to the transaction or both, which may be rebutted by appropriate evidence.

160. Some laws adopt a two-tiered approach combining the short period within which all transactions are avoided and no defences are available to creditors, with a longer period in which certain additional elements have to be proven. The law may specify that a certain type of transaction occurring within, for example, a six-month period before commencement, is avoided without requiring the insolvency representative to show anything other than that it is a transaction as defined for the purposes of the legislation and that it occurred within the time limit. No defences are available to the counterparty. For transactions occurring within, for example, a one-year period, the insolvency representative is required to show that the transaction was not in the ordinary course of business and that it had a certain effect, for example, the creation of a preference. To defeat the claim the counterparty must show that it has a relevant defence. As with subjective criteria, however, too great a reliance on objective criteria can also produce negative outcomes. Experience in several States has shown that where certain types of transaction are automatically or easily avoided under the insolvency law, insolvency representatives can avoid each transaction occurring within a suspect period without any individual analysis or calculation of the potential cost or benefit of recovery for creditors generally. Furthermore, such an approach may

result in the avoidance of essentially “fair” commercial transactions and impose the burden and expense of challenging avoidance actions on individual creditors.

161. A number of insolvency laws also combine these different approaches to address different types of transaction. For example, preferential transactions and undervalued transactions may be defined by reference to objective criteria, while transactions aimed at defeating or hindering creditors will be defined by reference to questions of the intent of both the debtor and the counterparty. One insolvency law that adopts a combination of those elements provides, for example, that transactions such as gifts, granting of a security interest for existing debts and extraordinary payments (those which have not been made with the usual means of payment or before the due time) can be avoided where they are made within three months prior to commencement. Other transactions can be set aside if the debtor was insolvent at the time of the transaction, if the transaction was unfair or improper in relation to a group of creditors and if the counterparty knew that the debtor was insolvent at the time the transaction occurred.

162. Whatever criteria are used, insolvency laws should attempt to achieve a balance between the interests of individual creditors and those of the estate which, in terms of the recovery of assets through avoidance actions, coincide with the collective interests of all creditors. While in its most simple form, this might appear to be a decision as to the party on which to impose the costs of challenging an avoidance action, other factors need to be taken into account. The principal of these is funding for avoidance actions. Criteria that require proof of a number of elements for a successful avoidance action require court proceedings to be commenced by the insolvency representative for every transaction it wishes to overturn, potentially representing a major expense for the estate with no guarantee of a return. In jurisdictions that follow such an approach, lack of funding is a major reason for avoidance actions not proceeding. A different approach in which all transactions occurring within the defined period are automatically suspect, however, does not require the use of assets of the estate or of other funds. Further factors relevant to the setting of criteria include the defences available to creditors subject to an avoidance action and the duties placed upon the insolvency representative. For example, some insolvency laws discourage misuse of the avoidance provisions by imposing certain duties on the insolvency representative. Professional regulation may also be relevant, as well as the ability of the court to order costs against an insolvency representative where the attempted avoidance action is found to have been unjustified or to have caused unnecessary costs.

163. Whichever approach is taken, it is highly desirable that an insolvency law provide certainty to all parties through clearly defined criteria for avoidance, including the elements that will need to be proved by the insolvency representative and the defences available to the creditors.

*(d) Ordinary course of business*

164. Many insolvency laws use the concept of the "ordinary course of business" in defining their avoidance criteria, so that an extraordinary payment, as noted above, may be subject to avoidance. The concept has wider relevance to an insolvency regime as it may also be used, for example, to draw a distinction between the exercise of powers regarding the use and disposition of assets during the insolvency proceedings in the "ordinary course of business" and in other circumstances, both in terms of who may exercise such powers and the protections that are required (see above, paras. 75 and 76).

165. States define the "ordinary course of business" with varying emphasis on different elements. However, in most jurisdictions a common purpose of the definition is to determine what constitutes routine conduct of business and allow a business to make routine payments and enter into routine contracts, without subjecting those transactions to possible avoidance in insolvency. Those routine payments might include the payment of rent, utilities such as electricity and telephone and possibly also payment for trade supplies.

166. To define what constitutes "ordinary course of business" with respect to a particular debtor, some laws focus on the prior conduct of the debtor and the parties with which it deals, focusing on elements of their relationship such as the method, quantity and regularity of supply and payment. In such a case, any variation from contract, custom or what may be deemed to be regular practice between the parties, for example a payment by abnormal means, will be regarded as being outside the "ordinary course of business". Another approach focuses on the intention of one or both of the parties and asks whether the creditor had knowledge, or ought to have had knowledge, of the debtor's financial state or whether the debtor intended to prefer one creditor to others.

167. A further approach is to apply standards based upon usual industry or even general commercial practice to the terms of the transaction and the circumstances in which it was entered into. Other laws regard any payment exceeding a certain percentage of the value of the debtor's assets as extraordinary.

168. It is important that a test for the "ordinary course of business" balance flexibility, so as to not unduly restrict new developments in commercial practice, with an overriding requirement for certainty.

*(e) Defences*

169. Where an insolvency law provides defences to avoidance for individual counterparties, those defences may have the potential to dilute the efficacy of avoidance provisions. Defences that involve elements that may be subject to dispute, such as whether the transaction occurred in the ordinary course of business, or the counterparty acted in good faith, or involving the state of the counterparty's actual or implied knowledge, can create uncertainty for all parties and will require determination by the court. The likelihood of such uncertainty occurring has been increased in some jurisdictions by the courts adopting a wide interpretation of such defences in favour of counterparties. Insolvency representatives may be reluctant to use avoidance provisions as an effective tool in an insolvency, because of associated costs or because the procedures are inefficient and unpredictable. These potential difficulties underscore the desirability of an insolvency law adopting clear and predictable avoidance criteria and defences that will enable all parties to assess potential risks and avoid disputes, for example objective criteria focusing on the effect or result of transactions rather than on the intent of the parties. Where elements such as "ordinary course of business" are included they should be clearly defined and circumscribed by an insolvency law.

*3. Types of transaction subject to avoidance*

170. Although variously defined, there are three broadly common types of avoidable transaction that are found in most legal systems and are used in the *Legislative Guide* as the basis for discussion. They are transactions intended to defeat, hinder or delay creditors from collecting their claims; transactions at undervalue; and transactions with certain creditors that could be regarded as preferential. Some transactions may have the characteristics of more than one of these different classes, depending upon the individual circumstances of each transaction. For example, transactions that appear to be preferential may be more in the character of transactions intended to defeat, hinder or delay creditors when the purpose of the transaction is to put assets beyond the reach of a creditor or potential creditor[42] or to otherwise prejudice the interests of that creditor and the transaction occurs when the debtor will be unable to pay its debts as they become due or where they leave the debtor with insufficient assets to conduct its business.

Similarly, transactions at an undervalue may also be preferential when they involve creditors, but not when they involve third parties. Where there is a clear intent to hinder, defeat or delay creditors, these transactions may fall into the first category of transactions. In cases such as these, the insolvency representative may be able to choose the category under which a particular transaction is to be avoided and thus take advantage of the variations in requirements of proof and suspect periods that typically apply.

[42] A potential creditor may be a party that was not a creditor at the time the avoidable transaction took place, but who was about to become a creditor through, for example, negotiation of a loan agreement with the debtor. The debtor may have transferred assets to avoid them becoming subject to that agreement.

171. To achieve as much clarity and certainty as possible and avoid unnecessary overlap it is desirable that, in determining the categories of transaction to be subject to avoidance provisions, an insolvency law specify the particular characteristics of a transaction (including the effect of the transaction) that are essential for it to be avoided, rather than relying on broader labels, such as "fraudulent" or "preferential".

*(a) Transactions intended to defeat, hinder or delay creditors*

172. Transactions intended to defeat, hinder or delay creditors involve the debtor transferring assets to any third party with the intention of putting them beyond the reach of creditors. The effect of such transactions will generally be to disadvantage all unsecured creditors. These transactions generally cannot be avoided automatically by reference to an objective test of a fixed period of time in which the transactions occurred because of the need to prove the intent of the debtor. That intent is rarely proven by direct evidence, but rather by identifying circumstances that are common to these types of transaction. Although differing between jurisdictions, there are a number of common indicators, including:

*(a)* The relationship between the parties to the transaction, where a transaction took place directly with a related person or via a third party to a related person;

*(b)* The lack or inadequacy of the value received for the transaction;

*(c)* The financial condition of the debtor both before and after the transaction was entered into, in particular where the debtor was already insolvent or became insolvent after the transaction occurred;

*(d)* The existence of a pattern or series of transactions transferring some or substantially all the debtor's assets occurring after the onset of financial difficulties or the threat of action by creditors;

*(e)* The general chronology of the events and transactions under inquiry, where for example, the transaction occurred shortly after a substantial debt was incurred;

*(f)* The transaction is concealed by the debtor, especially when it was not made in the ordinary course of business, or fictitious parties were involved;
or

*(g)* The debtor absconds.

173. Some laws also specify circumstances or types of transaction where the requisite intent or bad faith is deemed, or may be presumed, to exist, for example, in the case of transactions involving related persons[2] occurring within a specified period of time prior to the commencement of proceedings (discussed further below, paras. 182-184). Under other laws it may be sufficient for a transaction to be avoided if the debtor could, and therefore should, have realized that the effect, if not the intent, of a transaction would have been to disadvantage creditors and that the beneficiary could, and therefore should, have realized that the debtor's action could produce that effect. Some laws also provide that certain transfers, such as conveyances of land, will be exempt from avoidance under this category of transactions if the transfer was bona fide for good value to a person who had no notice or was unaware of any intent to defraud creditors.

*(b) Undervalued transactions*

*(i) Criteria*

174. A debtor who is in need of cash may sell assets quickly at a price significantly below the real value in order to achieve a quick result, without ever having any intention to defeat or delay creditors. The result, however, may be a clear reduction of the assets available to creditors in insolvency. For this reason, many insolvency laws focus on the exchange of value in a transaction. Transactions would generally be avoidable where the value received by the debtor

[2] Defined in the Glossary as: *(jj)* "Related person": as to a debtor that is a legal entity, a related person would include: (i) a person who is or has been in a position of control of the debtor; and (ii) a parent, subsidiary, partner or affiliate of the debtor. As to a debtor that is a natural person, a related person would include persons who are related to the debtor by consanguinity or affinity;

as the result of the transaction with a third party was either nominal or non-existent, such as a gift, or much lower than the true value or market price, provided the transaction occurred within the suspect period. Other laws also require a finding that the transaction had a catastrophic effect on the debtor, such as that the debtor was left with an unreasonably small amount of capital as a result of the transaction, was insolvent at the time the transaction occurred or became insolvent as a result of the transaction. These undervalued transactions include those with both creditors and third parties.

175. An important question in respect of these types of transaction is what constitutes a sufficient "undervalue" for the purposes of avoidance and how it can be determined. In many States, it is left to the courts to determine by reference to standards such as reasonable or market value prevailing at the time the transaction occurred on the basis of appropriate expert evidence. Where the relevant amounts in a transaction may not be certain, one approach to assist the court may be for the insolvency representative to provide the court with an estimated valuation of such amounts, which could be disputed upon the presentation of further evidence by the counterparty to the transaction. The court might also be given a power to specify a mode of determining the valuation rather than necessarily having to determine the value itself. Given the difficulties in proving undervalue, in some jurisdictions it may be easier to avoid a transaction on the grounds of preferential effect if it was entered into at a time when the debtor was unable to pay its due debts. Further, some laws presume less than fair, or no, consideration to be evidence of a transaction intended to defeat, hinder or delay creditors.

*(ii) Defences*

176. Some insolvency laws provide that these types of transaction will not be avoided if certain conditions are satisfied, such as that the beneficiary acted in good faith; that the transaction was for the purpose of carrying on the debtor's business; and that there were reasonable grounds for believing that the transaction would benefit the debtor's ordinary business.

*(c) Preferential transactions*

*(i) Criteria*

177. Preferential transactions may be subject to avoidance where: *(a)* the transaction took place within the specified suspect period; *(b)* the transaction involved a transfer to a creditor on account of a pre-existing debt; and *(c)* as a

result of the transaction, the creditor received a larger percentage of its claim from the debtor's assets than other creditors of the same rank or class (in other words, a preference). Many insolvency laws also require that the debtor was insolvent or close to insolvent when the transaction took place and some further require that the debtor have an intention to create a preference. The rationale for including these types of transaction within the scope of avoidance provisions is that, when they occur very close to the commencement of proceedings, a state of insolvency is likely to exist and they breach the key objective of equitable treatment of similarly situated creditors by giving one member of a class more than they would otherwise legally be entitled to receive.

178. Examples of preferential transactions may include payment or set-off of debts not yet due; performance of acts that the debtor was under no obligation to perform; granting of a security interest to secure existing unsecured debts; unusual methods of payment, for example, other than in money, of debts that are due; payment of a debt of considerable size in comparison to the assets of the debtor; and, in some circumstances, payment of debts in response to extreme pressure from a creditor, such as litigation or attachment, where that pressure has a doubtful basis. A set-off, while not avoidable as such, may be considered prejudicial when it occurs within a short period of time before the application for commencement of the insolvency proceedings and has the effect of altering the balance of the debt between the parties in such a way as to create a preference or where it involves transfer or assignment of claims between creditors to build up set-offs. A set-off may also be subject to avoidance where it occurs in irregular circumstances, such as where there is no contract between the parties to the set-off.

*(ii) Defences*

179. One defence to an allegation that a transaction was preferential may be to show that, although containing the elements of a preference, the transaction was in fact consistent with normal commercial practice and, in particular, with the ordinary course of business between the parties to the transaction. For example, a payment made on receipt of goods that are regularly delivered and paid for may not be preferential, even if made within proximity to the commencement of insolvency proceedings. This approach encourages suppliers of goods and services to continue to do business with a debtor that may be having financial problems, but which is still potentially viable. Other defences available under insolvency laws include that the counterparty extended credit to the debtor after the transaction and that credit has not been paid (the defence is limited to the

amount of the new credit); that the counterparty gave new value for which it was not granted a security interest; the counterparty can show that it did not know a preference would be created; that the counterparty did not know or could not have known that the debtor was insolvent at the time of the transaction; or that the debtor's assets exceeded its liabilities at the time of the transaction. Some of these latter defences, in particular those involving the intent of the parties to the transaction, suffer from the disadvantage of being difficult to prove and may make avoidance proceedings complex, unpredictable and lengthy.

*(d) Security interests*

180. While security interests effective and enforceable under the laws permitting the grant of a security interest should generally be regarded as valid under insolvency law, they may nevertheless be avoidable in insolvency proceedings on the same grounds that any other transaction might be challenged and avoided. The purpose of such an approach is to prevent a debtor that is not able to pay its debts from encumbering assets, unless the security interest provided is in consideration of new funds being advanced. Otherwise, the encumbered assets will not be available to creditors generally and will place restrictions on the debtor's use of those assets. A transaction granting a security interest might be avoided on the basis that it is a transaction intended to defeat, delay or hinder creditors, or a preferential or undervalued transaction. In many cases, it will be a preferential transaction because it involves an existing creditor. Examples of preferential transactions may include the grant of a security interest shortly before commencement of proceedings, which although otherwise valid, may be found to have favoured unfairly a certain creditor at the expense of the rest; the grant of a security interest to secure a prior debt or on the basis of past consideration (permitted in some legal systems, but not in others); payments to a secured creditor, if the secured creditor is undersecured and is paid in full within the suspect period. Where the security interest is granted to a new creditor, the transaction may not be preferential within the meaning of that category of transaction, but may be covered by another category. There are examples of laws that include provisions dealing specifically with the avoidance of such transactions, especially in the context of security interests in favour of directors (which might also be covered by provisions on transactions with related persons) to which different criteria apply in terms of provision of value and the suspect period.

181. Avoidance provisions may also apply to a security interest that has not been made effective against third parties under the relevant secured transactions law

and, under some laws, to a secured interest that was made effective within a short period before the commencement of proceedings, as well as to transfers to a secured creditor from the proceeds of an encumbered asset, where the transaction creating the security interest was tainted.

*(e) Transactions with related persons*

182. As noted above, one criterion relevant to avoidance of certain transactions is the relationship between the debtor and the counterparty. Where the types of transaction subject to avoidance involve related persons (sometimes referred to as connected persons or insiders), insolvency laws often provide stricter rules, in particular with regard to the length of suspect periods and treatment of any claim by the related person (see chap. V, para. 48), as well as presumptions or shifted burdens of proof (see below, paras. 199-201) to facilitate avoidance proceedings and dispensing with requirements that the debtor was insolvent at the time of the transaction or was rendered insolvent as a result of the transaction. A stricter regime may be justified on the basis that these parties are more likely to be favoured and tend to have the earliest knowledge of when the debtor is, in fact, in financial difficulty.

183. Related persons are generally defined by varying levels of connection to the debtor. Most jurisdictions regard those with some form of corporate or family relationship with the debtor as related persons. The legislative approach taken is generally, but not always, prescriptive. With regard to those with some form of business association with the debtor, a narrow approach would focus on the directors or management of the debtor, while a wider definition may extend not only to those who have effective control of the debtor, but include all employees of the debtor and guarantors of the debts of any person with a business connection to the debtor. Similarly, a family relationship may be defined to include relatives by blood or marriage and even, in some laws, persons living in the same household as the debtor, as well as trustees of any trust of which the debtor or a person connected with the debtor is a beneficiary. Relatives of those who have a business association with the debtor are also commonly regarded as related persons. An important element in many jurisdictions is to include as related persons those who had a defined relationship with the debtor in the past or may have a defined relationship in the future.

184. Where the debtor is a natural person, other legislation (such as that dealing with marital property) may be relevant and may affect the operation of the

insolvency law in terms of transactions that can be avoided, such as by supplementing or limiting the avoidance provisions of the insolvency law. It is desirable for such laws to be aligned with the insolvency law and for any effect on the insolvency law to be clearly stated in the insolvency law.

185. It may be desirable for an insolvency law to include specific exemptions from the operation of avoidance powers for certain types of transaction. Transactions essential to the functioning of financial markets, such as close-out netting of securities and derivative contracts (see chap. II below, paras. 208-215) are one example of transactions that should be exempted from the operation of avoidance provisions. Another example might be transactions that occur in the course of implementing a reorganization plan, where implementation of the plan fails and the proceedings are subsequently converted to liquidation.

*5. Effect of avoidance: void or voidable transactions*

186. Where a transaction falls into any of the categories of transactions subject to avoidance, insolvency laws either render it automatically void or make it voidable, depending upon the test that is adopted in respect of each category of transaction. For example, those laws which refer only to transactions occurring within a certain fixed period of time and include no subjective criteria sometimes specify that relevant transactions will be void. However, even where that approach is adopted the insolvency representative may have to commence proceedings to recover the assets or their equivalent value from the counterparty where the counterparty fails to return the assets or pay for their value.

187. In those laws where the transaction is voidable, the insolvency representative will be required to decide whether avoidance of the transaction will be beneficial to the estate, taking into account the elements of each category of avoidable transaction as well as possible delays in recovering either the assets involved or the value of the assets and the possible costs of litigation. That discretion would generally be subject to the insolvency representative's obligation to maximize the value of the estate and, under some laws, it may be responsible for its failure to do so.

*6. Establishing the suspect period*

188. Most insolvency laws explicitly specify the duration of the suspect period with reference to the particular types of transaction to be avoided and indicate the date from which the period is calculated retroactively. For example, so many days

or months before a particular event or date, such as the date the application for commencement of proceedings is made, the effective date of commencement of insolvency proceedings or the date decided by the court as being the date on which the debtor ceased paying its debts in the normal way (“cessation of payments”). The event or date specified by the law will depend upon other design features of the insolvency regime such as the requirements for commencement, including whether there is a potential for delay between the application for, and commencement of, insolvency proceedings. For example, if commencement typically takes several months from the time of application and the suspect period is a fixed period relating back from the effective date of commencement, then several months of that period will be taken up by the period of delay between application and commencement, thus limiting the potential effectiveness of the avoidance powers. However, if the proceedings commence automatically when an application is made, the same delay will not occur. To address situations where there is the potential for delay to occur, an insolvency law could stipulate that the suspect period applies retroactively from the date an application is made and address transactions between application and commencement in other terms, such as whether they were fraudulent or whether they were in the ordinary course of business or, where an interim insolvency representative is appointed, in terms of unauthorized transactions (see above, paras. 70-73). Where commencement occurs shortly after application, the suspect period could apply retroactively from the effective date of commencement.

189. Some insolvency laws provide one suspect period for all types of avoidable transaction, while others have different periods depending upon the type of transaction and whether the transferee was a related person. As noted above, there are also examples of laws that adopt the approach of combining a short suspect period within which certain types of transaction are automatically avoided (and no defences are available) and a longer period where additional elements have to be proved. Because some transactions involve intentionally wrongful conduct, many insolvency laws do not limit the time period within which these types of transaction must have occurred in order for them to be avoided. Other insolvency laws establish a very long limit (examples range from 1 to 10 years) where the suspect period is generally calculated from the date of commencement of proceedings. With the exception of transactions involving intentionally wrongful behaviour, it is highly desirable that suspect periods be of a reasonably short duration to ensure commercial certainty and to reduce any negative impact that avoidance provisions will have on the availability and cost of credit.

190. Where preferential and undervalued transactions involve creditors who are not related persons, it is desirable that the suspect period be relatively brief, perhaps no more than several months (e.g. from three to six months). However, where related persons are involved, stricter rules may apply and the suspect period will be longer (e.g. two years as opposed to three to six months for the same transaction when it does not involve a related person). For transactions intended to defeat, hinder or delay creditors, the suspect period could be longer, for example, one to two years.

191. A related issue is whether suspect periods stipulated in the insolvency law can be extended by the court in appropriate situations, such as where transactions that occurred outside the specified suspect periods in questionable circumstances had the effect of diminishing the estate. While a discretionary approach may allow a certain degree of flexibility with respect to the transactions to be caught by the avoidance provisions, it may also lead to delay in the proceedings and does not give a predictable or transparent indication to creditors as to the transactions that are likely to be avoided. If transactions can be unwound where they took place at some unspecified time prior to the commencement of insolvency proceedings and subject to the discretion of the court, there is likely to be less safety in commercial and financial transactions. For these reasons, it is desirable that extension of the suspect period be limited to transactions intended to defeat, hinder or delay, where issues of commercial certainty are of less concern.

*7. Conduct of avoidance proceedings*

*(a) Parties who may commence*

192. Avoidance of a particular transaction generally requires an application to the court to declare the transaction void and insolvency laws adopt a variety of approaches to the party that may commence such a proceeding. Recognizing the central role played by the insolvency representative with respect to the administration of the estate, many insolvency laws provide that proceedings for the avoidance of specified transactions should be taken by the insolvency representative, although some do require the insolvency representative to gain the agreement of creditors or a majority of creditors before any proceeding can be commenced. There are also laws that permit avoidance proceedings to be commenced by creditors (and, in some cases, the creditor committee), some of which limit the right to commence to those creditors whose debt precedes the challenged transaction in time. Some of the laws that permit creditors to commence such proceedings require the prior consent of the insolvency

representative. Should it be regarded as desirable to include such permission in an insolvency law, requiring consent ensures that the insolvency representative is informed as to what creditors propose and gives it the opportunity to refuse permission, thus avoiding any negative impact of avoidance proceedings on administration of the estate.

193. Where the consent of the insolvency representative is required, but not obtained, some insolvency laws permit a creditor to seek court approval to commence avoidance proceedings. The insolvency representative has a right to be heard in any resulting court hearing to explain why it believes the proceedings should not go ahead. At such a hearing, the court might give leave for the avoidance proceeding to be commenced or may decide to hear the case on its own merits. Such an approach may work to reduce the likelihood of any deal-making between the various parties. Where creditor-initiated avoidance actions are permitted, some laws require creditors to pay the costs of those proceedings or allow sanctions to be imposed on creditors to discourage potential abuse of avoidance proceedings.

194. Where the insolvency representative has the sole power to commence avoidance proceedings and, based on the balance of the considerations discussed above (i.e. for reasons other than negligence, bad faith or omission),[43] decides not to commence proceedings in respect of certain transactions, insolvency laws adopt different approaches to the conduct and funding of those proceedings. The manner in which they could be funded may be of particular importance where the insolvency estate has insufficient assets to do so (funding is discussed further below). As to the conduct of those proceedings, some laws permit a creditor or the creditor committee to require the insolvency representative to initiate an avoidance proceeding where it appears to be beneficial to the estate to do so or also permit a creditor itself or the creditor committee to commence proceedings to avoid these transactions, where other creditors agree.

[43]See chap. III, paras. 49-52, on the duties and functions of the insolvency representative.

195. Where creditors are permitted to commence avoidance proceedings, either on an equal basis with the insolvency representative or because the insolvency representative decides not to commence such proceedings, insolvency laws adopt different approaches to the assets or value recovered. The most common approach is to treat the assets or value recovered by the creditor as part of the estate on the basis that the principal justification of avoidance proceedings is to return value or assets to the estate for the benefit of all creditors, rather than to provide a benefit to individual creditors. Other laws provide that whatever is recovered can be

applied in the first instance to satisfy the claim of the creditor that commenced the proceedings, or that the priority of the claim of the creditor or creditors pursuing the action can be modified.

*(b) Funding of avoidance proceedings*

196. The most crucial restriction in a number of States on the efficacy of avoidance provisions has been the unavailability of funds with which to challenge potentially avoidable transactions. Different approaches to the question of funding have been adopted. Some States make public funds available to the insolvency representative to commence avoidance proceedings, while others require those proceedings to be funded from the insolvency estate. This latter approach may be appropriate where sufficient funds exist, but in some circumstances would prevent the recovery of assets that have been removed from the estate with the specific intention of leaving the estate with few assets from which to fund their recovery through avoidance proceedings. Some insolvency laws allow the insolvency representative to assign the ability to commence proceedings for value to a third party or to approach a lender to advance funds with which to commence avoidance proceedings. There are clearly significant differences between countries in the availability of public resources to fund avoidance proceedings that may justify use of some of these alternative mechanisms. Where there is no ability to fund avoidance proceedings from the insolvency estate, these alternative approaches may offer, in appropriate situations, an effective means of restoring value to the estate, avoiding abuse, investigating unfair conduct and furthering good governance.

*(c) Time limits for commencement of avoidance proceedings*

197. Some insolvency laws establish specific time periods within which avoidance proceedings should be commenced, while others are silent on this issue. Those laws which do specify time periods provide, for example, that the proceedings should be commenced within a specified period after the effective date of commencement of insolvency proceedings (e.g. 3 or 12 months) or no later than a specified time period (e.g. 6 months) after the insolvency representative is able to discover, assess and pursue claims. If an insolvency law is to establish specific time periods, rather than relying on those applicable under law other than the insolvency law, an approach that combines different periods, such as a fixed time period after commencement and a fixed time period after the discovery of the transaction by the insolvency representative, would be desirable. Such an approach provides sufficient flexibility to address those transactions

which are concealed from the insolvency representative and discovered only after the expiration of the specified time period. Whichever approach is adopted, it is desirable that the time period be relatively short, as in the examples noted above, to avoid uncertainty and ensure that the insolvency proceedings are conducted expeditiously.

*(d) Satisfying the criteria for avoidance*

198. Insolvency laws adopt different approaches to establishing the elements that have to be proved in order to avoid a particular transaction. The approach adopted will depend upon how the balance is struck between undoing transactions that are unfair or financially harmful to the insolvency estate on the one hand and protecting commercial transactions that are not regarded as wrong or harmful outside the insolvency context on the other. Whichever approach an insolvency law adopts to satisfying the avoidance criteria, it is highly desirable that the law state precisely which parts of the criteria have to be proved by which party, so that it is clear what is required of the insolvency representative in seeking to avoid a particular transaction and what is required of the counterparty seeking to defend a transaction from avoidance.

199. In some laws, the onus is on the debtor to prove that the transaction did not fall into any category of avoidable transactions and, for example, was a transaction in the ordinary course of business. Other insolvency laws provide that the insolvency representative or other person permitted to challenge the transaction, such as a creditor, is required to prove that the transaction satisfies the requirements for avoidance. Where these elements include intent, it will often be very difficult to prove and the party with the burden of proof will most often lose. To overcome this difficulty, some laws allow the burden of proof to be shifted to the counterparty where, for example, it is difficult for the insolvency representative to establish that the debtor's actual intent was to defraud creditors except through external indications, objective manifestations, or other circumstantial evidence of such intent. As a practical matter, however, the debtor's inability to satisfactorily explain the commercial purpose of a particular transaction, which extracted value from the estate, may point to the requisite intent.

200. Another approach is to provide that the requisite intent or bad faith is deemed or presumed to exist where certain types of transaction are undertaken within the suspect period and the counterparty to the transaction will have the burden of proving otherwise. These types of transaction may include, for example,

transactions with related persons, payment of unmatured debts and payment of gratuitous or onerous transactions. A further approach is to provide that where a certain type of transaction occurred within the suspect period and had a certain effect, such as conferring a preference, a rebuttable presumption as to intention to prefer will arise. Unless the counterparty can rebut the presumption, the transaction will be avoided and the insolvency representative can recover the assets involved in the transaction or obtain judgement for the value of the asset involved.

201. Where the counterparty's knowledge of the debtor's insolvency is a required element of avoidance, some insolvency laws include a presumption that the counterparty knew of the poor financial condition of the debtor if the transaction entered into with that person had certain characteristics. These may include that the repayment was in respect of an unmature debt or made in an unusual manner, or that the transaction occurred within a short period before an application for commencement or before commencement of insolvency proceedings.

*8. Liability of counterparties to avoided transactions*

202. Where a transaction is avoided, there is a question of the effect of avoidance on the counterparty. In most insolvency laws the result of avoidance of a transaction is that the transaction will be reversed and the counterparty will be required to return the assets obtained or make a cash payment for the value of the transaction to the insolvency estate. Some insolvency laws provide that the insolvency representative can be awarded judgement for the value of the property involved. Some insolvency laws also stipulate that a counterparty that has returned assets or value to the estate may make a claim as an unsecured creditor in the insolvency to the extent of the assets returned in the case of a preference and to the extent of the consideration paid in an undervalued transaction. Where the counterparty fails to disgorge assets or return value to the insolvency estate, most of the remedies available are under non-insolvency law. Some insolvency laws provide, however, that in addition to avoidance of the transaction, a claim by the counterparty (for amounts owed in addition to those involved in the voidable transaction) cannot be admitted in the insolvency.

*9. Conversion of reorganization to liquidation*

203. Where reorganization proceedings are converted to liquidation proceedings, some consideration may need to be given to the effect of that conversion on the

exercise of avoidance powers in respect of payments made in the course of the reorganization proceedings and the timing of the suspect period.

C. **UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises, adopted by the Commission at its fifty-fourth session,[3] available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/part_5_en.pdf [the commentary is expected to be finalized in December 2021]**

**Avoidance in simplified insolvency proceedings**

46. The insolvency law providing for a simplified insolvency regime should ensure that avoidance mechanisms available under the insolvency law[4] can be used in a timely and effective manner to maximize returns in simplified insolvency proceedings. The competent authority should be allowed to convert a simplified insolvency proceeding to a different type of insolvency proceeding where the conduct of avoidance proceedings necessitates doing so.

**Pre-commencement business rescue finance**

107. The law should:

(a) Facilitate and provide incentives for finance to be obtained by MSEs in financial distress before commencement of insolvency proceedings for the purpose of rescuing business and avoiding insolvency;

(b) Subject to proper verification of appropriateness of that finance and protection of parties whose rights may be affected by the provision of such finance, provide appropriate protection for the providers of such finance, including the payment of such finance provider at least ahead of ordinary unsecured creditors;

(c) Provide appropriate protection for those parties whose rights may be affected by the provision of such finance.

[3] *Official Records of the General Assembly, Seventy-sixth Session, Supplement No. 17* (A/76/17), para. 77 and annex II.

[4] See recommendations 87–99 of the Guide.