United Nations A/CN.9/WG.V/WP.183

General Assembly

Distr.: Limited
7 October 2022

Original: English

United Nations Commission on International Trade Law
Working Group V (Insolvency Law)
Sixty-first session
Vienna, 12–16 December 2022

Applicable law in insolvency proceedings

Note by the Secretariat

Contents

V.22-22718 (E) 141022 171022

I. Introduction

1. The provisional agenda of the sixty-first session of the Working Group (A/CN.9/WG.V/WP.181) provides background information about the project on applicable law in insolvency proceedings referred to the Working Group by the Commission at its fifty-fourth session, in 2021.[1] Although the prevailing view at the sixtieth session of the Working Group (New York, 18–21 April 2022) was that a model law should be prepared on the topic,[2] it was considered premature to commence drafting a model law in the light of many open issues.[3] The Working Group requested the secretariat to (a) present materials on which agreement was reached at that session in the form of draft legislative provisions with accompanying commentary and (b) present other materials in a form that would facilitate their consideration and resolution of outstanding issues.[4] To ensure a coherent and comprehensive discussion, it was considered timely to bring cross-border insolvency issues into discussion.[5]

2. Accordingly, this note contains draft legislative provisions with accompanying draft commentary on issues on which agreement was reached or on which a prevailing view emerged. The secretariat continues to use a generic reference to the "legislative provisions" although the form of a model law was used as a working assumption. The presentation of the content of the draft legislative provisions and accompanying commentary may need to change if that working assumption is overturned. In particular, if the legislative provisions remain part of the UNCITRAL Legislative Guide on Insolvency Law (the "Guide"), they would need to be properly integrated there. A more neutral approach may be taken in a stand-alone text or a supplement to a model law (presumably, to more than one UNCITRAL insolvency model law if applicable law issues are intended to be addressed in the context of both a single debtor and enterprise group members) although cross references in that text to the relevant provisions of the Guide would not be excluded.

3. The secretariat brings specific points to the attention of the Working Group in the secretariat notes preceding the draft legislative provisions and commentary, and also within square brackets in the draft text and in footnotes. An addendum to this note (A/CN.9/WG.V/WP.183/Add.1) sets out materials deferred for further consideration and issues of relevance to the project not yet considered by the Working Group. The texts that were used as the basis for drafting are cited in footnotes.

II. Draft legislative provisions with accompanying commentary

A. Purpose and objectives

4. At its sixtieth session, the Working Group agreed with the purpose and objectives of the project as stated in paragraphs 5–7 of working paper A/CN.9/WG.V/WP.179, noting that they might need to be supplemented with additional items at later stages of the project.[6] The following draft legislative provision with accompanying commentary reflects the Working Group's deliberations on the subject so far.

5. The draft legislative provision refers to the key objectives of an effective and efficient insolvency law as they are set out in recommendation 1 of the Guide. The Working Group may wish to consider whether such a generic reference is sufficient or whether the draft legislative provision should contain a cross reference to that recommendation or whether the most relevant objectives from those listed in that

[1] *Official Records of the General Assembly, Seventy-sixth Session, Supplement No. 17* (A/76/17), paras. 215–217.
[2] A/CN.9/1094, para. 66.
[3] Ibid., para. 98.
[4] Ibid., para. 99.
[5] Ibid.
[6] Ibid., para. 64.

recommendation should appear in the draft legislative provision itself, e.g.: (a) provide certainty in the market to promote economic stability and growth; (b) maximize value of assets; (c) ensure equitable treatment of similarly situated creditors; (d) provide for timely, efficient and impartial resolution of insolvency; (e) preserve the insolvency estate to allow equitable distribution to creditors; and (f) ensure a transparent and predictable insolvency law.

1. Draft legislative provision

Preamble[7]

The purpose of [these legislative provisions] is to establish clear rules on the law applicable in insolvency proceedings, including in concurrent proceedings with respect to a single debtor or members of an enterprise group, so as to achieve the key objectives of an effective and efficient insolvency law and reduce the risk of forum shopping and other acts detrimental to creditors and other parties in interest.[8]

2. Draft commentary[9]

1. Where insolvency proceedings involve parties or assets located in different States, complex questions may arise as to the law that will apply to the treatment of those assets and of the rights and claims of foreign parties in those proceedings. While procedural aspects of insolvency proceedings are without doubt governed by the law of the State in which those proceedings are commenced (the lex fori concursus), substantive aspects involved in insolvency proceedings, in particular the treatment of contracts and claims, lead to exceptions to the application of that law. The diversity in the number and scope of such exceptions may create uncertainty and unpredictability for parties involved in cross-border insolvency proceedings. In some jurisdictions, the law may be silent about the law applicable in insolvency proceedings to those issues or address it only partly, leaving much discretion to courts to determine applicable law on a case-by-case basis.

2. Ascertaining the applicable law becomes more complicated when several proceedings take place in respect of the same debtor concurrently (e.g. a foreign main proceeding, a foreign non-main proceeding and an insolvency proceeding that is neither foreign main nor foreign non-main proceeding, for example opened at the location of the debtor's assets (see article 28 of the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI))). Furthermore, foreign main or non-main proceeding may become the subject of a recognition proceeding in a receiving State that would apply its own law to issues such as the scope of the automatic relief resulting from the recognition of a foreign main proceeding (article 20 (2) of MLCBI), discretionary relief (articles 19 (1) (c) and 21 (1) (g) of MLCBI), additional assistance (article 7 of MLCBI) and allocation of assets among different types of proceedings (articles 21 (3), 23 (2), 28 and 29 (c) of MLCBI). In enterprise group insolvency, in the absence of the widespread recognition of separate legal personality of an "enterprise group" and provisions facilitating enterprise group insolvency like those envisaged in the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI), numerous concurrent insolvency and other parallel proceedings may be opened with respect to different members of an enterprise group and the group as a whole. Those concurrent or parallel proceedings necessitate clarification and coordination of applicable laws.

3. The main purpose of the [legislative provisions] is to offer simple and clear rules for applicable law in insolvency proceedings that States can incorporate in their

[7] If the legislative provisions are part of the Guide, this heading would read "Purpose of legislative provisions".

[8] A/CN.9/1094, paras. 62–64 and A/CN.9/WG.V/WP.179, paras. 5–7.

[9] See para. 80 of the commentary to recommendations 30–34 of the Guide, and reports of the Working Group (A/CN.9/1088, para. 57 and A/CN.9/1094, paras. 62–64).

domestic law. The [legislative provisions] do so by: (a) establishing a general rule that the law of the State of the opening of insolvency proceedings (the lex fori concursus) will apply to all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects on persons, rights, claims and proceedings; (b) clarifying the meaning and scope of that law; (c) providing for a limited number of exceptions to that rule; (d) delineating the scope of each exception and specifying when each of them will be applicable; and (e) clarifying the law applicable in concurrent proceedings with respect to a single debtor or members of an enterprise group.

4. Adherence to the framework suggested in [the legislative provisions] would help to address the existence of divergent, fragmented and incomplete legislative rules and approaches to the law applicable in insolvency proceedings. This in turn is expected to enhance: (a) certainty and predictability of outcomes of insolvency proceedings on the rights and claims of parties affected by those proceedings; (b) efficiency and effectiveness of insolvency proceedings through reduction of complexities and costs; (c) better coordination of insolvency proceedings with cross-border aspects; and (d) trade and investment. [*The expected impact of the legislative provisions on the achievement of other objectives of an effective and efficient insolvency law, such as on equitable treatment of similarly situated creditors, is to be explained in due course on the basis of the outcomes of the Working Group's deliberations on relevant matters*].

5. The [legislative provisions] aim at reducing the risk of forum shopping and other acts detrimental to creditors and other parties in interest but do not purport to define such acts. This is left to be assessed at the domestic level, including by courts on a case-by-case basis.

6. The [legislative provisions] aim to achieve an appropriate balance between competing considerations involved in the objectives of an effective and efficient insolvency law [listed in [recommendation 1 of the UNCITRAL Legislative Guide on Insolvency Law (the "Guide")][the legislative provision]]. For example, the objective of efficient and effective insolvency proceedings alone may favour the application of the lex fori concursus without exceptions because the forum court is best positioned to articulate and apply its own law. The application of a foreign law in the domestic context necessitates proving the content and interpretation of foreign law, raises differences as to whether foreign law is a question of law or fact and leads to difficulties when courts have to deal with foreign legal categories that are unknown in their legal systems. This increases the risk that courts may interpret foreign law using their own legal categories. The considerations of efficiency and effectiveness may thus favour that the appropriate forum coincides with the applicable law. Other considerations may however outweigh that consideration and require the application of the foreign law.

[*To be continued to reflect the results of future deliberations, including on the scope of application of the legislative provisions.*]

B. Scope of application of the [legislative provisions]

6. The Working Group agreed that: (a) the project would cover liquidation and reorganization as defined in the Guide, including insolvency proceedings commenced at an early stage of financial distress as envisaged in recommendation 294 of the Guide and interim and restructuring proceedings that met the test to be qualified as "insolvency" or "foreign" proceedings under the UNCITRAL insolvency texts;[10] (b) out-of-court debt restructuring negotiations held under contract law would be excluded from the scope of the project at this stage;[11] and (c) it would be sufficient to

[10] A/CN.9/1094, para. 68 and A/CN.9/WG.V/WP.179, paras. 8–12.
[11] A/CN.9/1094, para. 68.

note distinct issues arising from the application of applicable law rules in reorganization as opposed to liquidation in the commentary.[12]

7. The following draft legislative provision with accompanying commentary reflects the Working Group's deliberations on the subject so far. At the sixtieth session of the Working Group, clarification was sought as to which restructuring proceedings, other than reorganization proceedings included in the UNCITRAL definition of "insolvency" or "foreign" proceedings, would be within the scope of the project. The Working Group agreed not to refer separately to restructuring and to clarify the matter in the commentary, explaining in that context also the difference between reorganization and restructuring.[13] In that respect, the secretariat notes in the draft commentary that courts have granted recognition to various types of restructuring proceeding under MLCBI, including schemes of arrangement, as long as they met the cumulative set of requirements found in UNCITRAL insolvency texts for "insolvency" or "foreign" proceedings.

8. The Working Group may wish to recall that, at its fifty-ninth session, it had deferred issues raised by recommendation 30 of the Guide (the law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings)[14] for further consideration, noting that they were linked to recommendations 3 and 4 of the Guide. At its sixtieth session, the Working Group focused on issues arising from recommendations 31–34 of the Guide.[15] Paragraph 2 of the draft legislative provision invites the Working Group to consider whether issues raised by recommendation 30 of the Guide will be within the scope of the project. If so, the Working Group may wish to consider how to reflect all related issues from recommendations 3, 4 and 30 in the legislative provisions.

9. In addition, at the fifty-ninth session of the Working Group, a view had been expressed that a legislative provision itself rather than its commentary or drafting history should state that the commencement of insolvency proceedings should not displace the general, pre-insolvency conflict-of-laws rules applicable to the creation and effectiveness of a security right against third parties.[16] At the sixtieth session of the Working Group, the secretariat recalled that a similar provision appeared in UNCITRAL secured transactions texts.[17] The Working Group may wish to consider whether such a provision would be of general application and, as such, may supplement a legislative provision that would address issues raised by recommendation 30 of the Guide if they are brought within the scope of the legislative provisions.

10. The secretariat notes the relevance of jurisdictional rules and rules on localization of assets and allocation of assets among various proceedings (main, non-main, etc.) to the legislative provisions. Those rules are addressed in various international texts[18] and may fall outside the scope of the project. The commentary

---

[12] A/CN.9/1088, para. 89.
[13] A/CN.9/1094, para. 84.
[14] A/CN.9/1088, para. 61.
[15] A/CN.9/1094, chapter VI, and A/CN.9/WG.V/WP.179, para. 2.
[16] A/CN.9/1088, para. 87 (a).
[17] A/CN.9/WG.V/WP.179, para. 35 with reference to recommendation 223 of the UNCITRAL Legislative Guide on Secured Transactions and article 94 of the UNCITRAL Model Law on Secured Transactions.
[18] See e.g. recommendations 10–12 of the Guide that indicate minimum and non-exclusive connecting factors for exercise of jurisdiction over insolvency proceedings - the location of the centre of the debtor's main interests (COMI) and the establishment. Other grounds, such as presence of assets, although envisaged in the MLCBI, are not recommended. See also Global Principle 13 of the ALI-III Global Principles for Cooperation in International Insolvency Cases (2012) and the Global Rules on Conflict-of-Laws Matters in International Insolvency Cases of the American Law Institute and the International Insolvency Institute (the Global Rules), in particular the comment to Global Rule 1 that discusses internationally agreed standards for exercise of jurisdiction over insolvency proceedings in the context of choice-of-law rules of an internationally uniform nature. On the localization of assets, see in addition Global Rules 6–11. (The Global Principles and the Global Rules are available at

may address them in due course. The Working Group may wish to confirm whether this working assumption is accurate.

11. The Working Group may wish to consider whether any particular sectors or entities should be excluded from the scope of application of the legislative provisions[19] and whether the legislative provisions may be found useful not only in the international but also in the domestic context of federal States.

1. Draft legislative provision

Scope of application

1. The [legislative provisions] lay down rules for the law applicable in insolvency proceedings.

2. The [legislative provisions] [do not address] [also address] the law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings.

3. […].

2. Draft commentary

Paragraph 1

1. The scope of application of the [legislative provisions] is linked to the notions of "insolvency proceedings"[20] and "commencement of insolvency proceedings".[21] UNCITRAL insolvency texts set out a cumulative list of requisites that a proceeding must meet in order to be considered an "insolvency proceeding": (a) collective proceeding (judicial or administrative);[22] (b) pursuant to a law relating to insolvency (which includes a company law);[23] (c) under control or supervision by a court (which includes debtor-in-possession);[24] (d) with respect to a debtor (natural or legal person) that is in severe financial distress or insolvent;[25] and (e) with the goal of liquidating or reorganizing that debtor as a commercial entity.[26]

2. "Insolvency proceedings" under UNCITRAL insolvency texts encompass: (a) "liquidation" defined as proceedings to sell and dispose of assets for distribution to creditors in accordance with the insolvency law;[27] (b) "reorganization" defined as the process by which the financial well-being and viability of a debtor's business can

www.iiiglobal.org/initiatives/projects-sponsored-by-iii/) On the allocation of assets among proceedings, see e.g. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the EIR recast). MLCBI defers this matter to the law of the enacting State.

[19] UNCITRAL insolvency texts highlight that banks and insurance companies, state-owned companies, utility companies and consumers are usually subject to a special insolvency regime. See e.g. article 1 (2) of MLCBI and accompanying commentary in the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (GEI), paras. 55–61.

[20] See e.g. the Glossary in the Guide, terms (s) and (u), to be read together and also with the explanation provided in part one, para. 2; the Guide to Enactment of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-related Judgments (MLIJ) (GE), para. 22; and GEI, para. 48.

[21] See recs. 14–29 of the Guide.

[22] GEI, paras. 69–72.

[23] GEI, para. 73.

[24] Recommendation 112 of the Guide, and GEI, paras. 71, 74–76, and 86.

[25] GEI, paras. 1, 48, 49, 65 and 67, cross-referring to recommendations 15 and 16 of the Guide that sets out standards for commencement of insolvency proceedings by the debtor (the debtor is or will be generally unable to pay its debts as they mature or its liabilities exceed the value of its assets) and creditors (the debtor is generally unable to pay its debts as they mature or the debtor's liabilities exceed the value of its assets).

[26] See GEI, paras. 77–78.

[27] Term (w) of the Glossary in the Guide.

be restored and the business can continue to operate, using various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or part of it) as a going concern; [28] (c) "expedited reorganization proceedings" that combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the insolvency law for court confirmation of that plan; [29] (d) proceedings commenced by a micro- or small enterprise debtor at an early stage of financial distress; [30] and (e) interim, restructuring and any other proceeding that the court may ascertain on a case-by-case basis as meeting the cumulative list of the requisites set out above. [31]

3. Any other proceedings that do not meet the requisites set out above would fall outside the scope of application of the [legislative provisions]. For example, a debt collection proceeding or receiverships initiated by a particular creditor or group of creditors or gathering up assets in a winding up or conservation proceedings that do not also include provision for addressing the claims of other creditors are excluded. [32] A judicial or administrative proceeding for a solvent entity that does not seek to restructure its financial affairs but rather to dissolve its legal status is also excluded. [33] Financial adjustment measures or arrangements undertaken between the debtor and some of its creditors on a purely contractual basis concerning some debt, where the negotiations do not lead to the commencement of an insolvency proceeding conducted under the insolvency law, will also be outside the scope of the [legislative provisions]. [34] In addition, proceedings that are designed solely to prevent dissipation and waste of assets, rather than to liquidate or reorganize the insolvency state, as well as proceedings designed to prevent detriment to investors rather than to all creditors are also excluded. [35]

Paragraph 2 [36]

4. In an insolvency proceeding, a forum court will first apply its private international law (conflict-of-laws) rules (henceforth referred to as "PIL" or "PIL rules"), including any international conventions or other agreements in force for its State, to determine which law is applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings and to their treatment in the insolvency proceedings. Typically, the law governing the contract will determine if a contractual claim exists against the insolvent debtor and the amount of that claim; and the law where the property is situated (lex rei sitae) will determine if a security interest in immovable assets has been created in favour of a specific creditor. [These legislative provisions] [do not deal with or displace] [reaffirm] those rules.

5. The court will then decide which law will apply to: (a) determination of the insolvency effects on the pre-commencement rights and claims (i.e. how each of such a right and claim would be treated in insolvency proceedings); and (b) post-commencement rights, claims, actions and disputes. Examples of issues covered by (a) include the relative position of claims vis-à-vis each other (i.e. the ranking and priorities) and restrictions and modifications to which the pre-commencement rights and claims may become subject in order to fulfil the collective aims of insolvency proceedings (e.g. avoidance, subordination). Examples of issues covered by (b) include: submission, verification and admission of claims;

[28] Term (kk) of the Glossary in the Guide.
[29] See the text on the Purpose of legislative provisions preceding recommendation 160 of the Guide. See also GEI, para. 75.
[30] See recommendation 294 of the Guide.
[31] As regards interim proceedings, see GEI, paras. 79–80. As regards restructuring proceedings, see the Digest of Case Law on the UNCITRAL Model Law on Cross-Border Insolvency, para. 11, under article 2.
[32] GEI, para. 69.
[33] See e.g. GE, para. 22; and GEI, paras. 48 and 73.
[34] GEI, para. 78.
[35] GEI, para. 77.
[36] See paras. 82 and 83 of the commentary to recommendations 30–34 of the Guide.

the scope of the stay of proceedings upon commencement of insolvency proceedings and requests for relief from the stay; claims arising from the provision of post-commencement finance; liability of the insolvency representative; determination and authorization of administrative expenses; approval of a reorganization plan; and discharge of debt.

[*to be added*]

Paragraph 3

[*to be added*]

C. Definitions

12. At its sixtieth session, the Working Group confirmed that the term "insolvency law" found in recommendation 31 should be interpreted broadly as encompassing not only insolvency law but also non-insolvency law with sufficient connection to insolvency. A view was expressed that it might be necessary to identify criteria that would help establishing sufficient connection to insolvency law. Another view was that the existence of sufficient connection would need to be assessed on a case-by-case basis.[37]

13. In the light of those deliberations, the secretariat proposes the following definition of the "lex fori concursus" building on the explanation of that term in the Glossary of the Guide (term (x)) that does not refer to the "insolvency law" but to the "law of the State in which the insolvency proceedings are commenced" (in comparison, reference to the "insolvency law" is found in relation to the "lex fori concursus" in the chapeau provision of recommendation 31 of the Guide).[38] The secretariat notes that inclusion of rules of interpretation similar to those found in the Guide[39] and definitions of other terms, in particular Latin phrases, such as "lex rei sitae"[40] and "lex societatis," would facilitate uniform understanding and interpretation of the legislative provisions. If the Working Group chooses not to use Latin terms in the legislative provisions, the secretariat will propose corresponding paraphrases reflecting their meaning in plain language.

1. Draft legislative provision

Definitions[41]

For the purposes of [these legislative provisions]:

(a) "Lex fori concursus" means the law of the State in which the insolvency proceedings are commenced.

2. Draft commentary

1. The "lex fori concursus" should be interpreted broadly as encompassing insolvency law of the State of the opening of insolvency proceedings as well as its non-insolvency law with sufficient connection to insolvency. Sufficient connection to insolvency would be assessed on a case-by-case basis but usual examples of non-insolvency law with sufficient connection to insolvency include: (a) company law that addresses directors' obligations and liabilities in the period approaching insolvency; (b) company law that addresses pre-insolvency debt restructuring

[37] A/CN.9/1094, para. 69.
[38] A/CN.9/WG.V/WP.179, para. 15.
[39] See paras. 9 to 11 of the Glossary.
[40] Referred in the Glossary of the Guide, term (y), as "lex rei situs" and explained as the law of the State in which the asset is situated.
[41] If the legislative provisions are part of the Guide, the term will be retained in the Glossary.

procedures; (c) secured transactions law that, among other matters of relevance to insolvency, may address the treatment of pre-commencement finance in subsequent insolvency; (d) family law that may address the treatment of jointly owned assets in insolvency proceedings of individual entrepreneurs; (e) labour law that addresses workers' rights, the treatment and ranking of labour claims and handling of redundancies in case of insolvency; (f) tax and social security legislation that addresses the treatment and ranking of public debts; and (g) foreign investment law that may impose restrictions on foreign ownership of certain assets or operation of foreign investors in certain sectors of economy (which would be relevant, for example, in case of debt-equity conversions or sale of the business (or part thereof) as a going concern).

2. Where the lex fori concursus defers to the law of another State, that reference is to be interpreted as reference only to substantive internal law of that State excluding its PIL rules, i.e. renvoi is excluded. This is in line with the approaches taken in other international texts that provide for uniform PIL rules.[42] The goal of that approach is to promote certainty as regards applicable law.

3. In addition, the reference to the law of a foreign State would not encompass that State's public law, i.e. relating to the exercise of sovereign powers of a foreign State. Nevertheless, the lex fori concursus may address the treatment and ranking of foreign public claims (e.g. tax and social security claims).[43] The reference to the law of a foreign State does not encompass procedural law either since courts apply their own procedural law and do not apply any foreign rule which in their view is procedural. As discussed in [these legislative provisions] in the relevant contexts, some matters (e.g. a set-off or limitation period) may be qualified as substantive or procedural, depending on the legal systems. The [legislative provisions] point to the law that will govern those matters in insolvency proceedings.

D. Public policy exception

14. At its sixtieth session, the Working Group agreed to include a public policy exception under the terms discussed at the session.[44] Accordingly, the secretariat proposes the draft legislative provision and accompanying commentary set out below, which build on similar provisions found in UNCITRAL insolvency model laws[45] and other surveyed texts.[46]

15. The Working Group may wish to consider the expected outcome of the displacement of a foreign law: whether the lex fori concursus would apply in all instances, or the forum court would have the discretion to choose the law of a jurisdiction that has a materially greater interest than does the chosen jurisdiction or the lex fori concursus. (See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for related issues of prevailing international obligations and overriding mandatory rules not yet considered by the Working Group.)

[42] See e.g. references to the "internal law" in articles 5, 6 and 11 of the Hague Convention on the Law Applicable to Agency.

[43] See e.g. article 13(2) of MLCBI and its footnote b, as well as GEI, paras. 119–120.

[44] A/CN.9/1094, paras. 94–96.

[45] See e.g. article 6 of MLCBI and GEI, paras. 101–104; article 7 of MLIJ and GE, paras. 71–74; and article 6 of MLEGI and paras. 62–65 of its Guide to Enactment.

[46] E.g. article 93 of the UNCITRAL Model Law on Secured Transactions; article 32 of the United Nations Convention on the Assignment of Receivables in International Trade; and article 11 of the Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

1. Draft legislative provision

Public policy exception

The application of the law determined under [these legislative provisions] may be refused only if the effects of its application would be manifestly contrary to the public policy of this State.

2. Draft commentary

1. The [legislative provisions] include a public policy exception, which would aim at allowing courts in the enacting State to disapply a foreign law if applying that law would be manifestly contrary to the public policy of that State. As the notion of public policy is grounded in national law and may differ from State to State, no uniform definition of that notion is attempted. However, since the [legislative provisions] deal with matters of international cooperation, the public policy should be understood more restrictively than domestic public policy.

2. This intention is conveyed by the expression "manifestly" in the [legislative provision]. The purpose is to emphasize that public policy exception should be interpreted and applied narrowly and restrictively and invoked only under exceptional circumstances concerning matters of fundamental importance for the enacting State. The same narrow and restrictive interpretation of the exception should be followed regardless of the type of the proceeding (liquidation or reorganization).

3. The determination of public policy is to be performed in relation to the effects of the application of the foreign law designated by [these legislative provisions] in each concrete case. It is expected to be invoked where the relevant foreign rule, as applied to the facts of the case, would infringe into the security or sovereignty of the State or produce a result which departs so radically from the forum's concepts of fundamental justice that its application would be intolerably offensive to the forum's basic values (e.g. the application of the law of the State that commenced insolvency proceedings for attaining political goals or the law of the State that effectively legitimizes illegal schemes (for example, evasion of mandatorily applicable law and obligations, such as environmental, human rights and other social responsibilities)).

E. Law applicable in insolvency proceedings by default: the lex fori concursus

16. At the sixtieth session of the Working Group, no comment was made with respect to paragraph 16 and the items listed in paragraph 18 of A/CN.9/WG.V/WP.179. The secretariat thus considered that the approach suggested in those paragraphs was uncontroversial and reflected it in the draft legislative provision and accompanying commentary below.

17. The Working Group agreed to include an explicit reference to automatic termination and acceleration clauses (ipso facto clauses) in the list of items to be governed by the lex fori concursus (henceforth referred to as the "lex fori concursus list")[47] and refer in that list to the "treatment of set-off" (rather than simply "set-off" as in recommendation 31 (item i) of the Guide).[48] It agreed not to include in the lex fori concursus list references to creditors' rights after the closure of insolvency proceedings, to restructuring and to environmental damages and liability.[49] The Working Group did not discuss a suggestion to expand the lex fori concursus list with a reference to related actions (deriving from insolvency law and connected to

[47] A/CN.9/1094, para. 77.
[48] Ibid., para. 78.
[49] Ibid., paras. 81, 84 and 86.

insolvency proceedings).[50] Those outcomes are reflected in the draft legislative provision and accompanying commentary below. The issues deferred or not discussed by the Working Group in relation to the items on the lex fori concursus list are highlighted below and discussed in an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).

1. Draft legislative provision

Law applicable in insolvency proceedings by default: lex fori concursus

Except as provided otherwise in [these legislative provisions], the lex fori concursus shall apply to all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects, including:

(a) Identification of the debtors that may be subject to insolvency proceedings;

(b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement;

(c) Constitution and scope of the insolvency estate;[51]

(d) Protection and preservation of the insolvency estate [, including a stay of proceedings];[52]

(e) Use and disposal of assets;

(f) Proposal, approval, confirmation and implementation of a plan of reorganization;

(g) Avoidance of certain transactions that could be prejudicial to certain parties;[53]

(h) Treatment of contracts, including automatic termination and acceleration clauses (ipso facto clauses);[54]

(i) Treatment of set-off;[55]

(j) [Treatment of secured creditors;][56]

(k) Rights and obligations of the debtor;[57]

[50] Ibid., para. 71.

[51] There are issues in relation to this item that the Working Group deferred for further consideration (A/CN.9/1094, para. 72).

[52] The secretariat proposes adding an explicit reference to a stay of proceedings in this item for clarification, in the light of questions that arose in the Working Group as regards the scope of this item. There are issues in relation to this item that the Working Group deferred for further consideration (A/CN.9/1094, para. 73).

[53] No concern was expressed with respect to retaining this item on the lex fori concursus list but there are issues in relation to this item that the Working Group deferred for further consideration (A/CN.9/1094, paras. 74–76).

[54] Pursuant to the Working Group's agreement (A/CN.9/1094, para. 77), the secretariat added the explicit reference to ipso facto clauses using the terminology of the Guide. There are issues in relation to this item that the Working Group deferred for further consideration (ibid.).

[55] Pursuant to the Working Group's agreement (A/CN.9/1094, para. 78), the secretariat amended this item. There are issues in relation to this item that the Working Group deferred for further consideration (ibid.).

[56] There are issues in relation to this item that the Working Group deferred for further consideration. Decisions on them may affect the location and formulation of this item in the legislative provisions (A/CN.9/1094, para. 79 and A/CN.9/1088, para. 65 (c)).

[57] No concern was expressed with respect to retaining this item on the lex fori concursus list but there are issues in relation to this item that the Working Group deferred for further consideration (A/CN.9/1094, para. 80).

(l) Duties and functions of the insolvency representative;[58]

(m) Functions of the creditors and creditor committee;

(n) Treatment of claims;

(o) Ranking of claims;[59]

(p) Costs and expenses relating to the insolvency proceedings;

(q) Distribution of proceeds;

(r) Closure of the proceedings;

(s) Discharge;

[(t) Liability of directors of the debtor for actions taken when the debtor was insolvent or in the period approaching insolvency, and the cause of action relating to that liability that could be pursued by or on behalf of the debtor's insolvency estate];[60]

[(u) Related actions (deriving from insolvency law and connected to insolvency proceedings)].[61]

2. Draft commentary

1. Under the [legislative provisions], the lex fori concursus applies to all aspects of insolvency proceedings and their effects unless explicitly stated otherwise. The observed convergence of substantive insolvency rules should make the application, as a rule, of the lex fori concursus to all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects less problematic.[62]

2. The [legislative provisions] make the lex fori concursus first applicable to all aspects of the commencement, conduct, administration and closure of insolvency proceedings. Those aspects cover: (a) procedural matters (such as serving notices, convening meetings, establishing quorum, ascertaining voting rules or specifying deadlines for submission of claims);[63] and (b) all post-commencement rights, obligations and claims, i.e. those arising from the insolvency proceedings, such as claims against the insolvency representative or in relation to the post-commencement finance, realization of the insolvency estate or distribution of proceeds.

3. The [legislative provisions] make the lex fori concursus applicable also to the effects that insolvency proceedings produce, including on rights, claims and obligations that existed before the commencement of insolvency proceedings. For example, although under recommendation 4 of the Guide, a security interest effective and enforceable under law other than insolvency law will be recognized in insolvency proceedings as effective and enforceable, enforcement of security rights may be stayed under the lex fori concursus unless and until the court grants relief from the stay (see recs. 46–51 of the Guide). In addition, under recommendation 88 of the Guide, a security interest effective and enforceable under law other than the insolvency law may be subject to the avoidance provisions of the insolvency law on the same grounds as other transactions. Recommendation 3 of the Guide explicitly acknowledges that the insolvency law recognizes rights and claims arising under law

[58] Ibid.

[59] Ibid., but with reference to para. 82.

[60] There are issues in relation to this item that the Working Group deferred for further consideration. Decisions on them may affect the location and formulation of this item in the legislative provisions (A/CN.9/1094, para. 83, and A/CN.9/1088, para. 65 (e)).

[61] As noted in para. 16 above, the Working Group did not discuss this newly proposed item (A/CN.9/1094, para. 71).

[62] A/CN.9/1088, para. 86.

[63] Some matters that are considered procedural in some jurisdictions (e.g. set-off or limitation period) may be considered substantive in other jurisdictions. Courts make this determination in accordance with the law of their States, i.e. the lex fori concursus in insolvency proceedings.

other than the insolvency law, whether domestic or foreign, to the extent of any express limitation set forth in the insolvency law. Apart from a stay of proceedings and avoidance, the insolvency law may, for example, require subordination of claims (such as those of related persons (see rec. 184)). It may also prohibit enforcement of some contractual clauses (e.g. ipso facto clauses (see rec. 70)) and give some discretion to insolvency representatives as regards treatment of contracts, including their assignment notwithstanding restrictions in the contract (rec. 83), and the use and disposal of assets, including their sale free and clear of encumbrances and other interests (recs. 52–62).

(a) Identification of the debtors that may be subject to insolvency proceedings

4. Under the [legislative provisions], the lex fori concursus addresses issues of eligibility and jurisdiction and special insolvency regimes and treatment that may apply depending on different sectors of the economy, size of the debtor's business, its level of indebtedness or other criteria. It also identifies the connecting factors for establishing jurisdiction over the debtor and the commencement and conduct of insolvency proceedings.

(b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement

5. Under the [legislative provisions], the lex fori concursus determines commencement standards (whether it is the balance sheet test or cash flow test or both or something different or in addition). The lex fori concursus also specifies: (a) circumstances under which reorganization as opposed to liquidation and vice versa could be commenced; (b) whether it is the debtor only or creditors and other parties as well that will be able to apply for commencement of insolvency proceedings; and (c) procedural steps and other requirements that would need to be fulfilled by the applicant for commencement (for example, in some jurisdictions, only a certain number of creditors or creditors holding a certain value of claims can commence insolvency proceedings). That law further defines criteria for denial of the application and dismissal of the proceedings as well as rules for giving notices of application and commencement (e.g. their content and the manner of giving notices).

(c) Constitution and scope of the insolvency estate

6. Under the [legislative provisions], the lex fori concursus determines which assets of the debtor are to be included in the insolvency estate and the time of constitution of the insolvency estate. It also provides rules for the localization of assets. It also governs the treatment of post-commencement assets (e.g. assets acquired by either the debtor or the insolvency representative after commencement of insolvency proceedings and assets recovered through avoidance or other actions) and defines terms and conditions and rules for tracing, recovering and collecting the insolvency estate assets.

7. Non-insolvency law of the State of the opening insolvency proceedings, including human rights obligations, secured transactions law, family law, civil procedure law and tort law, may be applicable in the context of this item, including as regards the treatment of encumbered assets, third-party-owned assets, jointly owned assets and foreign assets. This item is thus closely linked to [another item on the lex fori concursus list –] the treatment of secured creditors since encumbered assets may or may not be made part of the insolvency estate.

[*The Working Group deferred issues related to the treatment of intellectual property (IP) rights and licences and digital assets for further consideration (A/CN.9/1094, para. 72). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*]

(d) Protection and preservation of the insolvency estate[, including a stay of proceedings]

8. Under the [legislative provisions], the lex fori concursus governs all issues related to measures for protection and preservation of the insolvency estate, including provisional measures and measures upon commencement of insolvency proceedings (e.g. a stay of proceedings, a total or limited displacement of the debtor or the debtor-in-possession regime). Those issues include conditions for imposing those measures, their duration and scope as well as grounds and procedures for seeking and granting relief from the measures and other protections.

9. Difficulties may arise in enforcing effects of the lex fori concursus on the protection and preservation of the insolvency estate across borders, in particular as regards provisional measures and secured creditors' enforcement actions with respect to the collateral and execution of rights in rem. They could be mitigated to some extent by domestic law enacting the UNCITRAL insolvency model laws that provide for recognition of foreign proceedings and recognition and enforcement of insolvency-related judgments. However, the principle underlying those texts is that recognition of a foreign proceeding does not mean extending the effects of the foreign proceeding as they may be prescribed by the law of the foreign State (i.e. the lex fori concursus). Instead, recognition of a foreign proceeding entails attaching to the foreign proceeding consequences envisaged by the law of the recognizing State.[64] For example, the scope, duration, modification, suspension or termination of stay and other relief in the recognizing State are determined by provisions of the laws of that State, not the lex fori concursus.[65] They may thus be different in the State of the opening of the insolvency proceeding and in the recognizing State. Nevertheless, States are expected to cooperate and coordinate in cross-border insolvency cases to the maximum extent possible to achieve the objectives of an effective and efficient insolvency law.[66]

10. In line with those objectives, the UNCITRAL insolvency model laws also build safeguards against interference with the effects of the lex fori concursus. For example, article 14 (e) of MLIJ envisages that recognition and enforcement of an insolvency-related judgment may be refused if this would interfere with the administration of the debtor's insolvency proceedings, including by conflicting with a stay or other order that could be recognized or enforced in the MLIJ enacting State. Those proceedings could be the proceeding to which the judgment is related or other insolvency proceedings (i.e. concurrent proceedings) concerning the same insolvency debtor. While the concept of interference is somewhat broad, the provision gives examples of what might constitute such interference. Inconsistency with a stay, for example, would typically arise where the stay permitted the commencement or continuation of individual actions to the extent necessary to preserve a claim, but did not permit subsequent recognition and enforcement of any ensuing judgment. It could also arise where the stay did not permit the commencement or continuation of such individual actions and the proceeding giving rise to the judgment was commenced after the issue of the stay (and was thus potentially in violation of the stay).[67]

[*The Working Group deferred for further consideration law applicable to effects of insolvency proceedings on enforceability of arbitration agreements, arbitral awards and ongoing arbitral proceedings (A/CN.9/1094, para. 73). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*]

(e) Use and disposal of assets

11. Under the [legislative provisions], the lex fori concursus: (a) addresses effects of insolvency proceedings on the debtor's control of the business, including total or limited displacement of the debtor or debtor-in-possession; (b) establishes terms and limits for use and disposal of the assets (e.g. creditor notifications, court approvals); (c) provides for the treatment of pre- and post-commencement finance, unauthorized transactions and transactions with related persons after commencement of insolvency

[64] GEI, para. 194.

proceedings and cause of action against a counterparty in unauthorized transactions; and (d) defines such notions as “ordinary course of business”, “related persons”, etc.

12. Non-insolvency law of the State of the opening of insolvency proceedings may apply to the use and disposal of assets, for example: the family law may apply to the use and disposal of assets co-owned by the debtor with family members; laws prohibiting or restricting foreign ownership in certain sectors of the economy will determine whether disposal of assets to foreigners is allowed and if so, under which conditions; secured transactions law may apply to the use and disposal of encumbered assets and their methods of sale; environmental and other law may address conditions for relinquishment of assets (e.g. environmentally dangerous assets or assets hazardous to public health and safety) and who might be entitled to claim the relinquished assets.

13. Difficulties may arise in enforcing effects of the lex fori concursus on the use and disposal of the insolvency estate across borders, for example immovable property or payments by the debtor in the ordinary course of business, the latter not being understood uniformly across jurisdictions. As noted above in the context of the protection and preservation of the insolvency estate[, including a stay of proceedings], States would be expected to cooperate and coordinate in cross-border insolvency cases to the maximum extent possible, including in the administration and supervision of the debtor’s assets and affairs.

(f) Proposal, approval, confirmation and implementation of a reorganization plan

14. Under the [legislative provisions], the lex fori concursus addresses the nature and form of the plan; when it is to be proposed; who is permitted to prepare a plan; its content; its approval by creditors; treatment of dissenting creditors; whether court confirmation of the plan is required; the effect of the plan; and its implementation.

15. Non-insolvency law of the State of the opening of insolvency proceedings may be applicable, for example, to: (a) debt-to-equity conversions; (b) involvement of employees and trade unions in reorganization, especially if redundancies or modifications in collective bargaining agreements are expected; (c) foreign investment and foreign exchange controls; and (d) protection of confidential or commercially sensitive information.[68]

(g) Avoidance of certain transactions that could be prejudicial to certain parties

[*See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for issues deferred for further consideration.*]

(h) Treatment of contracts, including automatic termination and acceleration clauses (ipso facto clauses)

16. Under the [legislative provisions], the lex fori concursus determines: (a) qualification of contracts; (b) the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations (henceforth referred to as “continued contracts”), in particular the power of the insolvency representative to decide whether to continue performance, reject or assign such contracts and the time when those powers could be exercised and the time from which rejection will be effective retroactively; (c) whether the insolvency law overrides automatic termination and acceleration clauses (also known as “ipso facto clauses”) or they are left to be addressed under general contract law and, if it does, the power of the insolvency representative to reinstate contracts terminated just before the commencement of insolvency proceedings to avoid the application of those overriding provisions of the insolvency law; (d) exceptions to the insolvency

[65] GEI, para. 38.
[66] See e.g. chapter IV of MLCBI and chapter 2 of MLEGI.
[67] GE, para. 107.
[68] General contract law and thus PIL rules outside the scope of [these legislative provisions] may apply to the implementation of the reorganization plan in those jurisdictions that provide for the closure of insolvency proceedings after approval (or confirmation where required) of the plan.

representative's powers in the preceding (b) and (c); and (e) the treatment of post-commencement contracts.

17. Non-insolvency law of the State of the opening of insolvency proceedings may apply to, for example, qualification of contracts, calculation of damages and treatment of government contracts. Under [these legislative provisions], certain types of contract (e.g. in a payment and settlement system or in a [regulated] financial market) and some aspects of labour contracts (e.g. their rejection or continuation) fall under an exception to the lex fori concursus.

[*In relation to this item, the Working Group deferred for further consideration law applicable to effects of insolvency proceedings on contracts relating to immovable property (A/CN.9/1094, para. 77). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*].

(i) Treatment of set-off

[*See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for issues deferred for further consideration in relation to this item*.]

(j) [Treatment of secured creditors]

[*See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for issues deferred for further consideration in relation to this item.*]

(k) Rights and obligations of the debtor

18. As noted above, under the [legislative provisions], the lex fori concursus addresses whether the debtor-in-possession regime or the total or limited displacement of the debtor will be in place. It also addresses conditions for conversion of one regime to another and rights and obligations of the debtor in each regime and specific case. This item is linked to other items on the lex fori concursus list, in particular those that address the use and disposal of the assets of the insolvency estate, and in that context also to the definition of "ordinary course of business" and treatment of unauthorized transactions.

19. Non-insolvency laws may be applicable to this item, in particular, if the debtor is a natural person (in such case, human rights instruments may address the extent of limitations that may be imposed on the freedom of movement by the debtor, disclosure of the debtor's private correspondence and other personal data protection aspects). There may also be a close interaction of insolvency law with civil and criminal procedure law, for example as regards disclosure, examination, search and seizure warrants. In the cross-border insolvency context, the Hague Service and Evidence Conventions may also be applicable.

[*The Working Group deferred some issues related to this item for further consideration, noting their relevance to concurrent proceedings (A/CN.9/1094, para. 80). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*]

(l) Duties and functions of the insolvency representative

20. Under the [legislative provisions], the lex fori concursus governs the mechanisms for selection, appointment, removal and replacement of the insolvency representative, including the insolvency representative appointed on an interim basis; a method of calculating renumeration for insolvency representative services; the role of the court and creditors in oversight of the work done by the insolvency representative; and liability of the insolvency representative. With respect to the latter, non-insolvency laws may be applicable especially if the insolvency representative is subject to certain professional standards and regulations (e.g. accountants, lawyers, etc.). Apart from general duties, functions and obligations of the insolvency representative, the lex fori concursus determines the authority conferred upon the insolvency representative in a specific case, which may include the authority to represent the proceeding across borders (article 5 of MLCBI) or to act in another State in respect of an insolvency-related judgment issued in the State of the opening of insolvency proceedings (article 5 of MLIJ), cooperate and directly

communicate with foreign courts and representatives (article 26 of MLCBI) and give undertakings with respect to the treatment of foreign creditors' claims (see articles 28–32 of MLEGI).

21. In performing their functions across borders, insolvency representatives may be assisted by the domestic law of foreign States, including international treaties and other agreements to which those States may be parties. For example, in those States that enacted the UNCITRAL insolvency model laws, the insolvency representative may enjoy expedited and direct access to the foreign courts without the need to meet formal requirements such as licences or consular action and without subjecting itself and the foreign proceeding to the jurisdiction of the foreign court for any purpose other than the application (see articles 9 and 10 of MLCBI).[69] The insolvency representative would have standing to request assistance under laws of the enacting State[70] and the commencement of an insolvency proceeding if the domestic conditions for commencing such a proceeding are met (article 11 of MLCBI).[71] Upon application for recognition of the foreign proceeding, the foreign representative can request provisional relief (article 19 of MLCBI). Upon recognition of the foreign proceeding, it may request an extension of that relief or granting additional relief and would have standing also to make petitions, requests or submissions concerning issues such as protection, realization or distribution of assets of the debtor or cooperation with the foreign proceeding (see article 12 of MLCBI). It may also request relief to initiate actions under the law of the recognizing State to avoid or otherwise render ineffective legal acts detrimental to creditors (article 23 of MLCBI) and to intervene in proceedings instituted by or against the debtor (article 24 of MLCBI).

22. Those provisions are limited to providing standing and do not vest the foreign representative with specific powers or rights or govern the fate of actions that it would decide to undertake.[72] These matters would depend on the foreign law and courts (see e.g. articles 5 of MLCBI and MLIJ). For example, if the insolvency representative applies for relief, it is the court in the recognizing State that would decide which relief to grant, and the insolvency representative will be subject to conditions that the court may order in connection with relief granted (see e.g. articles 19, 21 and 22 of MLCBI). They may impose limitations on the powers that the insolvency representative otherwise enjoys under the lex fori concursus. The usual limitations found relate to the use and disposal of immovable property of the debtor located abroad, removal of property from the foreign jurisdiction and the use of coercive measures (e.g. for obtaining evidence, gaining access to business books or records of the debtor). In some jurisdictions, however, the lex fori concursus may be seen as the source of the foreign representative's powers while the law of the recognizing State may be seen as the source of authority for implementing or enforcing those powers locally, even if some of those powers may be unfamiliar to the law of the recognizing State or that law may be silent about them, as long as those powers are not prohibited by the domestic law and subject to adequate protection of creditors and other interested persons. Those jurisdictions grant different types of relief to the foreign representative not limiting them to those available to a local insolvency representative under their laws.

[*The Working Group deferred some issues related to this item for further consideration, noting their relevance to concurrent proceedings (A/CN.9/1094, para. 80). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*]

(m) Functions of the creditors and creditor committee

23. The item is closely linked to the preceding two items that address rights and obligations of the debtor and duties and functions of the insolvency representative. Alongside those issues, the lex fori concursus governs mechanisms and the level of creditor participation in insolvency proceedings, in particular whether and, if so,

[69] GEI, paras. 108–111.
[70] See article 7 of MLCBI and article 6 of MLIJ; GEI, para. 105 and GE, para. 70.
[71] GEI, paras. 112–114.
[72] GEI, paras. 21 (d), 115–117, 197 and 200–208; GE, para. 69.

when, creditor meetings are to be convened or a creditor committee is to be established and the role of those bodies in the oversight of insolvency proceedings; eligibility to participate in those bodies; the matters that would require creditor approval; a threshold for the approval; and mechanisms for seeking the approval and ascertaining that the approval was obtained.

24. The item is closely linked also to the next item (treatment of claims), since under the lex fori concursus creditors may be able to assume certain functions in insolvency proceedings (e.g. participation in creditor meetings) after submitting claims while the exercise of other creditor functions (e.g. approval of a reorganization plan) may be conditioned upon verification and admission of claims.

(n) Treatment of claims

25. Under the [legislative provisions], the lex fori concursus addresses: (a) which creditors should be required to submit claims, types of claim that should be submitted, excluded claims and claims subject to special treatment (e.g. claims by related persons); (b) the procedure for submission, verification and admission of claims, including the deadline for submission of claims, to whom they should be submitted and formalities for submission of foreign claims;[73] (c) consequences of failure to submit a claim; (d) rules for valuation of claims; (e) treatment of disputed claims (who can dispute and which body adjudicates them); (f) effect of submission and admission of claims; (g) review of decisions related to claims (e.g. their rejection or special treatment); (h) treatment of post-commencement claims; (i) treatment of claims upon conversion; (j) accrual and payment of interest; and (k) formal requirements for undertakings as regards the treatment of foreign claims that the insolvency representative may be authorized to give to foreign creditors in order to avoid opening parallel proceedings, including the form and language of undertakings, with respect to which claims undertakings could be given and procedures for seeking approval, review and enforcement of those undertakings.[74] [Notwithstanding the exception to the lex fori concursus for some aspects of labour contracts [and labour relationships] in [these legislative provisions], the lex fori concursus determines the status and treatment of labour claims.]

26. This item raises issues of relevance to the items on the treatment of secured creditors and set-off as well as on the implementation of a reorganization plan since the plan usually addresses the treatment of creditor claims and may also stipulate the applicable law. Consequently, different non-insolvency laws may be applicable, such as secured transactions law in relation to the treatment of secured creditors' claims. In addition, criminal law may interact with the insolvency law in relation to the treatment of false claims. International conventions, such as the Apostille Convention, may be applicable to submission, verification and admission of foreign claims. Special rules may apply to the treatment of (foreign) public claims.

(o) Ranking of claims

27. Under the [legislative provisions], the lex fori concursus addresses the order in which claims will be satisfied from the estate, including claims of the insolvency representative, claims arising after commencement of insolvency proceedings and administrative costs and expenses. It specifies the classes of creditors that will be affected by the insolvency proceedings and the treatment of those classes in terms of priority and distribution. It may provide for subordination of certain types of claim, for example those of related persons (subordination by law) as well as conditions for subordination by the court ("equitable subordination") and limits for subordination by agreement ("contractual subordination", e.g. in a reorganization plan or in pre-commencement subordination agreements between interested parties). [Notwithstanding the exception to the lex fori concursus for some aspects of labour

[73] See articles 13 and 14 of MLCBI in this respect and accompanying commentary in paras. 118–126 of GEI.

[74] See e.g. article 28–32 of MLEGI and article 36 of the EIR recast.

contracts [and labour relationships] in [these legislative provisions], the lex fori concursus determines also the ranking of labour claims.]

28. Different non-insolvency laws may apply to the priority of claims in insolvency proceedings generally and in any given insolvency proceeding specifically, including the labour law that may encompass international labour conventions for State parties to those conventions;[75] tax law; secured transactions law; and tort law. Special rules may apply to the ranking of (foreign) public claims.

29. Difficulties may arise in achieving recognition of the effects of the lex fori concursus on the ranking of claims across borders, especially for public claims (see article 13.2 of MLCBI and commentary thereto).

30. The lex fori concursus may allow insolvency representatives to give, and domestic courts to approve, undertakings as regards the treatment of foreign claims similar to those envisaged in articles 28–32 of MLEGI so as to avoid opening parallel proceedings. Where such an undertaking was given and approved, those claims would be treated in accordance with the treatment they would receive in an unopened parallel proceeding.

[*The Working Group deferred some issues related to this item for further consideration, noting their relevance to concurrent proceedings (A/CN.9/1094, para. 82). See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1).*]

(p) Costs and expenses relating to the insolvency proceedings

31. Under the [legislative provisions], the lex fori concursus determines criteria relating to the allowance of administrative expenses, assessment of expenses, the role of the court in approval of expenses and distribution of costs and expenses relating to insolvency proceedings, in particular which expenses would be covered from the insolvency estate, which may need to be covered by creditors or other parties in interest and for which the insolvency representative may be personally liable. The lex fori concursus also determines the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceeding, in particular whether in such cases the application will be denied or alternative mechanisms for covering costs of administering insolvency proceedings will be used and if so, which ones. It also determines rules related to third-party funding.

(q) Distribution of proceeds

32. Under the [legislative provisions], the lex fori concursus establishes rules for distribution of proceeds, which may be different for liquidation and reorganization, and for steps to be taken if it is determined that no distribution can be made.[76]

(r) Closure of the proceedings

33. Under the [legislative provisions], it will be the lex fori concursus that will address the manner in which a proceeding is to be concluded and closed, the prerequisites for closure, the procedures to be followed and whether conversion constitutes formal closing of the proceeding being converted. The lex fori concursus specifies the party that can apply to close the proceedings; whether the application and the decision to close should be publicized; and whether creditors could be heard on the application.

(s) Discharge

34. Under the [legislative provisions], the lex fori concursus determines: (a) general conditions for discharge, including debts that are not dischargeable; (b) procedures

[75] E.g. the ILO Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173).

[76] General contract law, and thus PIL rules outside the scope of [these legislative provisions], would apply to the distribution of proceeds in reorganization proceedings if the proceedings close after approval (or confirmation where required) of the plan and the distribution of proceeds takes place in accordance with the distribution rules contained in the plan.

and preconditions for discharge, which may be different in liquidation and in reorganization, including the date from which discharge will be effective; and (c) criteria for denying discharge and revoking discharge granted.

35. Difficulties may arise with the cross-border recognition and enforcement of effects of the lex fori concursus on discharge of debts governed by another law.

[(t) Liability of directors of the debtor for actions taken when the debtor was insolvent or in the period approaching insolvency, and the cause of action relating to that liability that could be pursued by or on behalf of the debtor's insolvency estate]

[*See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for issues deferred for further consideration in relation to this item*.]

[(u) Related actions (deriving from insolvency law and connected to insolvency proceedings)]

[*See an addendum to this note (A/CN.9/WG.V/WP.183/Add.1) for issues raised by this newly proposed item. The Working Group did not consider it.*]

F. Exception to the lex fori concursus: labour contracts [and labour relationships]

18. At the sixtieth session of the Working Group, the prevailing view was that the legislative provisions on the law applicable to labour contracts in insolvency proceedings should unconditionally provide that the grounds on which the labour contract could be rejected, continued or modified after the commencement of insolvency proceedings ought to be governed by the law applicable to the labour contract, which would encompass the insolvency law.[77] A number of points were made with respect to that approach, including that the treatment and ranking of employment claims would not be subject to that exception since they would undoubtedly fall under the lex fori concursus.[78]

19. The Working Group may wish to consider the draft legislative provision and accompanying commentary below, which reflect the results of those deliberations and the secretariat's expert consultations with a representative of the International Labour Organization with respect to those draft provisions. During those consultations, a suggestion was made to keep reference to labour contracts as opposed to employment contracts in the light of the international labour treaty framework. It was also suggested to consider expanding that reference to labour relationships in the light of evolutions in the labour market pointing to the use of various mechanisms beyond traditional labour contracts for engaging labour.[79]

20. The Working Group may wish to consider whether references to "rejection, continuation and modification of labour contracts" should be retained in the draft legislative provision or replaced with another term[80] in the light of issues raised in the draft commentary. In particular, reference to "modification" may be very broad since modification may concern any clause in a labour contract, not only on rejection or continuation of the contract, including clauses that in accordance with these legislative provisions may fall under the lex fori concursus. The Working Group may also wish to consider consequences of displacement of a foreign law under the public policy exception (see section D above).

[77] A/CN.9/1094, para. 91.
[78] A/CN.9/1094, paras. 88–93.
[79] See e.g. the ILO Employment Relationship Recommendation, 2006 (No. 198).
[80] See in that respect article 13 of the EIR recast.

1. Draft legislative provision

Exceptions to the lex fori concursus

Law applicable to labour contracts [and labour relationships]

1. The effects of insolvency proceedings on [rejection, continuation and modification of] labour contracts [and labour relationships] shall be governed by the law applicable to the contract [or relationship].

2. [Notwithstanding paragraph 1 of this [legislative provision], the treatment and ranking of labour claims and avoidance actions that may be taken with respect to a labour contract [or labour relationship] shall be governed by the lex fori concursus.]

2. Draft commentary

1. According to paragraph 1 of this [legislative provision], the effects of insolvency proceedings on [rejection, continuation and modification of] labour contracts [and labour relationships] are to be governed by the law applicable to those contracts [and labour relationships]. Reference to that law intends to encompass the labour law, the insolvency law and any other law that may be relevant to [rejection, continuation and modification of] labour contracts [or labour relationships].

2. The scope of that paragraph is limited to the rejection, continuation and modification of labour contracts [and labour relationships] after commencement of insolvency proceedings. [For avoidance of doubt, paragraph 2 of this [legislative provision] makes it clear that the treatment of labour claims and ranking of labour claims (see the relevant items above) are not covered by the exception found in paragraph 1. The lex fori concursus (if different from the law applicable to the labour contract [or labour relationship], henceforth referred to as the "foreign lex fori concursus") remains applicable to them. The same applies to qualification of a contract [or labour relationship] as a labour contract [or labour relationship] and avoidance of labour contracts or any parts thereof (e.g. unreasonable remuneration packages as a consequence of modification of labour contracts [or labour relationships] between the debtor and chief executive officers or other managers in the period approaching insolvency) (see the relevant item above).]

3. The rationale for the exception to the application of the lex fori concursus found in the [legislative provision] is that labour contacts and relationships raise many socioeconomic policy considerations. For that reason, States usually devise a special regime for the treatment of issues arising from labour contracts [and labour relationships] in insolvency. In some insolvency laws, maintaining continuity of employment, for example, is priority to other objectives of insolvency proceedings, such as maximization of value of the estate for the benefit of all creditors. This may be evidenced by a focus on sale of the business as a going concern with the transfer of existing employment obligations, as opposed to liquidation or reorganization where those obligations may be altered or terminated. Mandatory provisions of law, including those found in international treaties,[81] may: protect workers against unfair dismissal and discrimination; provide for a financial safety net for workers; impose restrictions on the rejection or modification of labour contracts[82] and conditions for implementing redundancies (including an advance notice to relevant State authorities); and ensure workers' rights to be properly informed about all matters arising from insolvency proceedings affecting their employment status and entitlements. Different regimes may apply in case of liquidation and reorganization. For example, in some States, employees follow the business in case of sale as a going concern in both liquidation and reorganization, in others only in reorganization.

[81] See e.g. the ILO Termination of Employment Convention, 1982 (No. 158).

[82] See recommendation 71 of the Guide and accompanying commentary.

4. The [legislative provision] aims to reduce the risk of uncertainties or inconsistencies with respect to [the rejection, continuation and modification of] labour contracts [and labour relationships] in insolvency proceedings, which increases if the insolvency effects of the foreign lex fori concursus apply to those matters. Providing more certainty and consistency to workers' expectations is justified because workers usually have a relatively weaker bargaining position than their employer, especially where no collective bargaining agreements are in place. In addition, workers may be unfamiliar with insolvency proceedings and protections accorded to them in case of financial difficulties of their employer and remain uninformed and unaware of plans related to their employment status. Insolvency proceedings may be used to erode their protections, for example, where the business is to be sold as a going concern and the elimination of onerous employment contracts could increase the sale price, or where the debtor uses an application for insolvency as a means of obtaining relief from onerous obligations arising from labour contracts [or labour relationships].

5. Nevertheless, the approach taken in the [legislative provisions] may remove the flexibility that may be desired and necessary for preserving the operation of the business, employment and guaranteeing salaries. Retaining such flexibility may in particular be desirable in reorganization. It may also intervene in the efficient conduct and administration of insolvency proceedings where the debtor has workers to whom different arrangements for [rejection, continuation and modification of] labour contracts [or labour relationships] apply. The need to assess all those different arrangements would arise, for example, if the debtor has workers in different jurisdictions where the local labour law is mandatorily applicable to [rejection, continuation and modification of] labour contracts [or labour relationships]. Such need may also arise where freedom to choose the law applicable to labour contracts exists. That freedom is usually accompanied by safeguards to protect workers from the adverse consequences of their own, but potentially coerced or uninformed, agreement with the choice of law clauses in their labour contracts. Those safeguards may vary across jurisdictions (for example, with respect to non-competition clauses) but usually include that a choice of law may not have the result of depriving workers of the protection afforded to them by provisions that cannot be derogated from by agreement under the law that, in the absence of choice, would have been applicable (which for many States would include provisions of international labour treaties binding on them as well as constitutional guarantees) or that would have more connection with the labour contract [or relationship].

6. However, without that exception, the effects of insolvency proceedings on [rejection, continuation and modification of] labour contracts [and labour relationships] may end up being governed by the law of insolvency proceedings that may perform only a coordinating role with no or very distant connection to a labour contract [or relationship] in question. This would necessitate reconciling protection afforded to workers under the foreign lex fori concursus, the chosen law, where applicable, and the law that would have been mandatorily applicable in any event. Envisaging the combination or hierarchy of applicable laws may be another solution but, while preserving flexibility, it may also impede the efficient conduct and administration of insolvency proceedings since courts would be expected to compare implications of the application of various labour regimes.

7. The public policy exception would allow the court to displace the application of a foreign law that would be manifestly contrary to the public policy of its State (e.g. that effectively legitimizes modern slavery, etc.). [*Consequences of such displacement may need to be explained (see section D above).*]