

Session 2

Model Law or Convention on Selected International Insolvency Issues

Min Han

It is great honor for me to have this opportunity to speak as a panelist at the prestigious Colloquium organized by the UNCITRAL. I would like to address harmonization of the choice of law rules in the cross-border insolvency.

1. (Necessity for harmonization)

First, I would like to address the necessity for international harmonization

- Although international efforts have been made to harmonize the choice of law rules, it appears that such efforts have not yet extended to the harmonization of the choice of law rules applicable in the context of insolvency proceedings.
- The UNCITRAL Legislative Guide has recognized the importance of the legislation on the choice of law rules which determine the so-called “insolvency effect” on the treatment of the rights and claims in the insolvency proceedings. The Legislative Guide recommends that insolvency laws adopt the principle of *lex fori concursus* with certain exceptions.
- It seems, however, that many jurisdictions do not yet have sufficient statutory basis or judicial precedents for such choice of law rules, although the insolvency laws of some jurisdictions, including the EU Insolvency Regulation, have such rules.
- If the harmonization could be made to the extent practicable on important matters, it would be quite helpful in enhancing legal certainty and predictability in international trades. The harmonization may, in some respects, be helpful in reducing the global systemic risk as well.

- The efforts of the UNCITRAL Model Law for procedural harmonization in the recognition and enforcement of foreign insolvency proceedings would become more effective with the harmonization of the choice of law rules.
- So, I believe that it is time to consider introducing a higher level of international arrangement or commitment upgraded from the current recommendations made in the Legislative Guide.
- Although an international convention on the choice of law rules would be desirable, it seems that international convention might be a challenging task at the moment in view of the experiences in the adoption of the UNCITRAL Model Law. A model law, which would provide some flexibility in adoption and local implementation, may be more realistic.

2. (Improvements to the recommendations made by the Legislative Guide)

Secondly, I would like to address the current recommendations of the Legislative Guide and the improvements that may be required.

- The Legislative Guide recommends that in principle, *lex fori concursus*, namely, the law of the state where the insolvency proceeding is commenced, should apply to the effects of the insolvency proceedings on the rights and claims.

(a) (Payment and Settlement System)

- The Legislative Guide, however, recommends that the insolvency effect on the rights and obligations of the participants to a payment or settlement system or regulated financial market should be governed solely by the law applicable to that system or market. Recently, CCP (namely, Central Counterparty), a clearing and settlement system for OTC derivatives transactions has newly been established by G-20 member countries, including South Korea. Therefore, this exception for the protection of the finality of payment and netting in the recognized payment and settlement systems has become particularly more important to support the international efforts that have been made to

reduce the systemic risk since the occurrence of the global financial crisis.

(b) (Secured claims)

- In addition, the Legislative Guide illustrates certain additional exceptions for the principle of *lex fori concursus*, such as security interests, labor contracts and avoidance provisions, etc.
- Of such exceptions, the treatment of secured claims may be the most fundamental one. Whether and to what extent the effect of the insolvency proceeding of a state extends to the collateral located outside of that state is crucial issue in cross-border insolvency.
- Under the UNCITRAL Model Law, secured claims and rights in rem are carved out from the application of the so-called hotchpot rule. However, it seems that the Guide to Enactment and Interpretation on the Model Law does not elaborate on the rationale for such carve-out. Is it because the effect of a domestic insolvency proceeding does not extend to the security interest on collateral which is located in a foreign country? Or, should secured claims be excluded from the hotchpot rule because the *pari passu* rule cannot apply to secured claims and to what extent the secured claims are satisfied depends in large measure on the value of the collateral itself? To those jurisdictions where the holders of secured claims are granted a right of separation in all types of insolvency proceedings, it may be strange and considered unfair and not feasible to include secured claims in the hotchpot rule. However, in the jurisdictions where secured claims are subject to the rehabilitation proceedings which are similar to the U.S. Chapter 11 proceedings, there may be arguments that the hotchpot rule should apply to secured claims for the fair and equal treatment among secured creditors.
- Personally, I believe that the hotchpot rule should not be applied to such secured claims. However, if a clear rationale is given, it would be better. Therefore, I believe that It would be desirable to have a consensus on the choice of law rules applicable to the insolvency effect on the secured claims and that such consensus be reflected in the UNCITRAL Model Law.

(c) Next, I would like to discuss the choice of law rules applicable in the situation where there are only foreign proceedings or where there are both domestic and foreign proceedings.

- It seems that the above-mentioned recommendations of the Legislative Guide address only the application of lex fori concursus in a domestic insolvency proceeding. In other words, the Guide deals with the issue of whether and how the rights or claims governed by a foreign law would be affected by the domestic insolvency proceeding.
- In this regard, I would like to suggest that the current recommendations of the Legislative Guide be expanded to cover (i) the situation where there are only one or more foreign insolvency proceedings as well as (ii) the situation where there are both domestic and foreign insolvency proceedings.
- Although it may be difficult to reach consensus on all aspects of such rules, it would be worthwhile discussing the related issues and pursuing harmonization to the extent practicable.

3. (Procedures for recognition of the insolvency effect of a foreign insolvency proceeding, particularly the effect of the discharge)

- It appears that in most cases, the recognition and enforcement of the insolvency effect deriving from the forum state would likely be achieved by obtaining the recognition of the foreign insolvency proceeding and subsequently obtaining additional reliefs in another country which has adopted the UNCITRAL Model Law. One example may be the Qimonda A.G. case which will probably be discussed later in the Colloquium. For effective harmonization of the choice of law rules, therefore, it may be considered that the UNCITRAL Model Law specifically provides for certain procedural matters (including the expansion of available reliefs) required for the recognition of the insolvency effect by a non-forum state.
- Lastly, I would like to discuss the issues involving the recognition of the effect of discharge. I would like to suggest for consideration that the UNCITRAL Model Law include provisions for the recognition of the discharge effected in or relating to a

foreign insolvency proceeding for the following reasons:

(Issues)

- According to the choice of law rules suggested by the Legislative Guide, the effect of the discharge is governed by the law of the state where the related insolvency proceeding takes place (namely, *lex fori concursus*). However, the effect of discharge would not be automatically recognized by a foreign country merely by applying such choice of law rule.
- Then, how could the discharge effected in a foreign state be recognized in another country? For instance, after the close of a foreign proceeding, if a creditor attempts to enforce or otherwise exercise (e.g., by a set-off) discharged claims in a state other than the state of insolvency proceeding (i.e., the forum state), how could the debtor or any other interested party prohibit or deny such enforcement or exercise of discharged claims?
- It seems that the Model Law offers reliefs to support a foreign insolvency proceeding if such proceeding is still pending and if the insolvency representative of such proceeding petitions for recognition and reliefs. Further, it appears that the reliefs available under the Model Law do not encompass the recognition of substantive law matters, such as the discharge.
- In South Korea, recently the Supreme Court held that the discharge effected by a foreign court's decision in a foreign proceeding could be recognized in Korea if such decision meets the requirements for recognition of a foreign court's ordinary judgment in Korea. To my knowledge, there are scholarly views in Japan taking the same position although there is no Japanese court precedent on point.
- This approach may be inevitable if and to the extent the current Model Law does not provide for sufficient measures for the recognition of discharge effected in a foreign proceeding.
- However, the above approach seems to have the following two problems, among others:

- (i) Firstly, local law requirements for recognition of a foreign judgment (e.g., requirement for reciprocity) may be stricter than, or different from those for recognition of a foreign insolvency proceeding under the Model Law. As a result, the discharge, which would be one of the core elements for harmonization of cross-border insolvency, would be governed by different rules outside of the Model Law.
- (ii) Secondly, if the discharge is made by virtue of statutory provisions without the need for a court decision or is made by an order of an administrative authority, it is not clear how the effect of the discharge could be recognized.

(Suggestion)

- I would like to suggest for consideration that the Model Law provisions be expanded to encompass the procedures and requirements for the cross-border recognition of the discharge. For instance, such recognition of the discharge may be petitioned before or after the close of the foreign insolvency proceeding and by the insolvency representative or the debtor, as the case may be, and possibly, by an interested party. Once recognized, the effect of the discharge will be respected in any legal proceedings of such state.

Thank you.