

# UNCITRAL Yearbook

Volume XXXIV A: 2003



UNITED NATIONS



UNITED NATIONS COMMISSION ON  
INTERNATIONAL TRADE LAW

# UNCITRAL Yearbook

Volume XXXIV A: 2003



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## NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

The footnote numbering follows that used in the original documents on which this *Yearbook* is based. Any footnotes added subsequently are indicated by lower-case letters.

Changes of and additions to wording that appeared in earlier drafts of conventions, model laws and other legal texts are in italics, except in the case of headings to articles, which are in italics as a matter of style.

Volume XXXIV A contains the introduction, part one and chapters I-III of part two. Chapters IV-X of part two and the part three annexes are in volume XXXIV B.

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## INTRODUCTION

This is the thirty-fourth volume in the series of *Yearbooks* of the United Nations Commission on International Trade Law (UNCITRAL).<sup>1</sup>

The present volume consists of three parts. Part one contains the Commission's report on the work of its thirty-sixth session, which was held in Vienna, from 30 June to 11 July 2003, and the action thereon by the United Nations Conference on Trade and Development (UNCTAD) and by the General Assembly.

In part two most of the documents considered at the thirty-sixth session of the Commission are reproduced. These documents include reports of the Commission's Working Groups as well as studies, reports and notes by the Secretary-General and the Secretariat. Also included in this part are selected working papers that were prepared for the Working Groups.

Part three contains the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects, the corresponding Summary Records, bibliography of recent writings related to the Commission's work, a list of documents before the thirty-sixth session and a list of documents relating to the work of the Commission reproduced in the previous volumes of the *Yearbook*.

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<sup>1</sup>To date the following volumes of the *Yearbook of the United Nations Commission on International Trade Law* (abbreviated herein as *Yearbook* [year]) have been published:

<i>Volume</i>	<i>Years covered</i>	<i>United Nations publication Sales No.</i>
I	1968-1970	E.71.V.1
II	1971	E.72.V.4
III	1972	E.73.V.6
III Suppl.	1972	E.73.V.9
IV	1973	E.74.V.3
V	1974	E.75.V.2
VI	1975	E.76.V.5
VII	1976	E.77.V.1
VIII	1977	E.78.V.7
IX	1978	E.80.V.8
X	1979	E.81.V.2
XI	1980	E.81.V.8
XII	1981	E.82.V.6
XIII	1982	E.84.V.5
XIV	1983	E.85.V.3
XV	1984	E.86.V.2
XVI	1985	E.87.V.4
XVII	1986	E.88.V.4
XVIII	1987	E.89.V.4
XIX	1988	E.89.V.8
XX	1989	E.90.V.9
XXI	1990	E.91.V.6
XXII	1991	E.93.V.2
XXIII	1992	E.94.V.7
XXIV	1993	E.94.V.16
XXV	1994	E.95.V.20
XXVI	1995	E.96.V.8
XXVII	1996	E.98.V.7
XXVIII	1997	E.99.V.6
XXIX	1998	E.99.V.12
XXX	1999	E.00.V.9
XXXI	2000	E.02.V.3
XXXII	2001	E.04.V.4
XXXIII	2002	E.05.V.13



*Part One*

**REPORT OF THE COMMISSION  
ON ITS ANNUAL SESSION;  
COMMENTS AND ACTION THEREON**



# THE THIRTY-SIXTH SESSION (2003)

## A. Report of the United Nations Commission on International Trade Law on its thirty-sixth session (Vienna, 30 June-11 July 2003) (A/58/17) [Original: English]

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## I. INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law (UNCITRAL) covers the thirty-sixth session of the Commission, held in Vienna from 30 June to 11 July 2003.

2. Pursuant to General Assembly resolution 2205 (XXI) of 17 December 1966, the report is submitted to the Assembly and also for comments to the United Nations Conference on Trade and Development.

## II. ORGANIZATION OF THE SESSION

### A. Opening of the session

3. UNCITRAL commenced its thirty-sixth session on 30 June 2003.

### B. Membership and attendance

4. The General Assembly, in its resolution 2205 (XXI), established the Commission with a membership of

29 States, elected by the Assembly. By its resolution 3108 (XXVIII) of 12 December 1973, the Assembly increased the membership of the Commission from 29 to 36 States. The current members of the Commission, elected on 24 November 1997 and 16 October 2000, are the following States, whose term of office expires on the last day prior to the beginning of the annual session of the Commission in the year indicated:<sup>1</sup> Austria (2004), Benin (2007), Brazil (2007), Burkina Faso (2004), Cameroon (2007), Canada (2007), China (2007), Colombia (2004), Fiji (2004), France (2007), Germany (2007), Honduras (2004), Hungary (2004), India (2004), Iran (Islamic Republic of) (2004), Italy (2004), Japan (2007), Kenya (2004), Lithuania (2004), Mexico (2007), Morocco (2007), Paraguay (2004), Romania (2004), Russian Federation (2007), Rwanda (2007), Sierra Leone (2007), Singapore (2007), Spain (2004), Sudan (2004), Sweden (2007), Thailand (2004), the former Yugoslav Republic of Macedonia (2007), Uganda (2004), United Kingdom of Great Britain and Northern Ireland (2007), United States of America (2004) and Uruguay (2004, alternating annually with Argentina).

5. With the exception of Benin, Fiji, Honduras, Hungary, Romania, Sierra Leone and Uganda, all the members of the Commission were represented at the session.

6. The session was attended by observers from the following States: Algeria, Antigua and Barbuda, Argentina, Australia, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Costa Rica, Czech Republic, Ecuador, Finland, Gabon, Indonesia, Lebanon, Libyan Arab Jamahiriya, Madagascar, Nigeria, Panama, Peru, Philippines, Poland, Qatar, Republic of Korea, Serbia and Montenegro, Slovakia, Switzerland, Tunisia, Turkey, Ukraine, Venezuela and Yemen.

7. The session was also attended by observers for the following international organizations:

(a) United Nations system: World Bank and International Monetary Fund;

(b) Intergovernmental organizations: Common Market for Eastern and Southern Africa and International Institute for the Unification of Private Law (Unidroit);

(c) Non-governmental organizations invited by the Commission: American Bar Association, American Bar Foundation, Arab Union of International Arbitration, Cairo Regional Centre for International Commercial Arbitration, Center for International Legal Studies, Comité maritime international, European Lawyers' Union, Groupe de réflexion sur l'insolvabilité et sa prévention (GRIP 21), International Bar Association, Inter-Pacific Bar Association, Institute of International Banking Law and Practice, International Union of Latin Notaries, Society for World-

<sup>1</sup>Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 19 were elected by the Assembly at its fifty-second session, on 24 November 1997 (decision 52/314), and 17 were elected by the General Assembly at its fifty-fifth session, on 16 October 2000 (decision 55/308). By its resolution 31/99 of 15 December 1976, the Assembly altered the dates of commencement and termination of membership by deciding that members would take office at the beginning of the first day of the regular annual session of the Commission immediately following their election and that their terms of office would expire on the last day prior to the opening of the seventh regular annual session following their election.

wide Interbank Financial Telecommunication S.C. and Union internationale des avocats.

8. The Commission welcomed the participation of international non-governmental organizations with expertise in the major items on the agenda. Their participation was crucial for the quality of texts formulated by the Commission and the Commission requested the secretariat to continue to invite such organizations to its sessions.

### C. Election of officers

9. The Commission elected the following officers:

*Chairman:* Tore WIWEN-NILSSON (Sweden)

*Vice-Chairmen:* Neeru CHADHAH (India)  
François RWANGAMPUHWE  
(Rwanda)  
Oleg V. KRASNYYKH  
(Russian Federation)

*Rapporteur:* Juan Carlos YEPES ALZATE  
(Colombia)

### D. Agenda

10. The agenda of the session, as adopted by the Commission at its 758th meeting, on 30 June, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Finalization and adoption of the draft UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects.
5. Preliminary approval of the draft UNCITRAL Legislative Guide on Insolvency Law.
6. Arbitration: progress report of Working Group II.
7. Transport law: progress report of Working Group III.
8. Electronic commerce: progress report of Working Group IV.
9. Security interests: progress report of Working Group VI.
10. Monitoring implementation of the 1958 New York Convention.
11. Possible future work in the area of public procurement.
12. Possible future work relating to commercial fraud.
13. Case law on UNCITRAL texts (CLOUT) and digest of case law on Sales Convention and other uniform texts.
14. Training and technical assistance.
15. Status and promotion of UNCITRAL legal texts.
16. General Assembly resolutions on the work of the Commission; follow-up to in-depth evaluation of work of the Commission's secretariat.
17. Coordination and cooperation.
18. Other business.
19. Date and place of future meetings.
20. Adoption of the report of the Commission.

## E. Adoption of the report

11. At its 774th and 775th meetings, on 11 July, the Commission adopted the present report by consensus.

### III. DRAFT UNCITRAL MODEL LEGISLATIVE PROVISIONS ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

#### A. Preparatory work and organization of discussions

12. One year after the adoption of the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*,<sup>2</sup> in 2000, the Commission agreed, at its thirty-fourth session, in 2001, that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work in the field of privately financed infrastructure projects was to be accomplished within a reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the *Legislative Guide*. Accordingly, it was agreed that at its first session the working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the *Guide*, could be formulated.<sup>3</sup>

13. Working Group I commenced its work on the topic at its fourth session (Vienna, 24-28 September 2001). In accordance with a suggestion made at the Commission's thirty-fourth session,<sup>4</sup> the Working Group was invited to devote its attention to a specific phase of infrastructure projects, namely, the selection of the concessionaire, with a view to formulating specific drafting proposals for legislative provisions. Nevertheless, the Working Group was of the view that model legislative provisions on various other topics might be desirable (see A/CN.9/505, paras. 18-174). The Working Group requested the secretariat to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on its deliberations and decisions, to be presented to the Working Group at its fifth session for review and further discussion.

14. The Working Group continued its work on the drafting of core model legislative provisions at its fifth session (Vienna 9-13 September 2002). The Working Group reviewed the draft model provisions that had been prepared by the secretariat with the assistance of outside experts and approved their text, as set out in the annex to its report on that session (A/CN.9/521). The Working Group requested the secretariat to circulate the draft model provisions to States for comments and to submit the draft model provisions, together with the comments received from States, to the Commission, for its review and adoption, at its thirty-sixth session.

<sup>2</sup>United Nations publication, Sales No. E.81.V.6.

<sup>3</sup>*Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 369.

<sup>4</sup>*Ibid.*

15. The Commission had before it the following documents: (a) an explanatory note on the draft model provisions (A/CN.9/522); (b) the text of the draft model provisions, as they were approved by the Working Group (A/CN.9/522/Add.1); (c) a concordance table presenting side by side the draft model provisions and the legislative recommendations to which they relate (A/CN.9/522/Add.2); (d) a compilation of comments received from Governments and international organizations on the draft model provisions (A/CN.9/533 and Add.1-7); and (e) the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*.

16. The Commission took note of the background information on the preparation of the draft model legislative provisions, as summarized by the secretariat (see A/CN.9/522) and the written comments that had been submitted by Governments and international organizations on the draft model provisions (A/CN.9/533 and Add.1-7), which had been made available ahead of the session. The Commission decided that it would consider the issues raised in those comments in the context of the draft model legislative provisions to which they pertained. The Commission agreed that, for the purpose of optimizing the use of the time available for consideration of the draft model legislative provisions, it would only deal with written comments to the extent that they were raised by delegations and observers attending the session, regardless of whether the written comments had originated from them.

17. The Commission decided to establish a drafting group to review the text and to ensure its consistency in all the language versions. The Commission agreed that editorial suggestions to improve specific language versions or to correct translation errors should be dealt with directly by the drafting group.

#### B. Relationship between the draft model provisions and the *Legislative Guide*

18. The Commission concluded its deliberations on the draft model provisions (see paras. 22-170) by considering whether the model provisions and the legislative recommendations contained in the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* should be retained as two related but independent texts or whether they should be combined in a single text and, if so, whether all the legislative recommendations should be retained or only those on which no model provision had been drafted.

19. Pursuant to one view, which gathered strong support, the model provisions should supersede and replace all legislative recommendations dealing with the same subject matter. It was acknowledged that it would not be possible for the secretariat to immediately produce a consolidated new publication of the *Legislative Guide* that also contained the combined text of model provisions and the remaining legislative recommendations. For an interim period, and until sufficient resources were available to prepare such a new publication, the model provisions could be published as a separate document, which would also contain only those few legislative recommendations which had not been replaced. As soon as practicable, how-



ever, a consolidated text should be issued, so as to avoid confusion and to make the Commission's work as user-friendly as possible.

20. The countervailing view, which eventually prevailed, was that a future consolidated publication should reproduce the full text of the legislative recommendations contained in the *Legislative Guide*. The model provisions represented an evolution of the Commission's previous work and had to be understood against that background. While there was not sufficient support for retaining the two texts indefinitely as separate publications, the prevailing view was that the legislative recommendations should be reproduced in their entirety in a consolidated publication, as they represented the basis for the subsequent work on the model provisions.

21. The Commission therefore agreed that a future consolidated publication should combine the model provisions, as adopted by the Commission (see annex I), and the notes contained in the *Legislative Guide* and should reproduce, at the end of the publication, the full text of the legislative recommendations as originally adopted by the Commission in 2000. The secretariat was requested to review and, as appropriate, revise the notes contained in the *Legislative Guide* in order to adjust them to the terminology and structure used in the model provisions.

### C. Consideration of draft model provisions<sup>5</sup>

#### *Foreword*

22. The text of the foreword to the draft model provisions was as follows:

"The following pages contain a set of general recommended legislative principles entitled 'legislative recommendations' and model legislative provisions (the 'model provisions') on privately financed infrastructure projects. The legislative recommendations and the model provisions are intended to assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects. They are followed by notes that offer an analytical explanation of the financial, regulatory, legal, policy and other issues raised in the subject area. The user is advised to read the legislative recommendations and the model provisions together with the notes, which provide background information to enhance the understanding of the legislative recommendations and model provisions.

"The legislative recommendations and the model provisions consist of a set of core provisions dealing with matters that deserve attention in legislation specifically concerned with privately financed infrastructure projects.

"The model provisions are designed to be implemented and supplemented by the issuance of regulations providing further details. Areas suitable for being addressed by regulations rather than by statutes are identified accordingly. Moreover, the successful implemen-

tation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical, legal and financial expertise, appropriate human and financial resources and economic stability.

"It should be noted that the legislative recommendations and the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure projects but on which no specific legislative recommendations are made in the *Legislative Guide*. Those other areas of law include, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, general contract law, rules on government contracts and administrative law, tax law and environmental protection and consumer protection laws."

23. It was proposed that the last paragraph should also refer to tax, banking, foreign exchange and bankruptcy laws and regulations as being areas that were not addressed by the *Guide* but had an impact on privately financed infrastructure projects. An appropriate footnote or additional text in the form of a commentary should encourage Governments to authorize regulators to implement practical and straightforward regulations and procedures to implement the law. It was said, for example, that the system for converting and repatriating foreign exchange must be simple and fast. The last paragraph of the foreword should also state that experienced, transparent and predictable court systems were also essential. Finally, the paragraph should encourage Governments to reconcile inconsistencies with other conflicting laws and regulations, for example by clarifying whether the concession law of the country superseded the tax laws or laws relating to government contracts.

24. The Commission took note of that proposal, but was of the view that most of those matters were already addressed in various portions of the *Legislative Guide*, in particular in its chapter VII, "Other relevant areas of law". Nevertheless, the Commission accepted to insert a sentence at the end of the foreword drawing the attention of legislators to the relationship between legislation specific to privately financed infrastructure projects and other areas of law referred to in the foreword.

25. Subject to that amendment, the Commission approved the foreword and referred it to the drafting group.

### *Chapter I. General provisions*

#### **Model provision 1. Preamble**

26. The text of the draft model provision was as follows:

"WHEREAS the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to establish a favourable legislative framework to promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restric-

<sup>5</sup>This section contains provisions that were commented on by the Commission. The full text of the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects, including provisions that were approved without comments, is provided in annex I.

tions on private sector participation in infrastructure development and operation;

“WHEREAS the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;

“[Other objectives that the enacting State might wish to state];

“Be it therefore enacted as follows:”

27. It was suggested that draft model provision 1 would be improved if the first paragraph of the preamble was more closely aligned with the second sentence of the foreword and paragraph 4 of the introduction to the *Legislative Guide*. It was proposed to expand that paragraph to read as follows:

“WHEREAS, the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to establish a legislative framework favourable to private investment in public infrastructure; and

“WHEREAS, the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions in private sector participation in infrastructure investment, development and operation;”

28. The Commission was of the view that the draft model provision was sufficiently clear and that the proposed expansion was not needed. The Commission approved the substance of the draft model provision and referred it to the drafting group.

## Model provision 2. Definitions

29. The text of the draft model provision was as follows:

“For the purposes of this law:

“(a) ‘Infrastructure facility’ means physical facilities and systems that directly or indirectly provide services to the general public;

“(b) ‘Infrastructure project’ means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

“(c) ‘Contracting authority’ means the public authority that has the power to enter into a concession contract for the implementation of an infrastructure project [under the provisions of this law];<sup>1</sup>

“(d) ‘Concessionaire’ means the person that carries out an infrastructure project under a concession contract entered into with a contracting authority;

“(e) ‘Concession contract’ means the mutually binding agreement or agreements between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;

“(f) ‘Bidder’ and ‘bidders’ mean persons, including groups thereof, that participate in selection proceedings concerning an infrastructure project;<sup>2</sup>

“(g) ‘Unsolicited proposal’ means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;

“(h) ‘Regulatory agency’ means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>3</sup>

<sup>1</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession contracts. Depending on the regulatory regime of the enacting State, a separate body, referred to as ‘regulatory agency’ in subparagraph (h), may have responsibility for issuing rules and regulations governing the provision of the relevant service.

<sup>2</sup>The term ‘bidder’ or ‘bidders’ encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings or persons that have submitted a proposal in response to a contracting authority’s request for proposals.

<sup>3</sup>The composition, structure and functions of such regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, ‘General legislative and institutional framework’, paras. 30-53).”

30. A proposal was made to include a definition of the term “concession” so as to determine more clearly the scope of application of the model provisions. Such a definition was said to be necessary in order to establish clearly which law should apply to a particular contractual relationship, irrespective of the name given to the relevant contract (concession, licence, lease, usufruct rights, etc.). It was further stated that in many countries where a build-operate-transfer or concession law existed, it could be seen that contractors tried to escape its application (in particular the strict provisions on selection of concessionaires), by using different contract titles or by negating the fact that the contract involved a concession.

31. It was therefore proposed that the draft model provision could include a definition of the term “concession” as being acts attributable to the State whereby a public authority entrusted to a third party—by means of a contractual act or a unilateral act with the prior consent of the third party—the total or partial management of economic activities or services for which that authority would normally be responsible and for which the third party assumed the risk.

32. The Commission took note of that proposal, but was of the view that the new definition described a legal concept that, while familiar in some legal systems, might give rise to a number of questions in other legal systems where the notion of “concession” was not traditionally known. Furthermore, some of the elements of the proposed definition were considered to give rise to uncertainty, such as the amount of “risk” that needed to be assumed by the concessionaire in order for the project to involve a true “concession”. It was felt that the existing definition, along with the notes contained in the *Legislative Guide*, provided sufficient guidance as to the types of arrangement to which the draft model provisions applied.

33. The Commission approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 3. Authority to enter into concession agreements

34. The text of the draft model provision was as follows:

“The following public authorities have the power to enter into concession contracts<sup>4</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [*the enacting State lists the relevant public authorities of the host country that may enter into concession contracts by way of an exhaustive or indicative list of public authorities, a list of types or categories of public authority or a combination thereof*].”<sup>5</sup>

<sup>4</sup>Enacting States generally have two options for completing this model provision. It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing the approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, ‘General legislative and institutional framework’, paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, ‘Project risks and government support’).

<sup>5</sup>Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession contracts, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those contracts, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to ‘the Union, the states [or provinces] and the municipalities’. In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revision of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.”

35. It was suggested that, in practical terms, it was always difficult to fix precisely in a concession law what assets or services might be subject to a concession and by which organ the contract might be awarded. For legislation on privately financed infrastructure projects to be acceptable, in particular in countries with economies in transition, it was said that its provisions should not affect any previously agreed distribution of power (in particular of local self-government). It was therefore recommended to adopt a neutral provision referring to the proper authority having jurisdiction over assets and services to be conceded.

36. In response, it was said that in many countries there was considerable doubt as to which entities had the authority to award concessions and in which fields. The draft model provision represented a useful reminder of the importance of ensuring certainty in that matter. Furthermore, the draft model provision was drafted in a manner that was sufficiently flexible so as to be enacted in a manner that best suited the enacting State’s constitutional and administrative system.

37. The Commission agreed to retain the current substance of the draft model provision and referred it to the drafting group.

### Model provision 4. Eligible infrastructure sectors

38. The text of the draft model provision was as follows:

“Concession contracts may be entered into by the relevant authorities in the following sectors: [*the enacting State indicates the relevant sectors by way of an exhaustive or indicative list*].”<sup>6</sup>

<sup>6</sup>It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revision of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.”

39. It was observed that, in most legal systems, a concession law could not grant more rights than those granted by sectoral or specific laws. Rather than providing an indicative or exhaustive list of matters that might be the subject of a concession contract, it would be preferable to refer generally to services and assets in respect of which a concession contract could be awarded pursuant to any applicable law and, if necessary, to amend specific or sectoral laws to allow concessions, if not already provided for. Conversely, a list of assets or services that could not be conceded as being part of national sovereignty or national wealth was often established.

40. The Commission took note of those observations and suggestions. However, the Commission considered that, in much the same way as for draft model provision 3, the text under consideration was a useful reminder of the importance of the issue that left the enacting State with ample flexibility to implement it in a manner best suited to meeting its constitutional and administrative needs.

41. The Commission agreed to retain the current substance of the draft model provision and referred it to the drafting group.

## Chapter II. Selection of the concessionaire

### Model provision 5. Rules governing the selection proceedings

42. The text of the draft model provision was as follows:

“The selection of the concessionaire shall be conducted in accordance with [*model provisions 6-27*] and, for matters not provided herein, in accordance with [*the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts*].”<sup>7</sup>

<sup>7</sup>The user’s attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are based largely on the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (the ‘Model Procurement Law’). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for

the selection of the concessionaire. The model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, *mutatis mutandis*, supplement the practical elements of the selection procedure described herein.”

43. The Commission accepted a suggestion to delete the words “bid security” in the penultimate sentence of footnote 7. No other comments or suggestions were made on the draft model provision during the session. The Commission thus approved its substance and referred it to the drafting group.

### 1. Pre-selection of bidders

#### Model provision 6. Purpose and procedure of pre-selection

44. The text of the draft model provision was as follows:

“1. The contracting authority shall engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.

“2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [*the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the pre-qualification of suppliers and contractors*].

“3. To the extent not already required by [*the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the pre-qualification of suppliers and contractors*],<sup>8</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:

“(a) A description of the infrastructure facility to be built or renovated;

“(b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire);

“(c) Where already known, a summary of the main required terms of the concession contract to be entered into;

“(d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications; and

“(e) The manner and place for solicitation of the pre-selection documents.

“4. To the extent not already required by [*the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors in proceedings for the pre-qualification of suppliers and contractors*],<sup>9</sup> the pre-selection documents shall include at least the following information:

“(a) The pre-selection criteria in accordance with [*model provision 7*];

“(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [*model provision 8*];

“(c) Whether the contracting authority intends to request only a limited number<sup>10</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [*model provision 9, para. 2*], and, if applicable, the manner in which this selection will be carried out;

“(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [*this State*] in accordance with [*model provision 30*].

“5. For matters not provided in this [*model provision*], the pre-selection proceedings shall be conducted in accordance with [*the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the pre-qualification of suppliers and contractors*].<sup>11</sup>

<sup>8</sup>A list of elements typically contained in an invitation to participate in pre-qualification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

<sup>9</sup>A list of elements typically contained in pre-qualification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

<sup>10</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the Legislative Guide (see chap. III, ‘Selection of the concessionaire’, paras. 48 and 49). See also footnote 14.

<sup>11</sup>Procedural steps on pre-qualification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority’s decision on the bidders’ qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.”

45. The view was expressed that subparagraph (a) of paragraph 3 was too narrow and that the words “or operated” should be added after the words “to be built or renovated”. Another suggestion was to refer instead to the concept of “infrastructure project”, which, as defined in draft model provision 2, subparagraph (b), included the notion of infrastructure operation.

46. In response to those proposals, it was noted that subparagraph (a) was essentially concerned with a description of the physical infrastructure and that other subparagraphs referred to elements related to the operational phase.

47. The Commission approved the substance of the draft model provision and referred it to the drafting group, in particular with a request that it offer appropriate alternative wording to subparagraph (a) of paragraph 3.

**Model provision 7. Pre-selection criteria**

48. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 8. Participation of consortia**

49. The text of the draft model provision was as follows:

“1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.

“2. Unless otherwise [authorized by ... [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>13</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.

“3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

<sup>13</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.”

50. It was suggested that the draft model provision would be improved if it did not presumptively bar a member of a losing bidding consortium from joining another bidding consortium, as long as such joining was disclosed to all parties and otherwise acceptable and as long as no bidder could, at any one time, be a member of more than one bidding group.

51. There was agreement within the Commission that a bidder whose consortium abandoned or had to leave the selection procedure (for example because the consortium could not secure the required financing) but who desired instead to join another bidding group should be allowed to do so. Such a possibility was not felt to be inconsistent with legislative recommendation 16.

52. Subject to adding the words “at the same time” at the end of the first sentence of paragraph 2, the Commission approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 9. Decision on pre-selection**

53. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**2. Procedure for requesting proposals****Model provision 10. Single-stage and two-stage procedure for requesting proposals**

54. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 11. Content of the request for proposals**

55. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 12. Bid securities**

56. The text of the draft model provision was as follows:

“1. The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required bid security.

“2. A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>19</sup>

“(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;

“(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 17, para. 1];

“(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 17, para. 2];

“(d) Failure to sign the concession contract, if required by the contracting authority to do so, after the proposal has been accepted;

“(e) Failure to provide required security for the fulfilment of the concession contract after the proposal has been accepted or to comply with any other condition prior to signing the concession contract specified in the request for proposals.

<sup>19</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.”

57. The view was expressed that the draft model provision increased the recommended remedies of the contracting authority with regard to forfeiture of bid security. While the relevant portion of the *Legislative Guide* (chap. III, “Selection of the concessionaire”, para. 62) merely stated that it was advisable for the request for proposals to indicate any bid security terms, paragraph 2 (b) authorized forfeiture of a bidder’s security if the bidder failed to enter into final negotiations, or, as provided in subparagraph (c), if the bidder failed to formulate a best and final offer. Moreover, as currently drafted, the latter provision seemed to suggest that a bidder might forfeit its bid security merely because it had failed to formulate a “best and final offer” acceptable to the contracting authority.

58. In response, it was noted that, typically, the best and final offer and final negotiations occurred and should occur within the validity period of the bid and should be covered by the bid security. The procedure for final negotiations, including the requirement of a best and final offer, was not an unexpected event to the bidder, as they would have been advertised with the request for proposals. Furthermore, the terms of a best and final offer were entirely within the control of the bidder, who was under no obligation or constraint to improve upon its previous terms. The scope of the cross-reference to draft model provision 17 was limited to the time limit for submission of a best and final offer.

59. The Commission agreed that the concerns that had been expressed could be addressed by clarifying the relationship between draft model provisions 12 and 17. In particular, there was support for replacing the words “failure to formulate a best and final offer” in paragraph 2 (c) with the words “failure to submit its best and final offer”.

60. In response to suggestions to replace the words “best and final offer”, in the draft model provision and elsewhere in the text, simply with “offer” or “final offer”, it was noted that the words currently used in the text were a term of art that was widely known in international procurement practice. The Commission agreed to retain that expression. The Commission also agreed to retain the word “final” before the word “negotiations” in draft paragraph 2 (b), as those words formed an expression that adequately described a particular phase of the selection process.

61. Subject to the amendment referred to above, the Commission approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 13. Clarifications and modifications

62. The text of the draft model provision was as follows:

“The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise any element of the request for proposals as set forth in [model provision 11]. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 26] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the request for proposals at a reasonable time prior to the deadline for submission of proposals.”

63. It was proposed that the draft model provision should specify that there was no need for the contracting authority to inform the participants about the identity of the bidders. It was said that, in practice, where the identities of the bidders was known, there was a risk that a bidder might, for instance, artificially inflate its price so as to match the higher level of prices that would be expected from a particular competitor, to the detriment of the contracting authority.

64. That proposal was objected to on the grounds that, in the interest of transparency, the procurement practice in most countries required the identity of the bidders to be disclosed to any persons seeking such information. That was reflected, for example, in article 7, paragraph 6, of the Model Procurement Law, which required the procuring entity to make available “to any member of the general public, upon request, the name of the suppliers or contractors that had been pre-qualified”. Anonymity in procurement proceedings was said to be anathema to transparency and should not be endorsed by the draft model provisions.

65. The question was asked whether clarifications and modifications necessarily had to be made in writing and whether the identity of the bidder that had asked the question should be disclosed. In response, it was pointed out that those questions were left to the general procurement regime of the enacting State, which could not be entirely reproduced in the draft model provisions. The underlying assumption was that such a regime should provide, as the Model Procurement Law did, that communications other than those made during a meeting with bidders needed to be made in a manner that provided a record of the clarification sought or information provided (see the Model Procurement Law, art. 9, para. 1) and that clarifications should omit the source of the questions, so as to avoid distorting the competition among bidders (see the Model Procurement Law, art. 28, para. 1).

66. No other comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### Model provision 14. Evaluation criteria

67. The text of the draft model provision was as follows:

“1. The criteria for the evaluation and comparison of the technical proposals<sup>20</sup> shall include at least the following:

“(a) Technical soundness;

“(b) Compliance with environmental standards;

“(c) Operational feasibility;

“(d) Quality of services and measures to ensure their continuity.

“2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>21</sup> shall include, as appropriate:

“(a) The present value of the proposed tolls, unit prices and other charges over the concession period;

“(b) The present value of the proposed direct payments by the contracting authority, if any;

“(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

“(d) The extent of financial support, if any, expected from a public authority of [this State];

“(e) Soundness of the proposed financial arrangements;

“(f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;

“(g) The social and economic development potential offered by the proposals.

<sup>20</sup>See chap. III, ‘Selection of the concessionaire’, para. 74.

<sup>21</sup>See chap. III, ‘Selection of the concessionaire’, paras. 75-77.”

68. In response to a question, it was pointed out that the expression “present value” referred to a calculation method whereby future anticipated revenue or expenditures were expressed in present currency amounts that took into account future developments such as interest and exchange rates or inflation over the relevant period.

69. No other comments were made or questions raised on the draft model provision at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 15. Comparison and evaluation of proposals**

70. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 16. Further demonstration of fulfilment of qualification criteria**

71. The text of the draft model provision was as follows:

“The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so.<sup>23</sup>

<sup>23</sup>Where pre-qualification proceedings have been engaged in, the criteria shall be the same as those used in the pre-qualification proceedings.”

72. The question was asked whether the draft model provision also applied to consortia, or whether it was sufficient for one member of a consortium to have the required qualifications.

73. The Commission was of the view that it was implicit in the system recommended in the draft model provisions as well as in the *Legislative Guide* (for instance, in para. 41 of the notes on chap. III, “Selection of the concessionaire”), that, in respect of bidding consortia, qualification requirements (whether at the beginning or later in the selection proceedings) applied to the consortium as a whole and to each of its individual members. The Commission did not feel, however, that additional wording was needed to state that principle.

74. In response to a proposal that there should be a limit to the number of times that a contracting authority had the right to require a bidder to demonstrate again its qualifications, it was observed that the draft model provisions

were based on the assumption that the parties would act in good faith and that the consequence of their failure to do so, including failure by the contracting authority, was a matter left for the general procurement regime of the enacting State.

75. No further comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 17. Final negotiations**

76. The text of the draft model provision was as follows:

“1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession contract the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.

“2. If it becomes apparent to the contracting authority that the negotiations with the invited bidder will not result in a concession contract, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the other bidders in the order of their ranking until it arrives at a concession contract or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with which negotiations have been terminated pursuant to this paragraph.”

77. For the sake of clarity, it was agreed that the words “on the basis of the evaluation criteria” should be added after the words “responsive proposals” in paragraph 1.

78. The view was expressed that paragraph 2 involved the risk that any demand or unilateral imposition by the authority could lead to termination of the negotiations. In response, it was observed that the draft model provisions were meant to offer a structured procedure for final negotiations. They were not intended to curb bad faith in negotiations and indeed were not equipped for that purpose. Other remedies should be available under the general procurement regime in the enacting State to prevent and punish bad faith conduct by the contracting authority. The draft model provisions assumed the existence of a fair and transparent system of remedies, as stated, for instance, in draft model provisions 5 and 27.

79. With a view to clarifying the relationship between draft model provision 12, paragraph 2 (c), and provision 17, paragraph 2 (see paras. 58 and 59 above), it was agreed that the second sentence of draft model provision 17 should be redrafted along the following lines: “If the contracting authority does not find the proposal acceptable, it shall terminate the negotiations with the bidder concerned.”

80. The question was asked whether the contracting authority should be required to negotiate with all selected bidders or whether, upon reaching agreement with one of them, it could dismiss the bidders ranked lower even before negotiating with them. If such was the intention, draft model provision 17 should be amended to include a phrase such as “but without having to negotiate with all of them” or similar words at the end of the third sentence of paragraph 2.

81. In response to that question, it was observed that the final negotiations contemplated in the draft model provision were clearly conceived as consecutive negotiations and not simultaneous negotiations. The language in the draft model provision, it was noted, borrowed from the language in article 44 of the Model Procurement Law, which dealt with the consecutive negotiation procedure for the selection of service suppliers. The proposed addition, however, was not felt to be necessary.

82. In that connection, the view was expressed that the draft model provision, while being consistent with the advice contained in the *Legislative Guide* (see chap. III, “Selection of the concessionaire”, para. 84), went beyond legislative recommendation 27. It was said that there was little reason why the contracting authority should bar itself from re-starting discussions with a bidder that was earlier rejected. Various reasons might lead to a situation where the contracting authority could not complete negotiations with another bidder and might wish to try again with those very same bidders it had previously rejected. The complexity and prolonged nature of negotiations in such projects, it was said, made a more flexible provision desirable. The Commission took note of that view, but felt that allowing the contracting authority to reopen negotiations with a bidder with which negotiations had been terminated would amount to transforming the negotiations into simultaneous negotiations and would not be conducive to ensuring the level of transparency recommended in the *Legislative Guide*.

83. Subject to the amendments referred to above, the Commission approved the substance of the draft model provision and referred it to the drafting group.

### 3. *Negotiation of concession contracts without competitive procedures*

#### **Model provision 18. Circumstances authorizing award without competitive procedures**

84. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 19. Procedures for negotiation of a concession contract**

85. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### 4. *Unsolicited proposals*

86. The draft model provisions dealing with unsolicited proposals were clarified by a footnote.

87. No comments on the draft footnote were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 20. Admissibility of unsolicited proposals**

88. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 21. Procedures for determining the admissibility of unsolicited proposals**

89. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 22. Unsolicited proposals that do not involve intellectual property, trade secrets or other exclusive rights**

90. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 23. Unsolicited proposals involving intellectual property, trade secrets or other exclusive rights**

91. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### 5. *Miscellaneous provisions*

#### **Model provision 24. Confidentiality of negotiations**

92. The text of the draft model provision was as follows:

“The contracting authority shall treat proposals in such a manner as to avoid the disclosure of their content to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, paras. 3, 17, 18, 19 or 23, paras. 3 and 4] shall be confidential. Unless required by law or by a court order, no party to the negotiations shall disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.”

93. The view was expressed that the draft model provision went beyond legislative recommendation 36 in stating that all “communications” with bidders would be confidential. Another problem was that the third sentence referred only to confidential information that a party had



“received”, but not to confidential information that a party might have provided. As currently drafted, the draft model provision seemed to imply that a bidder would not be allowed to share with its agents, subcontractors, lenders, advisers or consultants any technical, price or other information it had provided. That problem, it was said, could be adequately addressed by adding the phrase “with appropriate exceptions, as may be provided in the request for proposals or negotiated with the contracting authority” at the end of the third sentence.

94. The Commission recognized the difficulties raised by the current text, but was not satisfied that the proposed amendment would be sufficient to solve them, in particular because the text, as it stood, already referred to a party’s consent to sharing of information. The Commission then proceeded to consider various alternative proposals, eventually agreeing on the following amendments to the third sentence of the model provision: insert the words “or permitted by the request for proposals” after the words “court order”; delete the words “apart from its agents, subcontractors, lenders, advisers or consultants”; and delete the words “that it has received” after the words “other information”.

95. Subject to those amendments and to deleting the words “of negotiations” in the heading, the Commission approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 25. Notice of contract award**

96. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 26. Record of selection and award proceedings**

97. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 27. Review procedures**

98. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### ***Chapter III. Construction and operation of infrastructure***

#### **Model provision 28. Contents of the concession contract**

99. The text of the draft model provision was as follows:

“The concession contract shall provide for such matters as the parties deem appropriate, such as:

“(a) The nature and scope of works to be performed and services to be provided by the concessionaire [*see chap. IV, para. 1*];

“(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire’s rights under the concession contract [*see recommendation 5*];

“(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project;

“(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [*model provision 30*] [*see recommendations 42 and 43 and model provision 30*];

“(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [*model provisions 31-33*] [*see recommendations 44 and 45 and model provisions 31-33*];

“(f) The remuneration of the concessionaire, whether consisting of tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of any such tariffs or fees; and payments, if any, that may be made by the contracting authority or other public authority [*see recommendations 46 and 48*];

“(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility [*see recommendation 52*];

“(h) The extent of the concessionaire’s obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users [*see recommendation 53 and model provision 38*];

“(i) The contracting authority’s or other public authority’s right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements [*see recommendations 52 and 54, subpara. (b)*];

“(j) The extent of the concessionaire’s obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations [*see recommendation 54, subpara. (a)*];

“(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled [*see chap. IV, paras. 73-76*];

“(l) Any rights of the contracting authority to review and approve major contracts to be entered into by

the concessionaire, in particular with the concessionaire's own shareholders or other affiliated persons [*see recommendation 56*];

“(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project [*see recommendation 58, subparas. (a) and (b)*];

“(n) Remedies available in the event of default of either party [*see recommendation 58, subpara. (e)*];

“(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession contract owing to circumstances beyond its reasonable control [*see recommendation 58, subpara. (d)*];

“(p) The duration of the concession contract and the rights and obligations of the parties upon its expiry or termination [*see recommendation 61*];

“(q) The manner for calculating compensation pursuant to [*model provision 47*] [*see recommendation 67*];

“(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire [*see recommendation 69 and model provision 49*].”

100. It was suggested that the draft model provision would benefit by the inclusion of a reference to each of the model provisions that concerned the contents of the concession contract. Otherwise, some model provisions of significance might appear to be subordinated. Furthermore, the draft model provision should also refer to the following: the available enforcement mechanisms if any public user of the infrastructure facility did not pay for the services provided; the allocation of risk for undisclosed defects in facilities to be rehabilitated; and the allocation of risk for undisclosed environmental conditions for facilities to be operated or renovated by the concessionaire. As an alternative, those topics could be mentioned in a footnote to the draft model provision. Other additional topics mentioned in the course of the deliberations included payments that the concessionaire might be required to make to the contracting authority.

101. While acknowledging the relevance of those additional matters, the Commission was generally inclined not to expand the list of subjects referred to in the draft model provision, in particular as some of the matters mentioned in the proposal had not been discussed in the *Legislative Guide*. The Commission agreed, however, that for purposes of clarity, a footnote should be added to the *chapeau* of the model provision to remind enacting States that the inclusion in the concession contract of provisions dealing with some of the matters listed in the model provision was mandatory pursuant to other model provisions.

102. The Commission noted that the Working Group, at its fourth session, in 2001, had generally taken the view that various matters dealt with in chapter IV of the *Legislative Guide* were contractual in nature and did not require specific draft model provisions (see A/CN.9/505, paras. 110-116). At the same time, however, the Working

Group had agreed that it would be useful to formulate a model provision that listed essential issues that needed to be addressed in the project agreement. The current list had been drawn up on the basis of the headings that preceded recommendations 41-68, with the adjustments that might be required so as to spell out clearly, but without unnecessary details, the various topics that needed to be covered by project agreements (A/CN.9/505, para. 114). Some of those issues were also the subject of specific draft model provisions. Other issues listed therein, however, related to legislative recommendations on which the Working Group did not request that specific draft model provisions be drafted (see A/CN.9/522, para. 56).

103. The Commission was aware of the overlap between some of the matters referred to in the list and a few matters dealt with in the following draft model provisions. That situation was a reflection of varying understandings in different legal systems as to which matters were of a contractual and which were of a statutory nature. Overall, the draft model provisions contained in chapters III, IV and V expressed a compromise that had been arrived at in the Working Group and it would be preferable for the Commission to avoid revisiting that decision of the Working Group.

104. Furthermore, it was noted that the words “such as” in the *chapeau* of the draft model provision had been chosen by the Working Group to emphasize the idea that the list, albeit relating to essential matters, was merely indicative and was not meant to be mandatory in its full length. The Commission then considered various proposals to improve the formulation of the draft model provision. One such proposal was to replace the words “such as” in the *chapeau* with the words “including, without limitation, any of the following”. Another proposal was to add a footnote containing language to the effect that the list was not exhaustive and that the parties to the concession contract could agree on provisions on any other matters they deemed appropriate, including those referred to in other model provisions. An alternative proposal was to present such a statement in a separate paragraph, rather than in a footnote.

105. After extensive discussion of those proposals, and noting that they had not obtained sufficient support, the Commission decided to retain the current formulation of the draft model provision, subject to adding a subparagraph referring to the extent to which information should be treated confidentially. The Commission also agreed that the title of the chapter should read “Concession contract” rather than “Construction and operation of infrastructure”.

106. Subject to those amendments, the Commission approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 29. Governing law**

107. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### Model provision 30. Organization of the concessionaire

108. The text of the draft model provision was as follows:

“The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [*this State*], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession contract.”

109. Subject to adding the words “consistently with the terms of the request for proposals” at the end of the second sentence, the Commission approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 31. Ownership of assets

110. Other than editorial suggestions, no comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### Model provision 32. Acquisition of rights related to the project site

111. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

### Model provision 33. Easements

112. The text of the draft model provision and the footnote to its heading was as follows:

“The concessionaire shall [have] [be granted] the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project in accordance with [*the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws*].

<sup>39</sup>The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the concessionaire directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 30-32). The alternative wording offered within the first set of square brackets in the model provision is intended to reflect those options.”

113. The view was expressed that, as currently drafted, the draft model provision was excessively compressed and did not adequately render the various possibilities for the creation of easements that might be required for the implementation of privately financed infrastructure projects.

114. It was pointed out that usually it was not an expeditious or cost-effective solution to leave it to the concessionaire to acquire easements directly from the owners of the properties concerned. Thus, the draft model provision should more clearly provide that those easements should be compulsorily acquired by the contracting authority simultaneously with the project site.

115. However, it was noted that, as indicated in the *Legislative Guide* (chap. IV, ‘Construction and operation of infrastructure’, para. 32), in some countries the law itself empowered public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure. Such an approach might obviate the need to acquire easements in respect of individual properties. This was one of the alternatives that the draft model provision appeared to attempt to address, although without the desirable degree of clarity.

116. The Commission considered various proposals for improving the text of the draft model provision. The Commission eventually agreed that greater clarity could be reached by aligning the draft model provision with the more analytical structure of draft model provision 32 and providing two variants in its paragraph 1 for the possible sources of easements (i.e. legislation itself or an act of the contracting authority or other public authority), whereas paragraph 2 should refer to the observance of the country’s legislation on procedures for the creation of easements.

117. The Commission requested the drafting group to prepare an appropriate text to replace the current draft model provision along those lines.

### Model provision 34. Financial arrangements

118. The text of the draft model provision was as follows:

“The concessionaire shall have the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession contract shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [*in accordance with the rules established by the competent regulatory agency*].<sup>40</sup>

<sup>40</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as ‘tariffs’, may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, ‘Project risks and government support’, paras. 30-60). The cost at which public services are provided is typically an element of the Government’s infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of ‘reasonableness’, ‘fairness’ or ‘equity’ (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 36-46).”

119. The view was expressed that the draft model provision should refer to the contracting authority’s power to make direct payments to the concessionaire as a substitute for, or in addition to, service charges paid by end users,

a matter of considerable commercial importance that was addressed in legislative recommendation 48.

120. That proposal was initially met with some reservations, in particular because the matter was referred to in draft model provision 28, subparagraph (f). In response to those reservations, it was observed that the reference in draft model provision 28, subparagraph (f), was to the inclusion of appropriate provision in the concession contract, a technique that might not be sufficient in some legal systems where the contracting authority might require statutory permission to commit itself to making direct payments to the concessionaire.

121. The Commission accepted that proposition and agreed to include a second paragraph in the draft model provision to the effect that the contracting authority should have the power to agree to make direct payments to the concessionaire as a substitute for, or in addition to, tariffs or fees for the use of the facility or its services.

122. In order to avoid the impression that the draft model provision created a peremptory right of the concessionaire to charge, receive or collect tariffs or fees for the use of the facility or its services, the Commission agreed to combine the two sentences of paragraph 1. The new text should make it clear that the concessionaire's right was to be "in accordance with the concession contract, which shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees".

123. Subject to those amendments, the Commission approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 35. Security interests

124. The text of the draft model provision was as follows:

"1. Subject to any restriction that may be contained in the concession contract,<sup>41</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

"(a) Security over movable or immovable property owned by the concessionaire or its interests in project assets;

"(b) A pledge of the proceeds of, and receivables owed to the concessionaire for, the use of the facility or the services it provides.

"2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire.

"3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is prohibited by the law of [this State].

<sup>41</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project."

125. It was pointed out that in some legal systems a provision in the concession contract that limited the concessionaire's right to create security interests might not be sufficient to effectively prevent the creation of security interest in contravention of such a contractual provision, since the restriction by the concession contract might not be effective vis-à-vis third parties. The Commission took note of that observation and was aware of the fact that the practical implementation of the draft model provision might require additional steps in some legal systems. It was said, however, that the draft model provision nevertheless reflected an important principle of law in several legal systems.

126. In that connection, the view was expressed that the draft model provision appeared to dilute the affirmative recommendations contained in legislative recommendation 49 in important respects, including whether or not the concessionaire should have the right to create security over the project assets that it owned, by stating that restrictions might appropriately be included in the concession contract. It was suggested that the problem could be solved by deleting the opening clause beginning with the words "subject to", as well as footnote 41.

127. In response to that proposal, it was observed that the draft model provision dealt with a sensitive issue of public policy and that its current wording reflected an acceptable compromise between initially conflicting views on the matter during the preparation of the *Legislative Guide*.<sup>6</sup> It was pointed out that, in some legal systems, any security given to lenders that made it possible for them to take over the project was only allowed under exceptional circumstances and under certain specific conditions, namely, that the creation of such security required the agreement of the contracting authority; that the security should be granted for the specific purpose of facilitating the financing or operation of the project; and that the security interests should not affect the obligations undertaken by the concessionaire. Those conditions often derived from general principles of law or from statutory provisions and could not be waived by the contracting authority through contractual arrangements.

128. Having considered those views, the Commission agreed to retain the substance of the draft model provision and referred it to the drafting group.

### Chapter III. Construction and operation of infrastructure

#### Model provision 36. Assignment of the concession contract

129. The text of the draft model provision was as follows:

"Except as otherwise provided in [model provision 35], the rights and obligations of the concessionaire under the concession contract may not be assigned to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which the contracting authority shall give its consent to an assignment of the rights and obliga-

tions of the concessionaire under the concession contract, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire's technical and financial capability as necessary for providing the service."

130. In response to a query concerning the meaning of the words "shall set forth" and "shall give its consent" in the second sentence, it was pointed out that the draft model provision would make it mandatory to spell out in the concession contract the conditions for authorizing an assignment of the concessionaire's rights and that, once such conditions were met, the contracting authority would be under an obligation to agree to an assignment.

131. No other comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 37. Transfer of controlling interest in the concessionaire**

132. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 38. Operation of infrastructure**

133. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 39. Compensation for specific changes in legislation**

134. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 40. Revision of the concession contract**

135. The text of the draft model provision was as follows:

"1. Without prejudice to [*model provision 39*], the concession contract shall further set forth the extent to which the concessionaire is entitled to a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:

"(a) Changes in economic or financial conditions; or

"(b) Changes in legislation or regulations not specifically applicable to the infrastructure facility or the services it provides;

provided that the economic, financial, legislative or regulatory changes:

"(a) Occur after the conclusion of the contract;

"(b) Are beyond the control of the concessionaire; and

"(c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the concession contract was negotiated or to have avoided or overcome their consequences.

"2. The concession contract shall establish procedures for revising the terms of the concession contract following the occurrence of any such changes."

136. In response to a question regarding the differences between the draft model provision and legislative recommendation 58, subparagraph (c), it was pointed out that a number of elements had been added to the language of the legislative recommendation so as to reflect the depth of the discussion in paragraphs 126-130 of chapter IV, "Construction and operation of infrastructure: legislative framework and project agreement", of the *Legislative Guide*.

137. No other comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 41. Takeover of an infrastructure project by the contracting authority**

138. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

#### **Model provision 42. Substitution of the concessionaire**

139. The text of the draft model provision was as follows:

"The contracting authority may agree with the entities extending financing for an infrastructure project on the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession contract upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession contract or other similar circumstances.<sup>43</sup>

<sup>43</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession contract (see chap. IV, 'Construction and operation of infrastructure: legislative framework and project agreement', paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority."

140. The proposal was made that the draft model provision should be amended in order to provide that the concessionaire should be a party to the agreement that set forth the terms and conditions of the concessionaire's substitution. In support of that proposal, it was stated that a distinction must be made between, on the one hand, agreeing on the principle of the right of substitution and,

on the other, setting out the procedure for effecting the substitution. It would be erroneous to suggest, it was further stated, that a right of substitution could be established without the agreement of the concessionaire. If the implementation of such a right remained at the option of the lenders, under a direct agreement with the contracting authority, the very existence of that right must be agreed by the concessionaire.

141. The Commission agreed that the words “and the concessionaire to provide for” should be inserted after the words “infrastructure project”.

142. No other comments on the draft model provision were made at the session. The Commission thus approved its substance, as amended, and referred it to the drafting group.

#### **Chapter IV. Duration, extension and termination of the concession contract**

##### **1. Duration and extension of the concession contract**

#### **Model provision 43. Duration and extension of the concession contract**

143. The text of the draft model provision was as follows:

“1. The term of the concession contract, as stipulated in accordance with [*model provision 28, subpara. (p)*], shall not be extended except as a result of the following circumstances:

“(a) Completion delay or interruption of operation due to circumstances beyond either party’s reasonable control;

“(b) Project suspension brought about by acts of the contracting authority or other public authorities; or

“(c) [*Other circumstances, as specified by the enacting State.*]<sup>44</sup>

“2. The term of the concession contract may further be extended to allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the concession contract, if the concessionaire would not be able to recover such costs during the original term.

<sup>44</sup>The enacting State may wish to consider the possibility of authorizing a consensual extension of the concession contract pursuant to its terms for compelling reasons of public interest.”

144. The view was expressed that the draft model provision, in particular subparagraph (c), was too restrictive, as it did not provide for the possibility for the contracting authority and the concessionaire to agree on the extension of the term of the concession in the concession contract. It was said that, as it was generally not advisable to exclude entirely the option to negotiate the extension of the concession period, the footnote could be modified by replacing the words “compelling reasons of public interest” with the words “under certain specific circumstances (as specified in the concession contract)”.

145. While there was some support for that proposal, the Commission also heard strong objections to it. It was pointed out that the provision reflected the advice of the *Legislative Guide* according to which such an extension should only be permissible if that possibility was set forth in the law of the enacting State. As currently drafted, and in keeping with the Commission’s policy as expressed in the *Legislative Guide*, the footnote reminded States that they might wish to consider the possibility of an extension of the concession contract by mutual agreement between the contracting authority and the concessionaire, but only for compelling reasons of public interest. Furthermore, such an additional possibility of extension would have to be expressed in the law itself.

146. After extensive deliberations on the matter, and having considered various alternative proposals, the Commission agreed to insert the words “for the law” after the word “possibility” in the footnote and, in the same sentence, to add a reference to a duty of the contracting authority to justify the reasons for such an extension in the records it was required to maintain.

147. At that juncture, it was observed that the title of chapter IV of the draft model provisions (“Duration, extension and termination of the concession contract”) was incorrect, since none of the provisions contained therein dealt with the duration of a concession contract. It was suggested that the word “duration” should be deleted from the title. In support of that proposal it was stated that the very notion of a specified duration for infrastructure concessions might not always be relevant, as States might transfer to the private sector for an indefinite period responsibility for providing certain services previously provided by the State.

148. In response to that proposal, it was pointed out that the policy adopted by the Commission in the *Legislative Guide* was that infrastructure concessions often involved an element of monopoly and that an excessively generous regime regarding their duration or extension might not be consistent with the laws and policies concerning competition of a number of countries. Clear rules on the matter were also needed in order to ensure transparency and protect the public interest. However, it was recognized that the draft model provision dealt only in part with those issues and that an additional provision was needed to the effect that the concession contract should specify the duration of the concession. The reference to the duration of the concession in draft model provision 28, subparagraph (p), was said to be insufficient, since the list contained in that draft model provision was not mandatory.

149. Having considered the various views that were expressed, the Commission agreed to insert a sentence at the beginning of the draft model provision whereby the duration of the concession should be set forth in the concession contract.

150. It was pointed out that, as currently drafted, the draft model provision seemed to suggest a different treatment for the circumstances listed in subparagraphs (a)-(c) of paragraph 1 from the case contemplated in paragraph 2. The draft model provision also left room for interpretation

as to whether a concessionaire had a right, possibly enforceable through the agreed dispute settlement mechanisms, to demand an extension of the concession contract or whether an extension was always subject to negotiation and agreement between the parties. It was generally agreed that extensions of the concession should always require prior agreement of the parties. With a view to reflecting that principle more clearly, the Commission agreed that paragraphs 1 and 2 should be combined and that the *chapeau* should refer to the contracting authority's consent.

151. No other comments on the draft model provision were made at the session. The Commission thus approved its substance, as amended, and referred it to the drafting group.

## 2. Termination of the concession contract

### Model provision 44. Termination of the concession contract by the contracting authority

152. The text of the draft model provision was as follows:

“The contracting authority may terminate the concession contract:

“(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

“(b) For [compelling]<sup>45</sup> reasons of public interest, subject to payment of compensation to the concessionaire, the terms of the compensation to be as agreed in the concession contract;

“(c) [Other circumstances that the enacting State might wish to add in the law.]”

<sup>45</sup>[Possible situations of a compelling reason of public interest are discussed in chapter V, ‘Duration, extension and termination of the project agreement’, paragraph 27, of the Legislative Guide.]”

153. Several questions were raised concerning the meaning of the word “reasonably” in subparagraph (a), which was felt to be ambiguous, to involve subjective judgement and to give rise to uncertainty in the application of the draft model provision. Another criticism was that the threshold for termination of the concession contract was said to be lower than the threshold for temporary takeover of an infrastructure project by the contracting authority under draft model provision 41, which was only possible in case of “serious failure” by the concessionaire to deliver the public service.

154. In response to those questions it was observed that the generally agreed understanding of the Commission was that, given the serious consequences of termination, such as that provision of the service might be interrupted or even discontinued, termination should under most circumstances be regarded as a measure of last resort. The *Legislative Guide* went further to state that it was generally advisable to provide that the termination of the project agreement in most cases should require a final

finding by the dispute settlement body provided for in the agreement (chap. V, “Duration, extension and termination of the project agreement”, para. 13). The threshold contemplated in subparagraph (a) of the draft model provision was by no means lower than the threshold envisaged in draft model provision 41. Indeed termination under draft model provision 44, subparagraph (a), was only possible in case of the permanent failure of or impossibility for the concessionaire to carry out its obligations under the concession contract. The assessment of the extent of the nature of the concessionaire’s inability or unwillingness to perform was not a subjective judgement of the contracting authority, which was clear from the impersonal formulation used in subparagraph (a) (i.e. when “it can no longer be reasonably expected”). The test of reasonableness was said to be used in various legal systems and would not be satisfied by a mere fear or unsubstantiated opinion of the contracting authority.

155. Having considered those views, and subject to removing the square brackets around the word “compelling” and around footnote 45, the Commission approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 45. Termination of the concession contract by the concessionaire

156. The text of the draft model provision was as follows:

“The concessionaire may not terminate the concession contract except under the following circumstances:

“(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession contract;

“(b) If the conditions for a revision of the concession contract under [model provision 40, para. 1] are met, but the parties have failed to agree on a revision of the concession contract; or

“(c) If the cost of the concessionaire’s performance of the concession contract has substantially increased or the value that the concessionaire receives for such performance has substantially diminished as a result of acts or omissions of the contracting authority or other public authorities, such as those referred to in [model provision 28, subparas. (h) and (i)], and the parties have failed to agree on a revision of the concession contract.”

157. The view was expressed that the draft model provision, in particular its subparagraph (b), was excessively favourable to the concessionaire and potentially harmful to the public interest. In response it was pointed out that the draft model provision had to be read in conjunction with the advice provided in the *Legislative Guide*, which made it clear that, in fact, the rights of termination of the concessionaire were more limited than those of the contracting authority. The relevant portion of the *Legislative Guide* indicated that while the contracting authority in some legal systems retained an unqualified right to terminate the project agreement, the grounds for termination by the concessionaire were usually limited to serious breach

by the contracting authority or other exceptional situations and did not normally include a general right to terminate the project agreement at will. Moreover, the *Legislative Guide* recognized that some legal systems did not recognize the concessionaire's right to terminate the project agreement unilaterally, but only the right to request a third party, such as the competent court, to declare the termination of the project agreement (chap. V, "Duration, extension and termination of the project agreement", para. 28).

158. No other comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 46. Termination of the concession contract by either party**

159. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

3. *Arrangements upon expiry or termination of the concession contract*

**Model provision 47. Financial arrangements upon expiry or termination of the concession contract**

160. The text of the draft model provision was as follows:

"The concession contract shall stipulate how compensation due to either party is calculated in the event of termination of the concession contract, providing, where appropriate, for compensation for the fair value of works performed under the concession contract, costs incurred or losses sustained by either party, including, as appropriate, lost profits."

161. The Commission agreed that the section heading preceding the draft model provision should be amended to read "Arrangements upon termination and expiry of the concession contract". The Commission also agreed that the title of the draft model provision should read "Compensation upon termination or expiry of the concession contract".

162. The Commission accepted a proposal that the draft model provision reflect the substance of legislative recommendation 67.

163. No other comments on the draft model provision were made at the session. The Commission thus approved its substance, as amended, and referred it to the drafting group.

**Model provision 48. Wind-up and transfer measures**

164. The text of the draft model provision was as follows:

"The concession contract shall set forth, as appropriate, the rights and obligations of the parties with respect to:

"(a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;

"(b) The transfer of technology required for the operation of the facility;

"(c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

"(d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire."

165. The Commission took note of the view that the reference to transfer of technology, including the relevant notes in the *Legislative Guide*, was somewhat dated and that it would have been preferable to refer to more modern concepts such as licensing of intellectual property rights, copyrights and other neighbouring rights.

166. The Commission accepted a proposal that the draft model provision should include a provision reflecting the principle of legislative recommendation 66, which required criteria for establishing compensation to the concessionaire for assets transferred upon expiry or termination of the project agreement.

167. No other comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

*Chapter V. Settlement of disputes*

**Model provision 49. Disputes between the contracting authority and the concessionaire**

168. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 50. Disputes involving customers or users of the infrastructure facility**

169. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**Model provision 51. Other disputes**

170. No comments on the draft model provision were made at the session. The Commission thus approved its substance and referred it to the drafting group.

**D. Adoption of the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects**

171. The Commission, after consideration of the text of the draft model provisions as revised by the drafting group, adopted the following decision at its 768th meeting, on 7 July 2003:



*“The United Nations Commission on International Trade Law,*

*“Bearing in mind the role of public-private partnerships to improve the provision and sound management of infrastructure and public services,*

*“Recognizing the need to provide an enabling environment that both encourages private investment in infrastructure and takes into account the public interest concerns of the country,*

*“Emphasizing the importance of providing efficient and transparent procedures for the award of privately financed infrastructure projects and of facilitating project implementation by rules that enhance transparency, fairness and long-term sustainability and remove undesirable restrictions on private sector participation in infrastructure development and operation,*

*“Recalling the valuable guidance it has provided<sup>1</sup> to Member States towards the establishment of a favourable legislative framework for private participation in infrastructure development through the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*,<sup>2</sup> which was welcomed by the General Assembly in its resolution 56/79 of 12 December 2001,*

*“Believing that the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects will be of further assistance to States, in particular developing countries, in establishing an appropriate legislative framework for such projects,*

*“1. Adopts the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects as they appear in annex I to the report on its thirty-sixth session;*

*“2. Requests the Secretariat to transmit the text of the Model Legislative Provisions along with the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*<sup>2</sup> to Governments, relevant international intergovernmental and non-governmental organizations, private sector entities and academic institutions;*

*“3. Also requests the Secretariat, subject to availability of resources, to consolidate in due course the text of the Model Legislative Provisions and the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* into one single publication and, in doing so, to retain the legislative recommendations contained in the *Legislative Guide* as a basis of the development of the Model Legislative Provisions;*

*“4. Recommends that all States give due consideration to the UNCITRAL Model Legislative Provisions and the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* when revising or adopting legislation related to private participation in the development and operation of public infrastructure.”*

<sup>1</sup>See *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, paras. 155-161.

<sup>2</sup>United Nations publication, Sales No. E.81.V.6.

#### IV. DRAFT UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW

##### A. Preliminary approval of the draft UNCITRAL legislative guide on insolvency law

172. The Commission expressed its satisfaction with the progress of Working Group V (Insolvency Law) in developing the draft legislative guide on insolvency law, commending the level of consensus achieved in a very complex area of law and the comprehensive and balanced nature of the draft text. It was suggested that the solutions in the draft legislative guide could provide useful guidance for States of different legal traditions and different levels of economic development.

173. Recognition was given to the open and transparent nature of the Commission process and to the contributions to the development of the draft legislative guide of a broad range of participants, which were acknowledged as important to the achievement of a widely acceptable product that would be readily used by States. The Commission expressed its appreciation for the level of cooperation and coordination with international organizations in the development of the draft guide and stressed the need to maintain that coordination and cooperation, not only to finalize the text, but also to promote awareness and to facilitate use of the draft guide. The UNCITRAL/International Federation of Insolvency Professionals International Judicial Colloquium, held in London on 16 and 17 July 2001, was cited as an example of an approach that might be adopted.

174. The representative of the International Monetary Fund stated that there was need for convergence around a single internationally developed standard to assist in insolvency law reform, where that standard combined both flexibility, acknowledging different approaches, and specificity, providing detailed guidance on those approaches. The contribution of the draft legislative guide in that regard was commended. The Commission noted that the World Bank, which had described its work to the Commission in general terms, was currently revising its *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*. It was widely agreed that, in developing texts on insolvency law, both duplication of effort and divergence in the texts should be avoided, while respecting the different mandates of the Commission and the World Bank. The common objectives of the draft guide and the World Bank *Principles* were noted and a cooperative approach to achieve convergence was strongly recommended. To that end, it was proposed that issues of divergence be considered at the next session of the Working Group and that the World Bank make the relevant documents available to facilitate that discussion.

175. The Commission noted that a number of recent efforts to reform insolvency law had been influenced by the draft legislative guide and that its completion would greatly assist future efforts in that area.

176. The Commission also noted the collaboration between Working Group V and Working Group VI (Security Interests) on the treatment of secured creditors and security interests in insolvency and stressed the need to con-

tinue that collaboration in completing the draft legislative guide.

177. Broad support was expressed in favour of approving in principle the key objectives and major policies of the draft legislative guide, while noting that the work had not yet been completed and some further development and refinement would be required. The Commission considered the broad policy approach of each chapter of the draft guide. It was noted that the issues discussed (see below) would be taken into account in the future revision of the text and brought to the attention of Working Group V at its next session.

### ***Part One. Designing the structure and key objectives of an effective and efficient insolvency regime***

#### *Chapter I. Introduction to insolvency procedures*

##### *A. Key objectives of an effective and efficient insolvency regime*

178. The view that the key objectives were well-targeted and reflected the components necessary for effective and efficient insolvency regimes was widely supported, subject to minor drafting changes. In particular it was suggested that paragraph 1 (see A/CN.9/WG.V/WP.63/Add.2) might be more balanced in its reference to the interests affected by an insolvency law, that paragraph 24 might be expanded to include references to the structure of an insolvency regime and to the possible use of out-of-court processes and that the last sentence of key objective 5 might be more flexible in its reference to application of the stay to secured creditors.

179. No comments of substance were raised with respect to sections B, "Balancing the key objectives", and C, "General features of an insolvency regime".

#### *Chapter II. Types of insolvency proceedings*

180. No comments of substance were made with respect to section A, "Liquidation".

##### *B. Reorganization*

181. Some concerns were expressed with respect to the inclusion of material on informal reorganization processes in a guide related principally to insolvency legislation and, in particular, with respect to the level of detail of the treatment of those processes in the introductory chapter. The Commission recognized, however, that those types of process were increasingly being developed, that they were a useful addition to the tools available for addressing financial distress and that the mandate given to the Working Group included consideration of out-of-court reorganization. In addition, the description of those processes served to introduce the expedited reorganization processes described in part two, chapter V. It was suggested that when discussing the part of the draft legislative guide relating to informal reorganization processes, the Working Group should bear in mind the interests of the debtor. Concern

was also expressed with respect to those processes described as "administrative" processes in part one, chapter II, section C, and to their relevance to a commercial insolvency regime, although it was also noted that those types of process had been widely developed and used to address recent systemic situations and for that reason should be mentioned in part one.

182. No comments of substance were made with respect to section D, "The structure of the insolvency regime".

### ***Part Two. Core provisions of an effective and efficient insolvency regime***

#### *Chapter II. Application and commencement*

183. No comments of substance were made with respect to sections A, "Eligibility and jurisdiction", and B, "Application and commencement criteria", of chapter II (see A/CN.9/WG.V/WP.63/Add.3 and 4).

#### *Chapter III. Treatment of assets on commencement of insolvency proceedings*

##### *A. Assets to be affected*

184. It was suggested that greater emphasis should be given to management of assets, as opposed to administration or disposition. With respect to the time of constitution of the estate in paragraph 65 of section A (see A/CN.9/WG.V/WP.63/Add.5), it was suggested that the implications of the estate being constituted retrospectively to the date of application to address, for example, transactions entered into between application and commencement, should be discussed further.

185. No comments of substance were raised with respect to sections B, "Protection and preservation of the insolvency estate", and C, "Use and disposition of assets" (see A/CN.9/WG.V/WP.63/Add.6 and 7).

##### *D. Treatment of contracts*

186. While noting the importance of labour contracts and their treatment in insolvency law, the Commission acknowledged that those contracts raised complex and difficult issues of both national and international law that could not be comprehensively addressed in the draft legislative guide (see A/CN.9/WG.V/WP.63/Add.8). The Commission noted, however, that the reorganization processes discussed in the draft guide were aimed specifically at facilitating business recovery and preserving employment.

##### *E. Avoidance proceedings*

187. It was suggested that the draft legislative guide (see A/CN.9/WG.V/WP.63/Add.9) should discuss further the implications of the suspect period applying retrospectively from either application or commencement and, more generally, that the effects of application and commencement and their treatment in the draft guide might need to be

examined more closely to ensure consistency. A question was raised with respect to “undervalued” transactions and what would constitute a sufficient undervalue, and how that value would be determined, for the purposes of avoidance.

#### F. *Set-off and netting*

188. The Commission noted the key importance of set-off and netting to the proper functioning and stability of the international financial system and financial transactions and to ensuring predictability and certainty in the insolvency context of the rights of parties to those transactions. It was expected that the Working Group, at its next meeting, would ensure that those systems would not be adversely affected.

### Chapter IV. *Participants and institutions*

189. No comments of substance were raised with respect to sections A, “The debtor”, and B, “The insolvency representative” (see A/CN.9/WG.V/WP.63/Add.10).

#### C. *Creditors*

190. The Commission took note of the concerns expressed with respect to the various mechanisms for creditor participation in insolvency proceedings and the need for greater clarity, in particular with respect to the relationship between the rights of creditors individually and the mechanisms for representation (see A/CN.9/WG.V/WP.63/Add.11).

#### D. *Institutional framework*

191. The Commission noted the key importance of the institutional framework to the efficient and effective functioning of an insolvency regime. It also took note with appreciation of the work on capacity-building being done by the World Bank (see A/CN.9/WG.V/WP.63/Add.11).

### Chapter V. *Reorganization*

#### A. *The reorganization plan*

192. It was proposed that the treatment of secured creditors in reorganization should be set forth clearly in the draft guide and, in particular, in respect of the voting of secured creditors on the plan as a class or otherwise (see A/CN.9/WG.V/WP.63/Add.12).

193. No comments of substance were made with respect to section B, “Expedited reorganization proceedings”.

### Chapter VI. *Management of proceedings*

#### A. *Treatment of creditor claims*

194. The suggestion was made that the draft legislative guide should include further discussion of the complex question of subordination of claims (see A/CN.9/WG.V/WP.63/Add.13).

195. It was noted that the Working Group had not completed its deliberations on the remaining parts of the draft guide and no comments of substance were raised with respect to sections B, “Post-commencement finance”, and C, “Priorities and distribution” (see A/CN.9/WG.V/WP.63/Add.14); section D, “Treatment of corporate groups in insolvency” (see A/CN.9/WG.V/WP.63/Add.16); the remaining part of the latter document dealing with rights of review and appeal of the debtor and creditors; and chapter VII, “Resolution of proceedings” (see A/CN.9/WG.V/WP.63/Add.15).

#### *Applicable law governing in insolvency proceedings*

196. The Commission noted that the Working Group had not had the opportunity to consider the issue of applicable law governing in insolvency proceedings, but wide support was expressed for the importance of the issue to insolvency proceedings and the desirability of treating the topic in the draft legislative guide (see A/CN.9/WG.V/WP.63/Add.17).

### B. **Approval in principle of the draft UNCITRAL legislative guide on insolvency law**

197. Having considered the draft legislative guide, the Commission approved it in principle as follows:

*The United Nations Commission on International Trade Law,*

*Recognizing* the importance to all countries of strong insolvency regimes,

*Recognizing also* that it is demonstrably in the public interest to have a functioning insolvency regime as a means of encouraging economic development and investment,

*Noting* the growing realization that reorganization regimes are critical to corporate and economic recovery, the development of entrepreneurial activity, the preservation of employment and the availability of venture capital,

*Noting also* that the effectiveness of reorganization regimes affects the pricing of loans in the capital market, with comparative analysis of such systems becoming both common and essential for lending purposes,

*Noting further* the importance of social policy issues to the design of an insolvency regime,

*Recognizing* that solutions to the key legal and legislative issues raised by insolvency that are negotiated internationally through a process involving a broad range of constituents will be useful both to States that do not have an effective and efficient insolvency regime and to States that are undertaking a process of review and modernization of their insolvency regimes,

*Recognizing also* that the text developed by Working Group V (Insolvency Law) was prepared in the light of, and is compatible with, the text of the UNCITRAL Model Law on Cross-Border Insolvency,<sup>1</sup> and that those texts will form, together with the draft UNCITRAL legislative guide on security interests, key elements in a modern commercial law framework,

Noting the collaboration between Working Group V (Insolvency Law) and Working Group VI (Security Interests) on the treatment of secured creditors and security interests in insolvency,

Recalling the mandate given to Working Group V to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches and recommendations,

Recognizing the work conducted on insolvency law reform by other international organizations, including the World Bank, the International Monetary Fund, the Asian Development Bank, the International Bar Association, the International Federation of Insolvency Professionals and others, and the need for cooperation and coordination between those organizations and the Commission to achieve consistency and alignment in the work under way and to facilitate the development of international standards,

Noting the progress of Working Group V in finalizing the draft legislative guide, and considering that, in view of the substantial completion of core elements and the demand for a text that can be used in law reform efforts, the draft guide could be applied even before its final adoption in 2004,

Stressing the need to complete work on the final text of the draft legislative guide as expeditiously as possible,

1. Expresses its appreciation to Working Group V (Insolvency Law) for its work in developing the draft UNCITRAL legislative guide on insolvency law;

2. Approves in principle the policy considerations reflected in the draft legislative guide and the key objectives, general features and structure of an insolvency regime as being responsive to the mandate given to the Working Group, subject to completion consistent with the key objectives;

3. Requests the secretariat to make the draft legislative guide available to Member States, relevant inter-governmental and non-governmental international organizations, as well as private sector and regional organizations and individual experts, for comment as soon as possible;

4. Recommends that the secretariat coordinate and cooperate with the World Bank to identify points of difference between its *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, currently being revised, and the draft legislative guide at the level of key principles, and identify a process for achieving alignment of those texts within the constraints of the process of each participating body and within the time frame for completion of the draft legislative guide;

5. Recommends also the continued collaboration between Working Group V (Insolvency Law) and Working Group VI (Security Interests) in finalizing the draft legislative guide on insolvency law;

6. Requests Working Group V (Insolvency Law) to complete its work on the draft legislative guide and to submit it to the Commission at its thirty-seventh session for finalization and adoption.

<sup>1</sup>Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17), annex I.

## V. ARBITRATION

198. At its thirty-second session, in 1999, the Commission had before it a note by the secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). The Commission continued its work on the issue at its subsequent sessions. A full account of the Commission's deliberations at those sessions can be found in the relevant reports of the Commission.<sup>6</sup>

199. At its current session, the Commission took note with appreciation of the reports of Working Group II (Arbitration and Conciliation) on the work of its thirty-seventh (Vienna, 7-11 October 2002) and its thirty-eighth (New York, 12-16 May 2003) sessions (A/CN.9/523 and A/CN.9/524, respectively). The Commission commended the Working Group for the progress accomplished so far regarding the issue of interim measures of protection.

200. With regard to the issue of the power of an arbitral tribunal to order interim measures of protection, the Commission noted that, at its thirty-seventh session, the Working Group had considered a revised draft text of article 17 of the UNCITRAL Model Law on International Commercial Arbitration on the basis of a note by the secretariat (A/CN.9/WG.II/WP.119) and a proposal by a State (A/CN.9/WG.II/WP.121). The issue whether to include a provision allowing for interim measures to be ordered ex parte by an arbitral tribunal had also been discussed at the thirty-seventh session of the Working Group (A/CN.9/523, paras. 16-27). The Commission noted that, in accordance with those discussions, a revised draft had been prepared by the secretariat for discussion at a future session of the Working Group (see A/CN.9/WG.II/WP.123).

201. With regard to the issue of recognition and enforcement of interim measures of protection, the Commission noted that the Working Group had had a brief discussion on that issue at its thirty-seventh session based on the note by the secretariat (A/CN.9/WG.II/WP.119, para. 83) and the draft text (also reproduced in document A/CN.9/523, paras. 78 and 79). The Commission noted that the discussions had continued at the thirty-eighth session of the Working Group (see A/CN.9/524) and that the secretariat had been requested to prepare a revised text setting out the various options discussed by the Working Group.

202. The Commission also noted that, at its thirty-eighth session, the Working Group had considered, on the basis of the note by the secretariat (A/CN.9/WG.II/WP.119, paras. 75-81), a possible draft provision expressing the power of the court to order interim measures of protection

<sup>6</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 389-399; *ibid.*, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), paras. 309-315; and *ibid.*, Fifty-seventh Session, Supplement No. 17 (A/57/17), paras. 178-184.

in support of arbitration, irrespective of the country where the arbitration took place. The Commission observed that, while the Working Group had expressed general support for such a provision, different views had been expressed as to the criteria and standards for the issuing of such measures (A/CN.9/524, paras. 77 and 78). It was noted that a revised draft provision based on the discussions in the Working Group would be prepared by the secretariat for consideration by the Working Group at a future session.

203. The Commission agreed that it was unlikely that all the topics, namely, the written form for arbitration agreements and the various issues to be considered in the area of interim measures of protection, could be finalized by the thirty-seventh session of the Commission, in 2004. It was the understanding of the Commission that the Working Group would give a degree of priority to interim measures of protection and the Commission noted the suggestion that the issue of *ex parte* interim measures, which the Commission agreed remained a point of controversy, should not delay progress on that topic.

204. With respect to future work, the Commission was informed that the secretariat had held an expert group meeting in conjunction with, and at the initiative of, the Organisation for Economic Cooperation and Development, which had found that arbitration was an appropriate method for resolving intra-corporate disputes, in particular where the disputes involved parties from different States. The question of arbitrability was considered central to that work. The Commission took note that arbitrability, a topic that had been accorded low priority by the Commission in the programme of work of the Working Group,<sup>7</sup> could be reassessed when considering future work. The Commission also heard proposals that a revision of the UNCITRAL Arbitration Rules (1976) and the UNCITRAL Notes on Organizing Arbitral Proceedings (1996) could be considered for inclusion in future work, once the existing projects currently being considered by the Working Group had been completed.

## VI. TRANSPORT LAW

205. At its thirty-fourth session, in 2001, the Commission established Working Group III (Transport Law) and entrusted it with the task of preparing, in close cooperation with interested international organizations, a legislative instrument on issues relating to the international carriage of goods such as the scope of application, the period of responsibility of the carrier, obligations of the carrier, liability of the carrier, obligations of the shipper and transport documents.<sup>8</sup> At its thirty-fifth session, in 2002, the Commission approved the working assumption that the draft instrument on transport law should cover door-to-door transport operations, subject to further consideration of the scope of application of the draft instrument after the Working Group had considered the substantive provisions of the draft instrument and come to a more complete understanding of their functioning in a door-to-door context.<sup>9</sup>

<sup>7</sup>Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 351-353.

<sup>8</sup>Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 345.

<sup>9</sup>Ibid., *Fifty-seventh Session, Supplement No. 17* (A/57/17), para. 224.

206. At its current session, the Commission had before it the reports of the tenth (Vienna, 16-20 September 2002) and eleventh (New York, 24 March-4 April 2003) sessions of the Working Group (A/CN.9/525 and A/CN.9/526, respectively).

207. The Commission was mindful of the magnitude of the project undertaken by the Working Group and expressed appreciation for the progress accomplished so far. It was widely felt that, having recently completed its first reading of the draft instrument on transport law, the Working Group had reached a particularly difficult phase of its work. The Commission noted that a considerable number of controversial issues remained open for discussion regarding the scope and the individual provisions of the draft instrument. Further progress would require a delicate balance being struck between the various conflicting interests at stake. The view was expressed that a door-to-door instrument might be achieved by a compromise based on uniform liability, choice of forum and negotiated contracts, which would not deal with actions against performing inland parties. It was also stated that involving inland road and rail interests was critical to achieving the objectives of the text. The view was expressed that increased flexibility in the design of the proposed instrument should continue to be explored by the Working Group to allow for States to opt in to all or part of the door-to-door regime.

208. The Commission also noted that, in view of the complexities involved in the preparation of the draft instrument, the Working Group had met at its eleventh session for a duration of two weeks, thus making use of additional conference time that had been made available by Working Group I completing its work on privately financed infrastructure projects at its fifth session, in September 2002. The Chairman of Working Group III confirmed that, if progress on the preparation of the draft instrument was to be made within an acceptable time frame, the Working Group would need to continue holding two-week sessions. After discussion, the Commission authorized Working Group III, on an exceptional basis, to hold its twelfth and thirteenth sessions on the basis of two-week sessions (for the general discussion regarding the allocation of conference time to the various working groups, see below, paras. 270-275 and 277-278). It was agreed that the situation of the Working Group in that respect would need to be reassessed at the thirty-seventh session of the Commission, in 2004. The Working Group was invited to make every effort to complete its work expeditiously and, for that purpose, to use every possibility of holding intersessional consultations, possibly through electronic mail. The Commission realized, however, that the number of issues open for discussion and the need to discuss many of them simultaneously made it particularly relevant to hold full-scale meetings of the Working Group.

## VII. ELECTRONIC COMMERCE

209. At its thirty-fourth session, in 2001,<sup>10</sup> the Commission endorsed a set of recommendations for future work

<sup>10</sup>Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), paras. 291-293.

made by Working Group IV (Electronic Commerce) at its thirty-eighth session (New York, 12-23 March 2001) and set out in the report of the Working Group (A/CN.9/484, para. 134). A full list of the recommendations may be found in the report of the Commission on its thirty-fifth session, in 2002.<sup>11</sup>

210. At its thirty-sixth session, the Commission took note of the reports of the Working Group on the work of its fortieth (Vienna, 14-18 October 2002) and its forty-first (New York, 5-9 May 2003) sessions (A/CN.9/527 and A/CN.9/528, respectively).

211. The Commission noted the progress made by the secretariat in connection with a survey of possible legal barriers to the development of electronic commerce in international trade-related instruments. The Commission reiterated its belief in the importance of that project and its support for the efforts of the Working Group and the secretariat in that respect. The Commission recalled that it had requested the Working Group to devote most of its time at its fortieth session, in October 2002, to a substantive discussion of various issues relating to legal barriers to electronic commerce that had been raised in the secretariat's initial survey (A/CN.9/WG.IV/WP.94).<sup>12</sup> In that respect, the Commission took note of the deliberations of the Working Group in connection with the secretariat's initial survey, in particular its endorsement of the conclusions of the secretariat. The Commission noted that the Working Group had recommended that the secretariat expand the scope of the survey to review possible obstacles to electronic commerce in additional instruments that had been proposed to be included in the survey by other organizations and to explore with those organizations the modalities for carrying out the necessary studies, taking into account the possible constraints put on the secretariat by its current workload. The Commission called on member States to assist the secretariat in that task by inviting appropriate experts or sources of information in respect of the various specific fields of expertise covered by the relevant international instruments.

212. The Commission noted with appreciation that the Working Group had continued its consideration of a preliminary draft convention dealing with selected issues on electronic contracting and reaffirmed its belief that an international instrument dealing with certain issues of electronic contracting would be a useful contribution that would facilitate the use of modern means of communication in cross-border commercial transactions. The Commission was informed that the Working Group had undertaken a review of articles 1-11 of the revised text of the preliminary draft convention and had asked the secretariat to prepare a revised version for consideration at a future session of the Working Group. However, it was observed that the form of an international convention had been used by the Working Group thus far as a working assumption, but that did not preclude the choice of another form for the instrument at a later stage of the Working Group's deliberations.

<sup>11</sup>Ibid., *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, para. 205.

<sup>12</sup>Ibid., para. 207.

213. The Commission was informed that the Working Group had exchanged views on the relationship between the preliminary draft convention and the Working Group's efforts to remove possible legal obstacles to electronic commerce in existing international instruments relating to international trade within the context of its preliminary review of draft article X, which the Working Group had agreed to retain for further consideration (A/CN.9/528, para. 25). The Commission expressed support for the Working Group's efforts to tackle both lines of work simultaneously.

214. The Commission was informed that, at its forty-first session, in 2003, the Working Group had held a preliminary discussion on the question of whether intellectual property rights should be excluded from the draft convention (A/CN.9/528, paras. 55-60). The Commission noted the Working Group's understanding that its work should not be aimed at providing a substantive law framework for transactions involving "virtual goods", nor was it concerned with the question of whether and to what extent "virtual goods" were or should be covered by the United Nations Convention on Contracts for the International Sale of Goods.<sup>13</sup> The question before the Working Group was whether and to what extent the solutions for electronic contracting being considered in the context of the preliminary draft convention could also apply to transactions involving licensing of intellectual property rights and similar arrangements. The secretariat was requested to seek the views of other international organizations on the question, in particular the World Intellectual Property Organization.

## VIII. SECURITY INTERESTS

215. At its thirty-fourth session, in 2001, the Commission entrusted Working Group VI (Security Interests) with the task of developing an efficient legal regime for security interests in goods involved in a commercial activity, including inventory.<sup>14</sup> At its thirty-fifth session, in 2002, the Commission confirmed the mandate given to the Working Group and that the mandate should be interpreted widely to ensure an appropriately flexible work product, which should take the form of a legislative guide.<sup>15</sup>

216. At its current session, the Commission had before it the reports of the Working Group on the work of its second (Vienna, 16-20 December 2002) and third (New York, 3-7 March 2003) sessions (A/CN.9/531 and A/CN.9/532, respectively). The Commission also had before it the report of the first joint session of Working Group V (Insolvency Law) and Working Group VI (A/CN.9/535).

217. The Commission commended Working Group VI for having completed the first reading of the chapters of the draft legislative guide on secured transactions (A/CN.9/WG.VI/WP.2 and Add.1-12) and the second reading

<sup>13</sup>*Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March-11 April 1980* (United Nations publication, Sales No. E.81.IV.3), part I.

<sup>14</sup>*Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3)*, paras. 358 and 359.

<sup>15</sup>Ibid., *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, para. 204.

of two chapters (A/CN.9/WG.VI/WP.6/Add.2 and 5). The Commission also expressed its appreciation to Working Group V and Working Group VI for the progress made during their first joint meeting on matters of common interest and noted with satisfaction the plans for joint expert meetings. In addition, the Commission noted with appreciation the presentation of modern registration systems of security rights in movable property, such as the system in New Zealand, which was organized in conjunction with the second session of Working Group VI, in December 2002, and for the plan of the secretariat to prepare a paper dealing with technical issues arising in the context of such registries, taking as an example the relevant registration system implemented recently in New Zealand. In that connection, it was suggested that reference should also be made to the *Guide to Movable Registries*, prepared recently by the Asian Development Bank, to the work undertaken under the auspices of the International Civil Aviation Organization towards an international notice-filing registry for international interests under the Convention on International Interests in Mobile Equipment<sup>16</sup> and the Protocol thereto on Matters Specific to Aircraft Equipment (Cape Town, 2001),<sup>17</sup> as well as to other similar papers being prepared by other organizations, such as the European Bank for Reconstruction and Development and the World Bank.

218. Moreover, the Commission emphasized the importance of coordination with organizations with interest and expertise in the field of secured transactions law, such as the International Institute for the Unification of Private Law (Unidroit), the Hague Conference on Private International Law, the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development and the Asian Development Bank. Reference was made to the current work of Unidroit on security rights in securities, to the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* to the extent they concerned secured transactions, to the Model Law on Secured Transactions and the *Principles* of the European Bank for Reconstruction and Development, to the Asian Development Bank's *Guide to Movable Registries* and to the Inter-American Model Law on Secured Transactions of 2002 prepared by the Organization of American States. Reference was also made to the need to coordinate with the Hague Conference with respect to the conflict-of-laws chapter of the draft legislative guide on secured transactions, in particular with respect to the law applicable to the enforcement of security rights in the case of insolvency. In that connection, in view of the fact that it was not clear whether Working Group V (Insolvency Law) would address the matter, it was suggested that experts from Working Group V might be asked to contribute to the discussion in Working Group VI.

219. With respect to coordination with the World Bank, the Commission noted an appeal by the Working Group for increased efforts (A/CN.9/532, para. 14) and noted with satisfaction that such efforts were actually under way in order to ensure that the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights*

*Systems* and the Commission's texts on secured transactions and insolvency were harmonized to form a single international standard.

220. With respect to the scope of work, it was suggested that Working Group VI should consider covering, in addition to goods (including inventory), certain types of intangible assets, such as trade receivables, letters of credit, deposit accounts and intellectual and industrial property rights, in view of their economic importance for modern financing practices. With respect to the importance of intellectual and industrial property rights, reference was made to equipment financing transactions in which security was also often taken in the trademark relating to such equipment and to transactions in which security was taken over the entirety of a debtor's assets. In view of the complexity of the matter and the expertise of international organizations such as the World Intellectual Property Organization, it was suggested that increased efforts of coordination and further studies were called for. There was broad support in the Commission for both suggestions. The Commission noted with satisfaction that the secretariat planned to prepare a working paper on those matters in consultation with all interested organizations.

221. As to the substance of the draft legislative guide, it was stated that, while the guide could discuss the various workable approaches to the relevant issues, it should also include clear legislative recommendations. It was observed that, with respect to issues in which alternative recommendations were formulated, the relative merits of each approach, in particular for developing countries and countries with economies in transition, needed to be discussed in detail.

222. After discussion, the Commission confirmed the mandate given to Working Group VI at its thirty-fourth session to develop an efficient legal regime for security rights in goods, including inventory, and its decision at its thirty-fifth session that the mandate should be interpreted widely to ensure an appropriate work product, which should take the form of a legislative guide. The Commission also confirmed that it was up to the Working Group to consider the exact scope of its work and, in particular, whether trade receivables, letters of credit, deposit accounts and intellectual and industrial property rights should be covered in the draft legislative guide.

## IX. MONITORING IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION

223. The Commission recalled that, at its twenty-eighth session, in 1995,<sup>18</sup> it had approved a project, undertaken jointly with Committee D of the International Bar Association, aimed at monitoring the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958, the "New York Convention").<sup>19</sup> It was noted that the purpose of the project, as approved by the Commission, was lim-

<sup>16</sup>DCME Doc. No. 74 (ICAO).

<sup>17</sup>DCME Doc. No. 75 (ICAO).

<sup>18</sup>*Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17)*, paras. 401-404.

<sup>19</sup>United Nations, *Treaty Series*, vol. 330, No. 4739.

ited to that aim and, in particular, that its purpose was not to monitor individual court decisions applying the New York Convention. The secretariat presented an oral progress report to the Commission informing the Commission that, as at 1 April 2003, there were 133 States parties to the New York Convention and the secretariat had received 66 replies to the questionnaire.

224. The Commission requested the secretariat to intensify its efforts to obtain the information necessary to make progress on the matter and to that end requested that the secretariat recirculate the questionnaire to the States parties to the New York Convention requesting those which had not yet replied to do so as soon as possible and requesting the States parties that had already replied to inform the secretariat about any new developments since their previous replies. The secretariat was also requested to obtain information from other sources, including from inter-governmental and non-governmental organizations.

#### X. POSSIBLE FUTURE WORK IN THE AREA OF PUBLIC PROCUREMENT

225. The deliberations of the Commission on public procurement were based on a note by the secretariat (A/CN.9/539) that set out current activities of other organizations in the area of public procurement and presented information on practical experience in the implementation of the UNCITRAL Model Law on Procurement of Goods, Construction and Services,<sup>20</sup> since its adoption in 1994.

226. It was observed that the UNCITRAL Model Procurement Law contained procedures aimed at achieving competition, transparency, fairness, economy and efficiency in the procurement process and had proved to be an important international benchmark in procurement law reform. Legislation based on or largely inspired by the UNCITRAL Model Procurement Law had been adopted in more than 30 jurisdictions in different parts of the world and the use of the UNCITRAL Model Procurement Law had resulted in widespread harmonization of procurement rules and procedures. The Commission's attention was drawn in that connection to the experience of law reform based on the UNCITRAL Model Procurement Law, together with issues that had arisen in the practical application of the Model Law.

227. One area of experience concerned the increased use of electronic commerce for public procurement, including methods based on the Internet, which were capable of further promoting the objectives of procurement legislation. For example, in addition to being efficient, electronic auctions could increase transparency over traditional tendering, while information technologies could be harnessed to improve supplier information. It had been argued, however, that, while many electronic procurement practices could be accommodated through the interpretation of existing laws and rules, undesirable obstacles to the use of electronic commerce in procurement might still remain. Some such obstacles were related to electronic procure-

ment procedures and might not be fully addressed by uniform legislation, in particular the UNCITRAL Model Law on Electronic Commerce (1996)<sup>21</sup> and the UNCITRAL Model Law on Electronic Signatures (2001),<sup>22</sup> which were based on the principle of functional equivalence of electronic and paper-based messages.

228. The Commission was also informed about the activities of selected international and regional organizations in the area of government procurement since the adoption of the UNCITRAL Model Procurement Law in 1994. Those activities reflected the growing importance of procurement regimes for the development of national economies and for regional and interregional integration. They also highlighted the need for harmonized and modern models and for coordination of efforts by international bodies active in the field of procurement.

229. Strong support was expressed for the inclusion of procurement law in the work programme of the Commission. An appropriate framework for public procurement was said to be essential for the efficient and transparent expenditure of public funds. Despite the widely recognized value of the UNCITRAL Model Procurement Law, novel issues and practices had arisen since its adoption, which might justify an effort to adjust its text. It was also observed by one delegate that alternative procurement methods, such as "reverse auction" and "off-the-shelf" purchases, should be taken into account, as those methods were believed to help in curbing collusion among bidders and to offer potential price savings, compared with traditional procurement methods such as tendering.

230. The Commission agreed to request the secretariat to prepare detailed studies on the issues identified in the note by the secretariat (A/CN.9/539 and Add.1) as a starting point, and to formulate proposals on how to address them with a view to their consideration by a working group that might be convened in the third quarter of 2004, subject to confirmation by the Commission at its thirty-seventh session (see below, para. 278 (a)). It was suggested that the secretariat's studies and proposals should take into account the fact that, in some countries, public procurement was not a matter for legislation, but for internal directives of ministries and government agencies. The Commission's work, it was further suggested, could also extend to the formulation of best practices, model contractual clauses and other forms of practical advice, in addition or as an alternative to legislative guidance. It was expected that the work would be carried out in close cooperation with organizations having experience and expertise in the area, such as the World Bank. The secretariat's studies should take into account the negotiations taking place in other international forums, such as the preparation of an international convention against corruption by the Ad Hoc Committee established by the General Assembly in its resolution 56/260 of 31 January 2002 and the negotiations under the auspices of the World Trade Organization and other international and regional organizations.

<sup>21</sup>United Nations publication, Sales No. E.99.V.4.

<sup>22</sup>*Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), annex II; see also General Assembly resolution 56/80, annex.

<sup>20</sup>*Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), annex I.



## XI. POSSIBLE FUTURE WORK RELATING TO COMMERCIAL FRAUD

231. At its thirty-fifth session,<sup>23</sup> in 2002, the Commission had considered a proposal that its secretariat prepare a study of fraudulent financial and trade practices in various areas of trade and finance for consideration at a future session of the Commission.

232. Also at its thirty-fifth session, the Commission had been informed that many fraudulent practices were international in character, that they had a significant adverse economic impact on world trade and that they also had a negative effect on the legitimate instruments of world trade. It was noted that the incidence of such fraud was growing, in particular since the advent of the Internet, which offered new opportunities for fraud.

233. After consideration of the proposal, the Commission decided that it should consider the question of work in the area of commercial fraud at a future session and requested the secretariat to carry out a study on fraudulent financial and trade practices in various areas of trade and finance. The Commission did not set a time limit for completion of the study, nor did it commit itself to taking action on the basis of it.<sup>24</sup>

234. At its thirty-sixth session, the Commission had before it a note by the secretariat on possible future work relating to commercial fraud (A/CN.9/540). The Commission noted with appreciation the work of the secretariat in convening a meeting of experts on the topic of commercial fraud in Vienna from 2 to 4 December 2002 and in preparing a note based on that meeting for the consideration of the Commission.

235. It was observed that commercial fraud continued to be an issue of growing concern in international trade and a threat to the world economy in general. It was noted that commercial fraud had grown significantly. It was suggested that the particular interests of victims of international commercial fraud should be borne in mind in future work in the area.

236. The Commission was informed that the advent and spread of technologies and use of the Internet had markedly affected the growth and incidence of commercial fraud, in particular given its transnational component. The Under-Secretary-General, the Legal Counsel, who also acted as Chairman of the Legal Advisers of the United Nations System, mentioned in that context that the Legal Advisers had discussed the absence of an international legal regime for the Internet. Pursuant to those discussions, the Legal Advisers had agreed on the following points, to be conveyed by them to Member States as appropriate:

(a) The Internet was of fundamental importance as a vehicle of communication, commerce, political and cultural expression, education and scientific cooperation;

<sup>23</sup>Ibid., *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, paras. 279-290.

<sup>24</sup>Ibid., para. 290.

(b) Because of the international nature and effects of the Internet, individual national laws and court systems were not able to provide an adequate legal framework for much of the activity that occurred on the Internet;

(c) It was urgent to develop a legal structure and institutions at the international level that favoured the further development of activity on the Internet in an environment of legal certainty and respect for the rule of law and for the international character of activity on the Internet.

237. The Commission's attention was drawn to efforts to combat fraud through international legal instruments in criminal law, both those already in existence (in particular, the United Nations Convention against Transnational Organized Crime (General Assembly resolution 55/25, annex I)) and those in the final stages of negotiation (in particular, the United Nations Convention against Corruption). The Commission considered the role that it could usefully play in that area, given its mandate in the area of international commercial law, in the face of the strong criminal law component of attempts to combat commercial fraud. It was noted that there were difficulties in developing a precise definition of commercial fraud, as a result, in particular, of its civil, regulatory and criminal law dimensions and that such ambiguity, exacerbated by obstacles to cross-border cooperation among the various competent authorities, was in fact used by perpetrators of commercial fraud to their own advantage. It was suggested that the difficulties in defining commercial fraud should not be seen as an impediment to the development of work in the area at the present stage and that a satisfactory definition would be more likely to result after further elucidation of the topic through discussion, dissemination of information and further study. It was noted that a key role for private law in the field could be its usefulness as a tool in the prevention of fraud. In particular, the Commission agreed that existing and future UNCITRAL texts could play an important role in that regard.

238. The Commission was informed that one of the major problems in attempting to combat commercial fraud in an effective manner was the difficulty of bringing together the appropriate public and private bodies necessary to do so. The Commission was seen as having a unique ability to marshal the necessary public and private interests in order to further efforts to combat commercial fraud effectively.

239. The Commission was informed that, for the time being, it could focus on coordinating with other bodies and highlighting awareness of commercial fraud. In that connection, it was mentioned that that could include highlighting the dangers of fraudulent schemes that could have a severe impact on the economies of developing countries, for example, pyramid schemes, especially when those schemes were perpetrated by persons from outside the affected countries. That should be done without intruding into issues pertaining to national criminal and regulatory laws.

240. Strong support was expressed for the recommendation made by the secretariat (A/CN.9/540, paras. 65-67)

that an international colloquium be organized to address various aspects of the problem of commercial fraud from the point of view of private law and to permit an exchange of views from various interested parties, including those working in national Governments, intergovernmental organizations and relevant private organizations with a particular interest and expertise in combating commercial fraud. Other interested United Nations bodies could be invited to participate in the colloquium, which would also provide an opportunity to promote an exchange of views with the criminal law and regulatory sectors that combat commercial fraud and to identify matters that could be coordinated or harmonized.

241. The Commission considered that it would be useful to conduct a study of forms of commercial fraud and was informed that it might be possible for the Commission on Crime Prevention and Criminal Justice to conduct such a study through the Centre for International Crime Prevention of the United Nations Office on Drugs and Crime, which could lead the research effort in consultation with UNCITRAL. It was suggested that the proposed colloquium on commercial fraud could serve as a useful forum to define the parameters of the study. The Commission was informed that the process of data collection and analysis would take two to three years and that interim reports would be provided to the Commission on Crime Prevention and Criminal Justice, if required. The Commission, noting that its resources were fully engaged in the formulation of private law rules and related activities, appealed to the Commission on Crime Prevention and Criminal Justice for assistance in conducting a study on commercial fraud as the basis for possible future work in that area. It was noted that the colloquium and related studies to be undertaken in cooperation with the Commission on Crime Prevention and Criminal Justice were considered useful of themselves and that there was no expectation of establishing an intergovernmental working group on commercial fraud.

## XII. CASE LAW ON UNCITRAL TEXTS, DIGESTS OF CASE LAW ON THE UNITED NATIONS SALES CONVENTION AND OTHER UNIFORM TEXTS

### A. Case law

242. The Commission noted with appreciation the continuing work under the system established for the collection and dissemination of case law on UNCITRAL texts (CLOUT), consisting of the preparation of case abstracts, compilation of the full text of decisions and the preparation of research aids and analytic tools such as thesauri and indices. To date, 41 issues of CLOUT have been prepared for publication, dealing with 476 cases. The Commission was informed about new enhancements to the CLOUT system, including, for the print editions, the addition of a table of cases included in that issue on the front cover, the inclusion of hyperlinks (active in the electronic version) to the full text of the decision in the original language (where available), as well as a hyperlink (active in the electronic version) to a translation into an official language of the United Nations (where available), the inclusion of an acknowledgement of the author of the ab-

stract, the inclusion of keywords (for cases interpreting the UNCITRAL Model Law on International Commercial Arbitration (1985))<sup>25</sup> and comprehensive indexing at the back of each issue. The Commission was informed about the preparation of a new thesaurus on the Model Arbitration Law as well as a comprehensive Model Arbitration Law index. The Commission viewed a demonstration of the new CLOUT search engine, which facilitated indexed access to individual CLOUT abstracts (currently those on the Model Arbitration Law), searchable by CLOUT abstract number, article number, jurisdiction, keyword, party name and date.

243. The Commission expressed its appreciation to the national correspondents for their work in selecting decisions and preparing case abstracts. It was noted that CLOUT continued to be an important aspect of the overall training and technical assistance information activities undertaken by UNCITRAL. The wide distribution of CLOUT in both print and electronic formats promoted the uniform interpretation and application of UNCITRAL texts by facilitating access to decisions and awards from other jurisdictions.

### B. Digests of case law on the United Nations Sales Convention and other uniform texts

244. The Commission recalled that, at its thirty-fourth session, in 2001,<sup>26</sup> it had requested its secretariat to prepare, in cooperation with experts and national correspondents, a text in the form of an analytic digest of court and arbitral decisions identifying trends in the interpretation of the United Nations Sales Convention. The Commission, recalling its considerations about the guidelines for preparing such a digest, was informed that, pursuant to its request at its thirty-fifth session,<sup>27</sup> in 2002, a draft digest had been prepared and was being edited, after which it would be circulated to Governments, national correspondents and other interested parties for comment prior to finalization and publication. The Commission expressed its appreciation to the experts and national correspondents for their contribution to the preparation of the initial draft chapters of the digest on the Convention.

245. The Commission was further informed that, pursuant to its request at its thirty-fifth session, the initial drafts of the digest on the Model Arbitration Law had been prepared by its secretariat, which was also exploring the feasibility of preparing a digest of case law on the New York Convention. It was noted that, while the preparation of digests on the United Nations Sales Convention and the UNCITRAL Model Arbitration Law had been carried out in cooperation with national correspondents, there were no national correspondents for the New York Convention and that, therefore, it would be useful to explore the possibility of preparing a digest on that Convention in cooperation with an organization such as the International Council for Commercial Arbitration.

<sup>25</sup>Ibid., *Fortieth Session, Supplement No. 17 (A/40/17)*, annex I.

<sup>26</sup>Ibid., *Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3)*, para. 395.

<sup>27</sup>Ibid., *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, para. 243.

### XIII. TRAINING AND TECHNICAL ASSISTANCE

246. The Commission had before it a note by the secretariat (A/CN.9/536) describing the training and technical activities undertaken since its thirty-fifth session, in 2002, and the direction of future activities, in particular in view of the increase in the requests for such activities received by the secretariat of the Commission. It was noted that training and technical assistance activities were typically carried out through seminars and briefing missions designed to explain the salient features of UNCITRAL texts and the benefits to be derived from their adoption. Such seminars and briefing missions were often followed by assistance in the drafting or finalizing of legislation.

247. It was also noted that, since the thirty-fifth session of the Commission, such seminars and briefing missions had been organized by the secretariat in the following cities: Belo Horizonte, Brazil (27-29 May 2002); Florianopolis, Brazil (30 May 2002); Quito (4 and 5 July 2002); Guayaquil, Ecuador (8 and 9 July 2002); Dhaka (28 October 2002); Bangkok (20-22 November 2002); Ouagadougou (19-21 November 2002); Astana (3 and 4 February 2003); and Hanoi (2-4 April 2003). In addition, it was noted that members of the secretariat had participated as speakers in a number of meetings convened by other organizations. Moreover, it was noted that a number of requests had been turned down for lack of resources.

248. The Commission expressed its appreciation for the activities undertaken and emphasized the importance of the training and technical assistance programme for the unification and harmonization efforts that were at the heart of the Commission's mandate. It was stated that training and technical assistance were particularly useful for developing countries and countries with economies in transition lacking expertise in the areas covered by the work of UNCITRAL. It was also observed that training and technical assistance activities of the secretariat could play an important role in the economic integration efforts being undertaken by many countries.

249. The Commission expressed its appreciation to France, Greece and Switzerland for their contribution to the UNCITRAL trust fund for symposiums and to Austria, Cambodia, Cyprus, Kenya, Mexico and Singapore for their contributions to the trust fund for travel assistance to developing countries that are members of the Commission and to other States. The Commission also expressed its appreciation to organizations that had contributed to the programme by providing funds or staff or by hosting seminars.

250. Stressing the importance of extrabudgetary funding, the Commission again appealed to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL trust funds to enable its secretariat to meet the increasing demands for training and assistance and to enable delegates from developing countries to attend UNCITRAL meetings. It was suggested that the secretariat should actively seek contributions from donor countries and organizations, for instance by formulating concrete proposals for projects to support its training and technical assistance activities.

251. In view of the limited resources available to the secretariat of the Commission, whether from budgetary or extrabudgetary resources, strong concern was expressed that the Commission could not fully implement its mandate with regard to training and technical assistance. The Commission noted the remarks made by the Office of Internal Oversight Services, in its report on the in-depth evaluation of legal affairs (E/AC.51/2002/5, para. 64), to the effect that it would be useful for assessment to be made on the effectiveness of the training and assistance provided and requested the secretariat to consider implementing that suggestion. Concern was also expressed that, without follow-up actions and effective cooperation and coordination between the secretariat and development assistance agencies providing or financing technical assistance, international assistance might lead to the adoption of national laws that did not represent internationally agreed standards. In that connection, the Commission noted with appreciation the initial steps taken to implement the request of the General Assembly that the Secretary-General increase substantially both the human and the financial resources available to the secretariat, part of which would be used to ensure the effective implementation of the training and assistance programme of the Commission and the timely publication and dissemination of its work (see below, paras. 256-261).

### XIV. STATUS AND PROMOTION OF UNCITRAL LEGAL TEXTS

252. On the basis of a note by the Secretariat (A/CN.9/537), the Commission considered the status of the conventions and model laws emanating from its work, as well as the status of the New York Convention. The Commission noted with pleasure the new action of States and jurisdictions subsequent to the closure of its last session on 28 June 2002 regarding the following instruments:

(a) United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). New action by the Syrian Arab Republic; number of States parties: 29;

(b) United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). New action by Honduras; number of States parties: 62;

(c) Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). New actions by Brazil, Jamaica and Qatar; number of States parties: 133;

(d) UNCITRAL Model Law on International Commercial Arbitration (1985). New jurisdictions that have enacted legislation based on the Model Law: Azerbaijan, Jordan, Paraguay, Illinois (United States of America) and Zambia;

(e) UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994). New jurisdictions that have enacted legislation inspired by the Model Law: Gambia, Malawi, Republic of Moldova and Romania;

(f) UNCITRAL Model Law on Electronic Commerce (1996). New jurisdictions that have implemented provisions of the Model Law: Jordan, Mexico, New Zealand, Pakistan, Thailand and Venezuela. New legislation has also been adopted on the basis of the Model Law in the Bailiwick of Guernsey and the Isle of Man (Crown Dependencies of the United Kingdom of Great Britain and Northern Ireland) and the Turks and Caicos Islands (Overseas Dependent Territory of the United Kingdom of Great Britain and Northern Ireland);

(g) UNCITRAL Model Law on Cross-Border Insolvency (1997). New jurisdiction that has enacted legislation based on the Model Law: Japan;

(h) UNCITRAL Model Law on Electronic Signatures (2001). New jurisdiction that has enacted legislation based on the Model Law: Thailand.

253. The Commission noted with appreciation the reports by a number of States that official action was being considered with a view to adherence to various conventions and to the adoption of legislation based on various model laws prepared by UNCITRAL. States that had enacted or were about to enact a model law prepared by the Commission or that were considering legislative action regarding a convention resulting from the work of the Commission, were requested to inform the secretariat of the Commission thereof. Consideration might also be given to reporting activities towards legislative action on an UNCITRAL text and legislation influenced by an UNCITRAL text. States that had enacted legislation based on UNCITRAL model laws were requested to provide copies to the UNCITRAL secretariat for inclusion in the UNCITRAL library. In that connection, the Commission was informed that the secretariat was examining the feasibility of including copies of such legislation on the UNCITRAL web site, in the original language and, where available, in a translation, even if unofficial, into one or more of the official languages of the United Nations. Making available domestic enactments of UNCITRAL instruments was said to be useful to other States in their consideration of similar legislative action. Member States were requested to assist the secretariat in obtaining the necessary licences to publish legislation on the UNCITRAL web site, in cases where specific texts or legislation databases were subject to copyright protection.

254. The Commission noted that to be complete and produce practical results, efforts towards the unification and harmonization of trade law needed to result in the adoption and uniform application by States of texts prepared by the Commission. To achieve that result, the Commission requested its secretariat to increase its efforts aimed at assisting States in considering texts prepared by the Commission for adoption. The Commission appealed to the representatives and observers attending the meetings of the Commission and its working groups to contribute, to the extent they deemed appropriate, to facilitating consideration of texts of the Commission by legislative organs of their States.

## XV. GENERAL ASSEMBLY RESOLUTIONS ON THE WORK OF THE COMMISSION AND FOLLOW-UP TO THE IN-DEPTH EVALUATION OF THE WORK OF THE COMMISSION'S SECRETARIAT

### A. Resolutions 57/17, 57/18 and 57/20

255. The Commission took note with appreciation of General Assembly resolutions 57/17, on the report of the Commission on the work of its thirty-fifth session, 57/18, on the UNCITRAL Model Law on International Commercial Conciliation, and 57/20, on the enlargement of the membership of the Commission, all of 19 November 2002.

### B. Resolution 57/19

256. The Commission also took note with appreciation of General Assembly resolution 57/19 of 19 November 2002 on enhancing coordination in the area of international trade law and strengthening the secretariat of UNCITRAL. Pursuant to paragraph 2 of resolution 57/19, the Commission considered the practical implications of the working methods it had adopted in 2001 (see chap. XVIII below).

257. The Commission recalled its deliberations at its thirty-fifth session,<sup>28</sup> in 2002, regarding the strengthening of its secretariat. The Commission was informed of the budget proposal made with respect to the Office of Legal Affairs of the Secretariat for the biennium 2004-2005, more particularly regarding subprogramme 5 (Progressive harmonization and unification of the law of international trade) of section 8 (Legal affairs) of the proposed programme budget (A/58/6). It was noted that the Legal Counsel, in preparing his submission for the budget requirements of the Office of Legal Affairs for the biennium 2004-2005 had found it possible to increase the level of resources for the UNCITRAL secretariat within the existing resources in the Office. As a result, the Secretary-General was essentially proposing that the International Trade Law Branch be restructured and expanded by three lawyers and one General Service staff member and that it become a division of the Office of Legal Affairs. The Division would be based on two pillars, one dealing primarily with uniform legislation and the other focusing on coordination and external affairs.

258. The first pillar would essentially take care of the traditional function performed by the secretariat of UNCITRAL in support of the legislative activities of the Commission and its working groups. The second pillar would deal essentially with the coordination function and with external affairs as envisaged in General Assembly resolution 2205 (XXI) of 17 December 1966, by which UNCITRAL was established. The role of that pillar would be centred around coordination of the work of international organizations active in the field of international trade law; technical legislative assistance, in particular to developing countries, to facilitate their participation in existing conventions and the implementation of model

<sup>28</sup>Ibid., paras. 258-271.

legislation prepared by UNCITRAL; and dissemination of information on modern legal developments, including case law, in the field of international trade law. In addition, States involved in providing technical assistance to developing countries in areas of commercial law reform were encouraged to use the Commission's documentation and, where feasible, collaborate with its secretariat and other member States in that work.

259. The Commission agreed that the coordination function, already important in 1966, had become essential in recent years, in view of the increased number of organizations, intergovernmental and non-governmental, involved in the production of legal standards. The production of reports on activities of organizations active in the field of international trade law should be resumed. The promotion of uniform legal standards should involve considerably expanded input by the UNCITRAL secretariat in supporting developing countries that required assistance with the technicalities of modernization of their laws. The dissemination of information required considerable resources to maintain and update the CLOUT databases and to produce digests of case law on the main instruments that resulted from the work of UNCITRAL. That work had already started, but was not progressing rapidly enough to meet demand because of the lack of adequate resources. It was estimated that a total of four Professional staff, headed by a Senior Legal Officer, were the minimum resources necessary for that second pillar.

260. The Commission noted that the above proposal needed to receive a favourable recommendation from both the Fifth Committee and the Sixth Committee of the General Assembly. The Commission urged its member States and the Assembly to take every step necessary to expedite the long-awaited increase in the resources of the secretariat of the Commission.

261. Having strongly supported the proposed creation of the International Trade Law Division, the Commission expressed its particular appreciation to the Under-Secretary-General, the Legal Counsel, for his personal involvement and his decisive contribution to the process of unification, harmonization and modernization of international trade law in the interest of world peace and stability.

## XVI. COORDINATION AND COOPERATION

### A. International Institute for the Unification of Private Law (Unidroit)

262. The Secretary-General of the International Institute for the Unification of Private Law (Unidroit) reported on the adoption in 2002 of a Model Law on Disclosure in Franchising and informed the Commission of instruments finalized or adopted since the thirty-fifth session of the Commission, in 2002, or currently being discussed at Unidroit.

263. The Commission was informed of two joint sessions of the Unidroit Governing Council and representatives of Governments of member States ("brainstorming

sessions"), which were designed to undertake an in-depth review of mid-term and long-term planning of the activities of Unidroit. In that connection, the Commission noted the request arising from those sessions to set up a common coordinating mechanism of the three organizations engaged in the formulation of universal private law, namely, UNCITRAL, the Hague Conference on Private International Law and Unidroit. One method of coordination would be for their three secretariats to meet once a year with a view to exchanging information regarding ongoing and future work and, in particular, attempting to coordinate dates for working sessions and other meetings so as to enable Governments to plan their participation in the work of all three organizations in a systematic manner. The secretariats should, if possible and where appropriate, also identify ways to involve other regional intergovernmental and international organizations engaged in the formulation of private and commercial law in such coordination.

### B. Regional economic commissions of the United Nations

264. The Commission considered a note by Henry M. Joko-Smart (Sierra Leone), Chairman of the twenty-first and thirty-fifth sessions of the Commission, in 1988 and 2002, respectively, on the possible duplication of efforts between the Commission and the regional commissions of the Economic and Social Council, in particular the Economic Commission for Europe. The note read as follows:

"1. As Chairman of the twenty-first (1988) and thirty-fifth (2002) sessions of UNCITRAL, I propose that the Commission, at its thirty-sixth session (2003), consider certain developments that may increase the risk of a possible overlap or duplication of efforts between UNCITRAL, on the one hand, and regional economic commissions, in particular the Economic Commission for Europe (ECE) of the United Nations, on the other hand. I would like to point out that various budgetary documents published with respect to ECE raise new concerns, in particular in view of the risk of duplication of efforts between such a regional organization and a universal body like UNCITRAL.

"2. For example, the proposed programme budget for the biennium 2004-2005 in respect of the ECE<sup>1</sup> suggests that 'a new impulse will be given to globalizing some of [the] agreements and standards [prepared by ECE], in particular in the areas of transport [and] trade facilitation'.<sup>2</sup> The document mentions a 'growing demand on ECE to organize global conferences and events'.<sup>3</sup> This suggests that the focus of ECE, when promoting its existing norms and standards and preparing new instruments, including legal standards, is increasingly global.

"3. An increase in ECE's activities with respect to norms and standards and an increased policy dialogue on the regulatory framework for trade facilitation are welcome developments for the countries represented in ECE. However, I would suggest that member States take a position about the wisdom of endorsing a new impulse to globalizing ECE work, in view of the fact that ECE is a regional organization and does not have the univer-

sal constituency necessary to produce global instruments. Coming from a country that is not represented at the Economic Commission for Europe, I could hardly overstate my surprise at seeing a regional body venturing into global harmonization of law. I believe that delegates from other regions will share my sentiment. If ECE's goal is to participate more actively in global bodies and influence them with the benefit of regional experience and standards, such an activity may be useful, but coordination and oversight by the ECE and UNCITRAL member States will be necessary. My suggestion is not to handicap ECE, but to avoid having the United Nations speak with two voices at the global level.

"4. Difficulties in coordination with ECE are not new. Already in 1995, we at UNCITRAL expressed our general concern with the possible implications of a document (TRADE/WP.4/R.1104), published in preparation for what later became the Centre for Trade Facilitation and Electronic Business (CEFACT), established within ECE.<sup>4</sup> That document suggested that the Economic and Social Council should recognize [CEFACT] as 'the centre of competence for all of the United Nations' in the area of trade facilitation (para. 64). The terms of reference suggested for CEFACT included '[facilitation of] international transactions, through the simplification and harmonization of procedures and information flows, thereby contributing to the growth of global commerce. To accomplish this general task, the Committee [should] in particular: review and analyse the procedures required to perform international transactions with a view to their reduction, simplification and harmonization; [...] develop recommendations to address legal issues and remove legal constraints to electronic trade transactions and electronic procedures; coordinate and, where relevant, harmonize the programme of work with other international organizations such as [...] UNCITRAL' (para. 72). As part of the suggested work programme for the proposed new Committee, 'the following would be given high priority: [...] develop recommendations to address legal issues and remove legal constraints to electronic transactions and to electronic procedures' (para. 96).

"5. At that time, we reiterated UNCITRAL's support of ECE's work in the technical field, particularly as regards the development of EDIFACT messages. However, the conclusion by UNCITRAL was that, in view of its general mandate as the core legal body in the field of international trade law in the United Nations system, the above-mentioned proposals by ECE were not acceptable. We then agreed that the matter should be brought to the attention of the General Assembly.<sup>5</sup>

"6. The result was a reaffirmation by the General Assembly of UNCITRAL's mandate to coordinate legal activities in this field in order to avoid duplication of effort and to promote efficiency, consistency and coherence in the unification and harmonization of international trade law. The General Assembly further recommended that UNCITRAL, through its secretariat, should continue to maintain close cooperation with the other international organs and organizations, including regional organizations active in the field of international trade law.<sup>6</sup>

"7. In its founding resolution 2205 (XXI), UNCITRAL received from the General Assembly, as the first task of its multifaceted role in the progressive harmonization and unification of the law of international trade, the mandate to coordinate the work of organizations active in this field and encourage cooperation among them.<sup>7</sup>

"8. Since 1995, in view of the increase of topics worked on by UNCITRAL, the need to avoid overlap and duplication of work in the United Nations system has become even more pressing. Last year we were informed that the Office of Internal Oversight Services (OIOS), as a result of its in-depth evaluation of legal affairs,<sup>8</sup> had noted that critical situation, particularly in its recommendations 13, on UNCITRAL's increased coordination with trade law organizations, and 15, on UNCITRAL's expanded programme of work.<sup>9</sup>

"9. I would like to conclude this note by suggesting that, in view of the above illustrations of possible difficulties between UNCITRAL and regional organizations active in the legal field, despite the continued relevance of General Assembly resolution 50/47, it may not be sufficient simply to renew a call for increased cooperation between various units of the United Nations Secretariat. In my view, UNCITRAL should urge each member State and observer to ensure coordination between its delegation to UNCITRAL on the one hand and its delegation to the relevant regional commission on the other hand."

<sup>1</sup>A/58/6 (sect. 20).

<sup>2</sup>Ibid., para. 20.6.

<sup>3</sup>Ibid., para. 20.16.

<sup>4</sup>CEFACT held its first session in 1997.

<sup>5</sup>The above discussion is reflected in more detail in the report of the Commission on the work of its twenty-eighth session, *Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17)*, paras. 310-313.

<sup>6</sup>General Assembly resolution 50/47.

<sup>7</sup>General Assembly resolution 2205 (XXI), sect. II, para. 8.

<sup>8</sup>See E/AC.51/2002/5.

<sup>9</sup>Ibid., para. 82.

265. The Commission strongly endorsed the remarks made in the note by the Chairman of the twenty-first and thirty-fifth sessions and approved his conclusions. It was stated that the type of difficulty outlined in the note, that is, the potential overlap between the work of a truly global body like the United Nations Commission on International Trade Law and that of a regional body within the United Nations system seeking global outreach was the type of recurring situation that should be avoided as it might damage the image of the United Nations and reduce the effectiveness of its action in support of modernization of trade law and might also result in inefficient use of already scarce resources. The Commission was of the view that the matter should be further discussed by appropriate organs of the General Assembly. The Commission also urged each of its member States to foster coordination between its delegation to UNCITRAL and its delegation to the regional commission for its region.

## XVII. OTHER BUSINESS

### A. Bibliography

266. The Commission noted with appreciation the bibliography of recent writings related to its work (A/CN.9/538). The Commission was informed that the bibliography was being updated on the UNCITRAL web site (www.uncitral.org) on an ongoing basis and that, for each UNCITRAL topic, a consolidated bibliography covering the period 1993-2003 had been made available online. The Commission stressed that it was important for the bibliography to be as complete as possible and, for that reason, requested Governments, academic institutions, other relevant organizations and individual authors to send copies of relevant publications to its secretariat.

### B. Willem C. Vis International Commercial Arbitration Moot

267. It was noted that the Institute of International Commercial Law at Pace University School of Law in White Plains, New York, had organized the Tenth Willem C. Vis International Commercial Arbitration Moot in Vienna from 11 to 17 April 2003. As in previous years, the Moot had been co-sponsored by the Commission. It was noted that legal issues dealt with by the teams of students participating in the Tenth Moot had been based on the United Nations Sales Convention, the Arbitration Rules of the German Institution of Arbitration (DIS), the UNCITRAL Model Law on International Commercial Arbitration and the New York Convention. Some 128 teams from law schools in 40 countries had participated in the Tenth Moot. The best team in oral arguments was that of the National University of Juridical Sciences, from Calcutta, India. The Commission took note that its secretariat had also organized lectures relating to its work coinciding with the period in which the Moot had been held. It was widely felt that the annual Moot, with its broad international participation, presented an excellent opportunity to disseminate information about uniform law texts and teaching international trade law. It was noted that the Eleventh Willem C. Vis International Commercial Arbitration Moot was to be held in Vienna from 2 to 8 April 2004.

268. On the occasion of the Tenth Moot, the Commission expressed its appreciation to Eric E. Bergsten, former Secretary of the Commission, for successfully developing and directing the annual event since its beginning in 1993/1994, and to the Institute of International Commercial Law for organizing it.

### C. UNCITRAL web site

269. The Commission expressed its appreciation for the UNCITRAL web site, regarded as an important component of the Commission's overall programme of information activities and training and technical assistance. It was noted that the UNCITRAL web site could be accessed worldwide by a wide range of users, including parliamentarians, judges, practitioners and academics. It was stated

that the web site provided delegates with rapid access to working texts in the six official languages of the United Nations, thus promoting transparency and facilitating the work of the Commission. Materials on the web site included adopted texts, up-to-date reports on the status of conventions and adopted texts, court and arbitral decisions interpreting UNCITRAL texts (CLOUT) and bibliographies of scholarly writing related to the work of the Commission. The Commission was informed of new enhancements to the UNCITRAL web site, including the ongoing addition of *travaux préparatoires* of UNCITRAL texts, the placement online of all volumes of the *UNCITRAL Yearbook* from 1968 to 1995 and the introduction of the new CLOUT search engine. The UNCITRAL web site was fully navigable in English, French and Spanish. It was anticipated that the site would be fully navigable in Russian by the end of 2003. Possible future developments were discussed, including the possibility of making available online audio and video recordings of lectures about the work of UNCITRAL, making the *UNCITRAL Yearbook* available online in Arabic and Chinese, and creating links to enactment of model laws in their original languages and links to translations of UNCITRAL texts in other languages, such as German and Portuguese.

## XVIII. DATE AND PLACE OF FUTURE MEETINGS

### A. General discussion on the duration of sessions

270. Pursuant to paragraph 2 of General Assembly resolution 57/19 of 19 November 2002 on enhancing coordination in the area of international trade law and strengthening the secretariat of the United Nations Commission on International Trade Law (see above, paras. 256-261), the Commission considered the practical implications of its working methods, in particular as regards the increase from three to six working groups working in parallel and the corresponding shortening of the duration of the working group sessions from two weeks to one week.

271. The Commission recalled that for many years it had had at its disposal an entitlement of four weeks per year to hold its plenary sessions and a total of 12 weeks of conference services per year (six weeks in Vienna and six weeks in New York) to hold its working group sessions. It was also recalled that over the previous two years the Commission had gradually introduced a new pattern of either one-week (five working days) or two-week sessions for working groups. At its thirty-fifth session,<sup>29</sup> in 2002, the Commission considered that, on the whole, its working methods had demonstrated their efficiency, thus implying that the new pattern of meetings introduced in 2001 had proved to be useful. The disadvantage of shortening the duration of a session of a working group from nine days to five days was considered to be outweighed by the advantages, which included the ability of the Commission to work on more than three subjects (which was necessary in view of the pressing need for modernization of commercial laws in an increased number of areas of commercial law); the savings in time and expenditure for delegates attending a given session; and the experience that a number of mem-

<sup>29</sup>Ibid., para. 271.

bers of delegations of member States and observers were able to attend a five-working-day session whereas, owing to their busy agenda, they could not attend a two-week session.

272. At its current session, the Commission noted, however, that there were two working groups in particular that, in view of the magnitude of their topics and the need to speed up their work, would benefit from being able to hold two-week sessions without thereby postponing the other working group sessions, which also had urgent topics on their agenda. Such a situation was expected to exist at least during the years 2004 and 2005. The working groups needing an increase in the duration of their sessions were Working Group III (Transport Law) (which had been able to meet for two two-week periods because it had been able to use the conference time of Working Group I) and Working Group VI (Security Interests). It was recalled that Working Group III (Transport Law) was in the process of preparing a preliminary draft instrument on the carriage of goods, which was a particularly lengthy and complex document. Working Group VI (Security Interests) was in the process of preparing a draft guide on secured transactions, which was also a complex instrument and which had to be completed by 2005 in order to fit in with the work of other international organizations.

273. Support was expressed for the extension of the duration of the sessions of Working Group III and Working Group VI. It was recalled that, when it had established the six working groups meeting in a one-week pattern in 2001, the Commission had expressed its understanding that the new arrangements should be used in a flexible manner and that, depending on its relative priority, a working group could devote an entire two-week session to the consideration of only one topic, while other topics could be combined for consideration by a working group within a two-week period of meeting.<sup>30</sup> As to the total number of 12 weeks of conference services per year currently allotted to working group sessions, it was proposed that the Commission should request the Committee on Conferences to allocate the necessary additional resources. The Commission was informed of the practical implications of that proposal, which would require up to four weeks of additional conference meetings and would result in conference costs (e.g. the cost of conference rooms, document clerks and conference officers, sound recording and engineering and interpretation services).<sup>31</sup>

274. Objections were raised to changing the new meeting pattern only two years after it had been established. It was pointed out that only in exceptional circumstances could such a deviation from established practice be recommended. It was proposed that, should they wish to be

<sup>30</sup>*Ibid.*, *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 382. The entire discussion held during that session regarding the working methods of the Commission is contained in paragraphs 376-384.

<sup>31</sup>The Commission noted that the total cost for extension by one additional week of a working group session per year in Vienna would be €68,166. The total cost for extension by one additional week of a working group session in New York would be \$80,565 for the year 2004 and \$82,338 for the year 2005.

considered by the Commission for an increase in the conference resources allocated to them, working groups should make a request indicating the precise reasons for which such a derogation was sought. One delegate stated that neither Working Group III nor Working Group VI had sufficiently explained the reasons for which an increase in conference services was necessary for continuation of its work. Some support was received for the view that, in justifying an increase in conference services, a working group should include a time frame for completion of its task.

275. After discussion, the Commission decided that a spirit of flexibility should prevail when considering the possibility of increasing the amount of conference services allocated to a working group. It was generally agreed that working groups should normally meet for a one-week session twice a year. Within the current entitlement of 12 weeks of conference services for all six working groups, extra time could be allocated to a working group if another working group did not make full use of its entitlement. However, any request for an increase in the duration of sessions that would result in more than 12 weeks of conference services being required by working groups should be reviewed by the Commission, with proper justification being given by each working group regarding the reasons for which a change in the meeting pattern was needed. As to the specific case of Working Group III and Working Group VI, it was noted that two weeks of conference time would become available before the next Commission session, in view of the fact that Working Group I (Procurement) would not reconvene until the second half of 2004. It was decided that those two additional weeks should be allocated to Working Group III for continuation of its work. As to the possibility of adding one or two weeks to the 12-week allotment to accommodate the needs of Working Group VI, it was decided that the issue might need to be reopened at the next session on the basis of a reasoned request by the Working Group before the matter could be taken to the Committee on Conferences.

## B. Thirty-seventh session of the Commission

276. The Commission approved holding its thirty-seventh session in New York from 14 June to 2 July 2004. It was noted that the Commission did not intend to make full use of its four-week allotment of conference services in 2004. The duration of the session might be shortened further, should a shorter session become advisable in view of the draft texts produced by the various working groups.

## C. Sessions of working groups up to the thirty-seventh session of the Commission

277. The Commission approved the following schedule of meetings for its working groups, subject to possible cancellation of working group sessions being decided by the respective working groups in situations where, for lack of the necessary resources, the secretariat could not envisage the timely production of the necessary documentation:



(a) Working Group I (Procurement). The sixth session was rescheduled to be held during the second half of 2004; the two weeks of sessions initially scheduled for Working Group I were allocated to Working Group III (Transport Law) by the Commission to allow it to hold two sessions, for a duration of two weeks each;

(b) Working Group II (Arbitration) is to hold its thirtieth session in Vienna from 10 to 14 November 2003, immediately before the session of Working Group IV, and its fortieth session in New York from 23 to 27 February 2004;

(c) Working Group III (Transport Law) is to hold its twelfth session in Vienna from 6 to 17 October 2003 and its thirteenth session in New York from 3 to 14 May 2004;

(d) Working Group IV (Electronic Commerce) is to hold its forty-second session in Vienna from 17 to 21 November 2003, immediately after the session of Working Group II, and its forty-third session in New York from 15 to 19 March 2004, immediately before the session of Working Group V;

(e) Working Group V (Insolvency Law) is to hold its twenty-ninth session in Vienna from 1 to 5 September 2003, immediately before the session of Working Group VI, and its thirtieth session in New York from 22 to 26 March 2004, immediately after the session of Working Group IV;

(f) Working Group VI (Security Interests) is to hold its fourth session in Vienna from 8 to 12 September 2003, immediately after the session of Working Group V, and its fifth session in New York from 29 March to 2 April 2004, immediately after the session of Working Group V.

#### **D. Sessions of working groups after the thirty-seventh session of the Commission**

278. The Commission noted that tentative arrangements had been made for working group meetings after its thirty-seventh session (the arrangements are subject to the approval of the Commission at its thirty-seventh session):

(a) Working Group I (Procurement) would hold its sixth session in Vienna from 11 to 15 October 2004, immediately before the session of Working Group IV;

(b) Working Group II (Arbitration) would hold its forty-first session in Vienna from 13 to 17 September 2004;

(c) Working Group III (Transport Law) would hold its fourteenth session in Vienna from 22 November to 3 December 2004 (see paras. 270-275);

(d) Working Group IV (Electronic Commerce) would hold its forty-fourth session in Vienna from 18 to 22 October 2004, immediately after the session of Working Group I;

(e) Working Group V (Insolvency Law). The thirty-first session was rescheduled to be held in 2005, depending on its work programme and subject to the approval of the Commission; the one-week session initially scheduled for Working Group V to meet during the second half of 2004 was provisionally allocated by the Commission to Working Group III (Transport Law) to allow it to hold a two-week session;

(f) Working Group VI (Security Interests) would hold its sixth session in Vienna from 30 August to 3 September 2004.

#### **ANNEX I**

##### ***UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects***

[Annex I is reproduced in part three, I of this *Yearbook*.]

#### **ANNEX II**

##### ***List of documents before the Commission at its thirty-sixth session***

[Annex II is reproduced in part three, V of this *Yearbook*.]

#### **B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board (fiftieth session) (TD/B/50/14 (Vol. I))**

##### **“D. Other action taken by the Board**

##### **Progressive development of the law of international trade: thirty-sixth annual report of the United Nations Commission on International Trade Law (agenda item 8)**

3. At its 950th plenary meeting, on Tuesday, 14 October 2003, the Board took note of the report of UNCITRAL on the work of its thirty-sixth session (A/58/17).

**C. General Assembly: Report of the United Nations Commission on International Trade Law on the work of its thirty-sixth session: report of the Sixth Committee (A/58/513)**

**I. INTRODUCTION**

1. At its 2nd plenary meeting, on 19 September 2003, the General Assembly, on the recommendation of the General Committee, decided to include in the agenda of its fifty-eighth session the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-sixth session" and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 2nd, 3rd and 12th meetings, on 6 and 21 October 2003. The views of the representatives who spoke during the Committee's consideration of the item are reflected in the relevant summary records (A/C.6/58/SR.2, 3 and 12).

3. For its consideration of the item, the Committee had before it the report of the United Nations Commission on International Trade Law on its thirty-sixth session.<sup>1</sup>

4. At the 2nd meeting, on 6 October, the Chairman of the United Nations Commission on International Trade Law at its thirty-sixth session introduced the report of the Commission on the work of that session. At the same meeting, the Legal Counsel made a statement (see A/C.6/58/SR.2).

**II. CONSIDERATION OF PROPOSALS**

**A. Draft resolution A/C.6/58/L.11**

5. At the 12th meeting, on 21 October, the representative of Austria, on behalf of Afghanistan, Algeria, Armenia, Australia, Austria, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, the Democratic Republic of the Congo, Denmark, Finland, Germany, Greece, Guatemala, Hungary, India, the Islamic Republic of Iran, Ireland, Israel, Italy, Japan, Liechtenstein, Lithuania, Madagascar, Malaysia, Malta, Mexico, Mongolia, Morocco, New Zealand, Norway, Paraguay, the Philippines, Portugal, Romania, the Russian Federation, Serbia and Montenegro, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Thailand, The former Yugoslav Republic of Macedonia, Trinidad and Tobago, Tunisia, Turkey, Ukraine, the United Kingdom of Great Britain and Northern Ireland and Venezuela, introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-sixth session" (A/C.6/58/L.11).

6. At the same meeting, the Committee adopted draft resolution A/C.6/58/L.11 without a vote (see para. 9, draft resolution I).

<sup>1</sup>Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17).

**B. Draft resolution A/C.6/58/L.12**

7. At the 12th meeting, on 21 October, the Chairman of the Committee introduced a draft resolution entitled "Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Nations Commission on International Trade Law" (A/C.6/58/L.12).

8. At the same meeting, the Committee adopted draft resolution A/C.6/58/L.12 without a vote (see para. 9, draft resolution II).

**III. RECOMMENDATIONS OF THE SIXTH COMMITTEE**

9. The Sixth Committee recommends to the General Assembly the adoption of the following draft resolutions:

*Draft resolution I*

*Report of the United Nations Commission on International Trade Law on the work of its thirty-sixth session*

*The General Assembly,*

*Recalling* its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law with a mandate to further the progressive harmonization and unification of the law of international trade and in that respect to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

*Reaffirming its belief* that the progressive modernization and harmonization of international trade law, in reducing or removing legal obstacles to the flow of international trade, especially those affecting the developing countries, would contribute significantly to universal economic cooperation among all States on a basis of equality, equity and common interest and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples,

*Having considered* the report of the Commission on its thirty-sixth session,<sup>2</sup>

*Concerned* that activities undertaken by other bodies in the field of international trade law without adequate coordination with the Commission might lead to undesirable duplication of efforts and would not be in keeping with the aim of promoting efficiency, consistency and coherence in the unification and harmonization of international trade law,

<sup>2</sup>Ibid.

*Reaffirming* the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in this field, in particular to avoid duplication of efforts, including among organizations formulating rules of international trade, and to promote efficiency, consistency and coherence in the modernization and harmonization of international trade law, and to continue, through its secretariat, to maintain close cooperation with other international organs and organizations, including regional organizations, active in the field of international trade law, as stated in General Assembly resolution 50/47 of 11 December 1995,

*Taking note* of the proposals made by the Secretary-General in the proposed programme budget for the biennium 2004-2005 with a view to strengthening the secretariat of the Commission within the bounds of the resources available in the Organization so as to enable it to deal with the increased workload arising, inter alia, from the coordination of work with other organizations and growing demands for legislative technical assistance,<sup>3</sup>

1. *Takes note with appreciation* of the report of the United Nations Commission on International Trade Law on its thirty-sixth session;<sup>1</sup>

2. *Takes note with satisfaction* of the completion and adoption by the Commission of the Model Legislative Provisions on Privately Financed Infrastructure Projects;<sup>4</sup>

3. *Commends* the Commission for its approval in principle to the draft legislative guide on insolvency law,<sup>5</sup> elaborated in close cooperation with other international organizations, including the World Bank, the International Monetary Fund, the Asian Development Bank, the International Bar Association and the International Federation of Insolvency Professionals, and requests that the draft legislative guide be made available for comment to Member States, relevant intergovernmental and non-governmental organizations, as well as private sector and regional organizations and individual experts;

4. *Also commends* the Commission for the progress made in the work on the draft legislative guide on secured transactions, on model legislative provisions on interim measures in international commercial arbitration and on issues of electronic contracting and transport law;

5. *Requests* the Commission and its secretariat, relying on its role as the core legal body within the United Nations system in the field of international trade law, to take the lead in assuring cooperation and coordination with the World Bank, the International Monetary Fund, regional economic commissions and other international organizations in the work on international legal texts and propose appropriate and widely accepted international standards with due respect to the distinct objectives of the Commission and the international financial institutions;

6. *Reaffirms* the importance, in particular for developing countries, of the work of the Commission concerned with training and legislative technical assistance in the field of international trade law, and in this connection:

(a) Expresses its appreciation to the Commission for organizing seminars and briefing missions in Bangladesh, Botswana, Burkina Faso, Cuba, Kazakhstan, Mongolia, New Zealand, Peru, the Republic of Korea, the Russian Federation, Serbia and Montenegro, Thailand and Viet Nam;

(b) Expresses its appreciation to the Governments whose contributions enabled the seminars and briefing missions to take place, and appeals to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the United Nations Commission on International Trade Law Trust Fund for Symposia and, where appropriate, to the financing of special projects, and otherwise to assist the secretariat of the Commission in carrying out training and legislative technical assistance activities, in particular in developing countries;

(c) Reiterates its appeal to the United Nations Development Programme and other bodies responsible for development assistance, such as the World Bank and regional development banks, as well as to Governments in their bilateral aid programmes, to support the training and legislative technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission;

7. *Appeals* to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the trust fund established to provide travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General;

8. *Decides*, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to continue, in the competent Main Committee during the fifty-eighth session of the General Assembly, its consideration of granting travel assistance to the least developed countries that are members of the Commission, at their request and in consultation with the Secretary-General;

9. *Stresses* the importance of bringing into effect the conventions emanating from the work of the Commission for the global unification and harmonization of international trade law, and, to this end, urges States that have not yet done so to consider signing, ratifying or acceding to those conventions;

10. *Requests* the Secretary-General, in view of the continuing demands on personnel resources of the secretariat of the Commission resulting, inter alia, from the need for coordination among a growing number of international organizations in the field of international trade law and the growing demand for legislative technical assistance, to keep under review the level of resources available to the Commission in order to ensure its ability to carry out its mandate.

<sup>3</sup>A/58/6 (Sect. 8), paras. 8.13 and 8.48.

<sup>4</sup>Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17), annex I.

<sup>5</sup>Ibid., Supplement No. 17 (A/58/17), para. 197; see also A/CN.9/534.

*Draft resolution II**Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Nations Commission on International Trade Law*

*The General Assembly,*

*Bearing in mind* the role of public-private partnerships to improve the provision and sound management of infrastructure and public services in the interest of sustainable economic and social development,

*Recognizing* the need to provide an enabling environment that both encourages private investment in infrastructure and takes into account the public interest concerns of the country,

*Emphasizing* the importance of efficient and transparent procedures for the award of privately financed infrastructure projects,

*Stressing* the desirability of facilitating project implementation by rules that enhance transparency, fairness and long-term sustainability and remove undesirable restrictions on private sector participation in infrastructure development and operation,

*Recalling* the valuable guidance that the United Nations Commission on International Trade Law has provided to Member States towards the establishment of a favourable legislative framework for private participation in infrastructure development through the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*,<sup>6</sup>

*Believing* that the Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Na-

<sup>6</sup>United Nations publication, Sales No. E.01.V.4.

tions Commission on International Trade Law will be of further assistance to States, in particular developing countries, in promoting good governance and establishing an appropriate legislative framework for such projects,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for the completion and adoption of the Model Legislative Provisions on Privately Financed Infrastructure Projects, the text of which is contained in annex I to the report of the United Nations Commission on International Trade Law on its thirty-sixth session;<sup>7</sup>

2. *Requests* the Secretary-General to publish the Model Legislative Provisions and to make all efforts to ensure that the Model Legislative Provisions along with the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*<sup>5</sup> become generally known and available;

3. *Also requests* the Secretary-General, subject to availability of resources, to consolidate in due course the text of the Model Legislative Provisions and the *Legislative Guide* into one single publication and, in doing so, to retain the legislative recommendations contained in the *Legislative Guide* as a basis of the development of the Model Legislative Provisions;

4. *Recommends* that all States give due consideration to the Model Legislative Provisions and the *Legislative Guide* when revising or adopting legislation related to private participation in the development and operation of public infrastructure.

<sup>7</sup>*Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17).*

## D. General Assembly resolutions 58/75 and 58/76 of 9 December 2003

### RESOLUTIONS ADOPTED BY THE GENERAL ASSEMBLY

*[on the report of the Sixth Committee (A/58/513)]*

58/75. *Report of the United Nations Commission on International Trade Law on the work of its thirty-sixth session*

*The General Assembly,*

*Recalling* its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law with a mandate to further the progressive harmonization and unification of the law of international trade and in that respect to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

*Reaffirming its belief* that the progressive modernization and harmonization of international trade law, in re-

ducing or removing legal obstacles to the flow of international trade, especially those affecting the developing countries, would contribute significantly to universal economic cooperation among all States on a basis of equality, equity and common interest and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples,

*Having considered* the report of the Commission on its thirty-sixth session,<sup>1</sup>

*Concerned* that activities undertaken by other bodies in the field of international trade law without adequate coordination with the Commission might lead to undesirable duplication of efforts and would not be in keeping with the aim of promoting efficiency, consistency and coherence in the unification and harmonization of international trade law,

<sup>1</sup>*Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17).*

*Reaffirming* the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in this field, in particular to avoid duplication of efforts, including among organizations formulating rules of international trade, and to promote efficiency, consistency and coherence in the modernization and harmonization of international trade law, and to continue, through its secretariat, to maintain close cooperation with other international organs and organizations, including regional organizations, active in the field of international trade law, as stated in General Assembly resolution 50/47 of 11 December 1995,

*Taking note* of the proposals made by the Secretary-General in the proposed programme budget for the biennium 2004–2005 with a view to strengthening the secretariat of the Commission within the bounds of the resources available in the Organization so as to enable it to deal with the increased workload arising, inter alia, from the coordination of work with other organizations and growing demands for legislative technical assistance,<sup>2</sup>

1. *Takes note with appreciation* of the report of the United Nations Commission on International Trade Law on its thirty-sixth session;<sup>1</sup>

2. *Takes note with satisfaction* of the completion and adoption by the Commission of the Model Legislative Provisions on Privately Financed Infrastructure Projects;<sup>3</sup>

3. *Commends* the Commission for its approval in principle to the draft legislative guide on insolvency law,<sup>4</sup> elaborated in close cooperation with other international organizations, including the World Bank, the International Monetary Fund, the Asian Development Bank, the International Bar Association and the International Federation of Insolvency Professionals, and requests that the draft legislative guide be made available for comment to Member States, relevant intergovernmental and non-governmental organizations, as well as private sector and regional organizations and individual experts;

4. *Also commends* the Commission for the progress made in the work on the draft legislative guide on secured transactions, on model legislative provisions on interim measures in international commercial arbitration and on issues of electronic contracting and transport law;

5. *Requests* the Commission and its secretariat, relying on its role as the core legal body within the United Nations system in the field of international trade law, to take the lead in assuring cooperation and coordination with the World Bank, the International Monetary Fund, regional economic commissions and other international organizations in the work on international legal texts and propose appropriate and widely accepted international standards with due respect to the distinct objectives of the Commission and the international financial institutions;

<sup>2</sup>A/58/6 (Sect. 8), paras. 8.13 and 8.48.

<sup>3</sup>Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17), annex I.

<sup>4</sup>Ibid., Supplement No. 17 (A/58/17), para. 197; see also A/CN.9/534.

6. *Reaffirms* the importance, in particular for developing countries, of the work of the Commission concerned with training and legislative technical assistance in the field of international trade law, and in this connection:

(a) Expresses its appreciation to the Commission for organizing seminars and briefing missions in Bangladesh, Botswana, Burkina Faso, Cuba, Kazakhstan, Mongolia, New Zealand, Peru, the Republic of Korea, the Russian Federation, Serbia and Montenegro, Thailand and Viet Nam;

(b) Expresses its appreciation to the Governments whose contributions enabled the seminars and briefing missions to take place, and appeals to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the United Nations Commission on International Trade Law Trust Fund for Symposia and, where appropriate, to the financing of special projects, and otherwise to assist the secretariat of the Commission in carrying out training and legislative technical assistance activities, in particular in developing countries;

(c) Reiterates its appeal to the United Nations Development Programme and other bodies responsible for development assistance, such as the World Bank and regional development banks, as well as to Governments in their bilateral aid programmes, to support the training and legislative technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission;

7. *Appeals* to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the trust fund established to provide travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General;

8. *Decides*, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to continue, in the competent Main Committee during the fifty-eighth session of the General Assembly, its consideration of granting travel assistance to the least developed countries that are members of the Commission, at their request and in consultation with the Secretary-General;

9. *Stresses* the importance of bringing into effect the conventions emanating from the work of the Commission for the global unification and harmonization of international trade law, and, to this end, urges States that have not yet done so to consider signing, ratifying or acceding to those conventions;

10. Requests the Secretary-General, in view of the continuing demands on personnel resources of the secretariat of the Commission resulting, inter alia, from the need for coordination among a growing number of international organizations in the field of international trade law and the growing demand for legislative technical assistance, to keep under review the level of resources available to the Commission in order to ensure its ability to carry out its mandate.

58/76. *Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Nations Commission on International Trade Law*

*The General Assembly,*

*Bearing in mind* the role of public-private partnerships to improve the provision and sound management of infrastructure and public services in the interest of sustainable economic and social development,

*Recognizing* the need to provide an enabling environment that both encourages private investment in infrastructure and takes into account the public interest concerns of the country,

*Emphasizing* the importance of efficient and transparent procedures for the award of privately financed infrastructure projects,

*Stressing* the desirability of facilitating project implementation by rules that enhance transparency, fairness and long-term sustainability and remove undesirable restrictions on private sector participation in infrastructure development and operation,

*Recalling* the valuable guidance that the United Nations Commission on International Trade Law has provided to Member States towards the establishment of a favourable legislative framework for private participation in infrastructure development through the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*,<sup>5</sup>

<sup>5</sup>United Nations publication, Sales No. E.01.V.4.

<sup>6</sup>*Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17 (A/58/17).*

*Believing* that the Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Nations Commission on International Trade Law will be of further assistance to States, in particular developing countries, in promoting good governance and establishing an appropriate legislative framework for such projects,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for the completion and adoption of the Model Legislative Provisions on Privately Financed Infrastructure Projects, the text of which is contained in annex I to the report of the United Nations Commission on International Trade Law on its thirty-sixth session;<sup>6</sup>

2. *Requests* the Secretary-General to publish the Model Legislative Provisions and to make all efforts to ensure that the Model Legislative Provisions along with the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*<sup>5</sup> become generally known and available;

3. *Also requests* the Secretary-General, subject to availability of resources, to consolidate in due course the text of the Model Legislative Provisions and the *Legislative Guide* into one single publication and, in doing so, to retain the legislative recommendations contained in the *Legislative Guide* as a basis of the development of the Model Legislative Provisions;

4. *Recommends* that all States give due consideration to the Model Legislative Provisions and the *Legislative Guide* when revising or adopting legislation related to private participation in the development and operation of public infrastructure.

*72nd plenary meeting  
9 December 2003*

*Part Two*

**STUDIES AND REPORTS ON  
SPECIFIC SUBJECTS**





# I. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

## A. Report of the Working Group on Privately Financed Infrastructure Projects on the work of its fifth session (Vienna, 9-13 September 2002) (A/CN.9/521) [Original: English]

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### I. INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law (UNCITRAL) covers the fifth

session of the Working Group on Privately Financed Infrastructure Projects (previously known as the Working Group on time-limits and limitations (prescription) in the international sale of goods).

## II. ORGANIZATION OF THE SESSION

2. The Working Group, which was composed of all States members of the Commission, held its fifth session in Vienna from 9 to 13 September 2002. The session was attended by representatives of the following States members of the Working Group: Argentina, Austria, Brazil, Cameroon, China, Colombia, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Romania, Russian Federation, Rwanda, Spain, Sweden, Thailand and United States of America.

3. The session was attended by observers from the following States: Algeria, Antigua and Barbuda, Czech Republic, Libyan Arab Jamahiriya, Peru, Philippines, Poland, Republic of Korea, Slovakia, Turkey, Ukraine and Yemen.

4. The session was also attended by observers from the following international organizations: United Nations Industrial Development Organization, Centre for International Legal Studies, European Law Students' Association and European Lawyers' Union.

5. The Working Group elected the following officers:

*Chairman:* TORE WIWEN-NILSSON (Sweden)

*Rapporteur:* ALI HAJIGHOLAM SARYAZDI  
(Islamic Republic of Iran)

6. The Working Group had before it the following documents: the provisional agenda (A/CN.9/WG.I/WP.28); a note by the secretariat setting out issues related to formulation of model legislative provisions on privately financed infrastructure projects (A/CN.9/WG.I/WP.29) and two additional notes containing a set of draft model legislative provisions, which had been prepared by the secretariat in consultation with outside experts (A/CN.9/WG.I/WP.29/Add.1 and 2); and the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects.

7. The Working Group adopted the following agenda:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Consideration of draft model law provisions.
5. Other business.
6. Adoption of the report.

## III. DELIBERATIONS AND DECISIONS

8. At its fifth session, the Working Group continued its work on the drafting of core model legislative provisions in the field of privately financed infrastructure projects, pursuant to a decision taken by the Commission at its thirty-fourth session (Vienna, 25 June-13 July 2001).<sup>1</sup> The Working Group used the notes referred to in paragraph 6 (see A/CN.9/WG.I/WP.29/Add.1 and 2) as a basis for its deliberations.

<sup>1</sup>Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 369.

9. The Working Group reviewed the draft model legislative provisions and approved their version, as set out in the annex to the present report. The secretariat was requested to circulate the draft model legislative provisions to States for comments and to submit the draft model legislative provisions, together with the comments received from States, to the Commission, for its review and adoption, at its thirty-sixth session (Vienna, 30 June-18 July 2003).

## IV. GENERAL REMARKS ON THE DRAFT MODEL LEGISLATIVE PROVISIONS ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

### A. Introduction

10. At its thirty-third session (New York, 12 June-7 July 2000), the Commission adopted the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, consisting of the legislative recommendations (A/CN.9/471/Add.9), with the amendments adopted by the Commission at that session and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the secretariat was authorized to finalize in the light of the deliberations of the Commission.<sup>2</sup> The *Legislative Guide* has since been published in all official languages.

11. At the same session, the Commission also considered a proposal for future work in that area. It was suggested that, although the *Legislative Guide* would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure, it would nevertheless be desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues.<sup>3</sup>

12. After consideration of that proposal, the Commission decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the *Legislative Guide* should be considered by the Commission at its thirty-fourth session. In order to assist the Commission in making an informed decision on the matter, the secretariat was requested to organize a colloquium, in cooperation with other interested international organizations or international financial institutions, to disseminate knowledge about the *Legislative Guide*.<sup>4</sup>

13. The Colloquium on Privately Financed Infrastructure: Legal Framework and Technical Assistance was organized with the co-sponsorship and organizational assistance of the Public-Private Infrastructure Advisory Facility, a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. It was held in Vienna from 2 to 4 July 2001, during the second week of the thirty-fourth session of the Commission.

<sup>2</sup>Ibid., *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 195-368.

<sup>3</sup>Ibid., para. 375.

<sup>4</sup>Ibid., para. 379.

14. At its thirty-fourth session, the Commission took note with appreciation of the results of the Colloquium as summarized in a note by the secretariat (A/CN.9/488). The Commission expressed its gratitude to the Public-Private Infrastructure Advisory Facility for its financial and organizational support and to the various international organizations represented, both intergovernmental and non-governmental, as well as to the speakers who participated in the Colloquium.

15. The various views that were expressed as to the desirability and feasibility of further work of the Commission in the field of privately financed infrastructure projects are reflected in the report of the Commission on the work of its thirty-fourth session.<sup>5</sup> The Commission agreed that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work was to be accomplished within a reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the *Legislative Guide*. Accordingly, it was agreed that, at its first session, such a working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the *Legislative Guide*, could be formulated.<sup>6</sup>

16. The Working Group held its fourth session in Vienna from 24 to 28 September 2001. The Working Group had before it the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. The Working Group decided to use the legislative recommendations contained in the *Legislative Guide* as the basis for its deliberations. The Working Group also had before it the report on the Colloquium referred to in paragraph 6 (A/CN.9/488).

17. In accordance with a suggestion made at the Colloquium (see A/CN.9/488, para. 19), the Working Group was invited to devote its attention to a specific phase of infrastructure projects, namely, the selection of the concessionaire, with a view to formulating specific drafting proposals for legislative provisions. Nevertheless, the Working Group was of the view that model legislative provisions on various other topics might be desirable (see A/CN.9/505, paras. 18-174). The Working Group requested the secretariat to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on those deliberations and decisions, to be submitted to the Working Group at its fifth session for review and further discussion. The draft model provisions were contained in the notes by the secretariat that were before the Working Group at its fifth session.

#### **B. Relationship between the draft model legislative provisions and the *Legislative Guide***

18. At its fifth session, the Working Group considered at length the relationship between the draft model provisions

and the *Legislative Guide*. There was general agreement that the draft model provisions were not a departure from, but rather a development of, the policies and principles upon which the *Legislative Guide* was based. Thus, the draft model provisions did not replace the *Legislative Guide* in its entirety and were to be understood and applied in the light and with the assistance of the explanatory notes contained in the *Guide*.

19. The Working Group proceeded to consider the particular relationship between the draft model provisions and the legislative recommendations contained in the *Legislative Guide*. The Working Group noted, in that connection, that the draft model provisions covered most of the subject matter addressed in the legislative recommendations. However, the Working Group also noted that there were matters dealt with in some legislative recommendations that were not addressed in any of the draft model provisions, as was the case, in particular, of recommendations 1 and 5-13. That circumstances alone excluded the possibility of replacing the entirety of the legislative recommendations with the draft model provisions.

20. The Working Group then considered whether the draft model provisions and the legislative recommendations should be retained as two related but independent texts or whether they should be combined in a single text that contained all draft legislative provisions and those of the legislative recommendations on which no draft model provision had been drafted.

21. Although there were expressions of support for keeping the legislative recommendations separate from the draft model provisions, so as to reflect more clearly the development of the Commission's work on the matter, the general preference was that, for the user's ease of reference, it was desirable to explore combining them. The secretariat was requested to review both the draft model provisions and the legislative recommendations carefully so as to identify which legislative recommendations dealt with matters not covered in the draft model provisions. Those legislative recommendations should then be presented under a separate heading in the same text as the draft model provisions, in order for the Commission to make an informed decision on the matter. The Working Group recommended to the Commission to consider whether, once adopted, the model legislative provisions should supersede those legislative recommendations which dealt with the same subject matter. The Working Group agreed to recommend to the Commission that, subject to the availability of funds in its publications budget, the draft model provisions should be consolidated with the *Legislative Guide* in one single publication as soon as possible after their adoption by the Commission. In order, however, not to delay their dissemination, and with a view to avoiding wasting the existing stocks of the *Legislative Guide*, it was suggested that the Commission could consider whether draft model provisions might, for an interim period, appear in a separate publication, which should contain appropriate indication of its relationship to the *Guide*.

<sup>5</sup>Ibid., *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 366-369.

<sup>6</sup>Ibid., para. 369.

## V. CONSIDERATION OF THE DRAFT MODEL LEGISLATIVE PROVISIONS

### Foreword

22. The text of the foreword was as follows:

*“The following model legislative provisions (hereinafter referred to as “model provisions”) have been prepared by the United Nations Commission on International Trade Law (UNCITRAL) as an addition to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (hereinafter referred to as “the Legislative Guide”), which was adopted by the Commission in 2000. The model provisions are intended to further assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects. The user is advised to read the model provisions together with the legislative recommendations and the notes contained in the Legislative Guide, which offer an analytical explanation to the financial, regulatory, legal, policy and other issues raised in the subject area.*

*“The model provisions consist of a set of core provisions dealing with matters that deserve attention in legislation specifically concerned with privately financed infrastructure projects. While most model provisions relate to specific legislative recommendations contained in the Legislative Guide, they do not cover the entire range of issues dealt with in the legislative recommendations. In particular, no specific model provisions have been formulated on administrative or institutional matters, such as those dealt with in legislative recommendations 1 and 5-13.*

*“The model provisions are designed to be implemented and supplemented by the issuance of regulations providing further details. Areas suitable for being addressed by regulations rather than by statutes are identified accordingly. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources and economic stability.*

*“It should be noted that the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure projects but on which no specific legislative recommendations are made in the Legislative Guide. Those other areas of law include, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, rules on government contracts and administrative law, tax law, environmental protection and consumer protection laws.*

*“For the user’s ease of reference, the model provisions are preceded by headings and bear titles that follow as closely as possible the headings of relevant sections of the Legislative Guide and the titles of its legislative recommendations. However, with a view to ensuring uniformity of style throughout the model provisions, a few headings and titles have been added and*

*some of the original headings and titles have been modified so as to reflect the content of the model provisions to which they relate.”*

23. The Working Group agreed to replace the words “technical expertise” with the words “technical, legal and financial expertise” in the last sentence of the third paragraph, and to add the words “general contract law” before the words “rules on government contracts” in the last sentence of the fourth paragraph.

24. The Working Group also noted that the parts of the foreword referring to the relationship between the draft model provisions and the legislative recommendations contained in the *Legislative Guide* might need to be adjusted in the light of the Commission’s final decision on the matter.

25. Subject to those changes, the Working Group approved the substance of the foreword and referred it to the drafting group.

### I. General provisions

#### Model provision 1. Preamble

26. The text of the draft model provision was as follows:

##### Variant A

“WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a legislative framework to promote and facilitate private investment in infrastructure development,

“Be it therefore enacted as follows:”

##### Variant B

“WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a favourable framework for the implementation of privately financed infrastructure projects by promoting transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;

“WHEREAS the [Government] [Parliament] of ... considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;

“[Other objectives that the enacting State might wish to state:]

“Be it therefore enacted as follows:”

27. It was noted that, at its fourth session, the Working Group had acknowledged that both provisions contained in legislative recommendation 1 of the *Legislative Guide* were of a general nature and as such were not suitable for translation into legislative language. However, it had then been agreed that the substance of the recommendation might usefully be retained as a reminder of the broad

objectives to be pursued in the field of privately financed infrastructure, possibly in a preamble or in explanatory notes to the model legislative provisions that the Working Group might decide to prepare (A/CN.9/505, para. 91).

28. It was pointed out that variant A reflected the substance of legislative recommendation 1 only. Variant B was more elaborate and included a preambular paragraph reflecting the substance of legislative recommendation 14, which the Working Group also found worthy of being formulated in legislative language.

29. Wide support was expressed in favour of retaining variant B only. In addition to it being more comprehensive, it would allow enacting States to add further objectives they might deem appropriate.

30. With respect to the wording of the preamble, it was agreed that the word “legislative” should be added before the word “framework” and that the words “to promote and facilitate” should be added before the words “the implementation of privately financed infrastructure projects”. With those additions, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

## Model provision 2. Definitions

31. The text of the draft model provision was as follows:

“For the purposes of this law:

“(a) ‘*Infrastructure facility*’ means physical facilities and systems that directly or indirectly provide services to the general public;

“(b) ‘*Infrastructure project*’ means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

“(c) ‘*Contracting authority*’ means the public authority that has the power to enter into a concession agreement for the implementation of an infrastructure project [under the provisions of this law];<sup>1</sup>

“(d) ‘*Concessionaire*’ means the person that carries out an infrastructure project under a concession agreement entered into with a contracting authority;

“(e) ‘*Concession agreement*’ means the legally binding contract or contracts between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;

“(f) ‘*Bidder*’ and ‘*bidders*’ mean persons, including groups thereof, that participate in selection proceedings for the award of infrastructure projects;<sup>2</sup>

“(g) ‘*Unsolicited proposal*’ means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;

“(h) ‘*Regulatory agency*’ means a public authority that is entrusted with the power to issue and enforce

rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>3</sup>

<sup>1</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession agreements. Depending on the regulatory regime of the enacting State, a separate body, referred to as ‘regulatory’ agency in subparagraph (h), may have the responsibility for issuing rules and regulations governing the provision of the relevant service.

<sup>2</sup>The term ‘bidder’ or ‘bidders’ encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings or persons that have submitted a proposal in response to a contracting authority’s request for proposals.

<sup>3</sup>The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, ‘General legislative and institutional framework’, paras. 30-53).”

32. The Working Group noted that, unless otherwise indicated, all definitions included in the draft model provision had been derived from or were based upon the *Legislative Guide* (see, in particular, *Legislative Guide*, “Introduction and background information on privately financed infrastructure projects”, paras. 9-20).

### *Contracting authority*

33. It was pointed out that the proposed definition linked the notion of “contracting authority” to “concession agreement”, with a view to avoiding the difficulty of referring to the entity having actual responsibility for the implementation of infrastructure projects.

### *Concession agreement*

34. The Working Group noted that, in view of the difficulty of offering a definition of the term “concession” that would be acceptable to various legal systems, the secretariat had suggested combining the notions of “project agreement” and “concession” in one single definition. The use of the words “concession agreement”, as compared with the corresponding notion of “project agreement”, which was used in the *Legislative Guide*, it was said, would have the advantage of facilitating the incorporation of the draft model provisions in domestic legal systems, since the term “concession agreement”, which in the past was more widely used in civil law jurisdictions only, is being increasingly used in common law jurisdictions as well.

35. For those reasons, the Working Group agreed that words such as “concession agreement” or “concession contract” would be preferable to “project agreement”. From the available options, preference was eventually given to the expression “concession contract”, as it was already used in many legal systems and avoided some of the ambiguities of the word “agreement”, which some delegations felt to be more appropriately used in a public law context.

36. The view was expressed that the phrase “legally binding” was redundant, since it was generally assumed that a contract would in most cases be legally binding. In response to that view, it was pointed out that in some jurisdictions the public entity concluding the concession contract enjoyed powers to change unilaterally the terms and conditions of the concession contract. Some qualification was considered to be useful so as to stress that a concession contract was equally binding upon both parties. The Working Group

agreed with the suggestion, approved the substance of the draft model provision and referred it to the drafting group. The Working Group requested the secretariat to revise the entire model law provisions so as to ensure that consequential changes were also made elsewhere.

### Model provision 3. Authority to enter into concession agreements

37. The text of the draft model provision was as follows:

“The following public authorities have the power to enter into concession agreements<sup>4</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [*the enacting State lists the relevant public authorities of the host country that may enter into concession agreements by way of an exhaustive or indicative list of public authorities, a list of types or categories of public authorities or a combination thereof*].<sup>5</sup>”

“It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, ‘General legislative and institutional framework’, paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, ‘Project risks and government support’).

“Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession agreements, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those agreements, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to ‘the Union, the states [or provinces] and the municipalities’. In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.”

38. It was noted that the draft model provision reflected legislative recommendation 2. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 4. Eligible infrastructure sectors

39. The text of the draft model provision was as follows:

“Concession agreements may be entered into by the relevant authorities in the following sectors: [*the enacting State indicates the relevant sectors by way of an exhaustive or indicative list*].<sup>6</sup>”

“It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.”

40. It was noted that the draft model provision reflected legislative recommendation 4. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

## II. Selection of the concessionaire

### Model provision 5. Rules governing the selection proceedings

41. The text of the draft model provision was as follows:

“The award of infrastructure projects shall be conducted in accordance with [*model provisions 6-26*] and, for matters not provided herein, in accordance with [*the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts*].<sup>7</sup>”

“The user’s attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are based largely on the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (hereinafter referred to as the ‘Model Procurement Law’). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for the selection of the concessionaire. The model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following matters: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, *mutatis mutandis*, supplement the practical elements of the selection procedure described herein.”

42. The Working Group noted that the draft model provision reflected the principles underlying legislative recommendation 14 and that the accompanying footnote was designed to highlight the close relationship between the procedures for selecting a concessionaire and the enacting State’s general laws on government procurement.

43. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### 1. Pre-selection of bidders

### Model provision 6. Purpose and procedure of pre-selection

44. The text of the draft model provision was as follows:

“1. The contracting authority [may] [shall] engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.

“2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [*the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the pre-qualification of suppliers and contractors*].

“3. To the extent not already required by [*the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the pre-qualification of suppliers and contractors*],<sup>8</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:

“(a) A description of the infrastructure facility to be built or renovated;

“(b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire);

“(c) Where already known, a summary of the main required terms of the concession agreement to be entered into;

“(d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications; and

“(e) The manner and place for solicitation of the pre-selection documents.

“4. To the extent not already required by [*the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors in proceedings for the pre-qualification of suppliers and contractors*],<sup>9</sup> the pre-selection documents shall include at least the following information:

“(a) The pre-selection criteria in accordance with [*model provision 7*];

“(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [*model provision 8*];

“(c) Whether the contracting authority intends to request only a limited number<sup>10</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [*model provision 9, para. 2*], and, if applicable, the manner in which this selection will be carried out;

“(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [*this State*] in accordance with [*model provision 29*].

“5. The pre-selection proceedings shall be conducted in accordance with [*the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the pre-qualification of suppliers and contractors*].<sup>11</sup>”

<sup>8</sup>A list of elements typically contained in an invitation to participate in pre-qualification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

<sup>9</sup>A list of elements typically contained in pre-qualification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

<sup>10</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective pro-

posals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, ‘Selection of the concessionaire’, paras. 48-49). See also footnote 13.

<sup>11</sup>Procedural steps on pre-qualification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority’s decision on the bidders’ qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.”

45. It was pointed out that although there was no specific legislative recommendation reflecting the substance of draft model provision 6, paragraph 1, the provision was necessary to complement the remaining provisions on pre-selection so as to clarify the purpose of the exercise and provide for the basic rules governing the proceedings. The Working Group noted that the draft model provision was based on article 7, paragraph 1, of the UNCITRAL Model Law on Procurement of Goods, Construction and Services (hereinafter referred to as the “UNCITRAL Model Procurement Law”).

46. The Working Group noted that paragraph 3 contained a few additional elements drawn from chapter III, paragraph 36, of the *Legislative Guide* and that the elements referred to in paragraph 4 had been added to ensure transparency as regards the important information referred to in draft model provisions 7-9 and 29.

47. With respect to paragraph 1, the Working Group agreed to delete the word “may” and the square brackets around the word “shall” to emphasize the mandatory character of the provision.

48. It was suggested that paragraph 5 should clarify that general rules of the enacting State on the pre-selection of bidders only applied to the extent that the subject matter was not dealt with in paragraphs 1-4 of the draft model provision. The Working Group agreed with that suggestion.

49. With those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 7. Pre-selection criteria

50. The text of the draft model provision was as follows:

“In order to qualify for the selection proceedings, interested bidders must meet objectively justifiable criteria<sup>12</sup> that the contracting authority considers appropriate in the particular proceedings, as stated in the pre-selection documents. These criteria shall include at least the following:

“(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, including design, construction, operation and maintenance;

“(b) Sufficient ability to manage the financial aspects of the project and capability to sustain its financing requirements;

“(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating similar infrastructure facilities.”

<sup>12</sup>The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. The various issues raised by domestic preferences are discussed in the *Legislative Guide* (see chap. III, ‘Selection of the concessionaire’, paras. 43 and 44). The *Legislative Guide* suggests that countries that wish to provide some incentive to national suppliers may wish to apply such preferences in the form of special evaluation criteria, rather than by a blanket exclusion of foreign suppliers. In any event, where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.”

51. The Working Group noted that draft model provision 7 reflected the substance of legislative recommendation 15.

52. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 8. Participation of consortia**

53. The text of the draft model provision was as follows:

“1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.

“2. Unless otherwise [authorized by ... [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>13</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.

“3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.”

<sup>13</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.”

54. The Working Group noted that paragraph 1 of the draft model provision reflected legislative recommendation 16, and that paragraph 2 reaffirmed essentially the restrictive approach taken by the Commission in the *Legislative Guide* to the effect that each of the members of a qualified consortium might participate, either directly or through subsidiary companies, in only one bid for the project. However, it was pointed out that the reference, in paragraph 2, to the possibility of an exception was intended to render the rule more flexible, as there might be cases where no project could be carried out without a certain company, in view of its particular expertise.

55. The Working Group noted that paragraphs 1 and 2 had been added to reflect the advice contained in chapter III, ‘Selection of the concessionaire’, paragraph 40, of the *Legislative Guide*.

56. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 9. Decision on pre-selection**

57. The text of the draft model provision was as follows:

“1. The contracting authority shall make a decision with respect to the qualifications of each bidder that has submitted an application for pre-selection. In reaching that decision, the contracting authority shall apply only the criteria that are set forth in the pre-selection documents. All pre-selected bidders shall thereafter be invited by the contracting authority to submit proposals in accordance with [model provisions 10-16].

“2. Notwithstanding paragraph 1, the contracting authority may, provided that it has made an appropriate statement in the pre-selection documents to that effect, reserve the right to request proposals upon completion of the pre-selection proceedings only from a limited number<sup>14</sup> of bidders that best meet the pre-selection criteria. For this purpose, the contracting authority shall rate the bidders that meet the pre-selection criteria on the basis of the criteria applied to assess their qualifications and draw up [a short] [the final] list of the bidders that will be invited to submit proposals upon completion of the pre-selection proceedings. In drawing up the short list, the contracting authority shall apply only the manner of rating that is set forth in the pre-selection documents.

“3. The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so.”

<sup>14</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, ‘Selection of the concessionaire’, para. 48). It should be noted that the rating system is used solely for the purpose of the pre-selection of bidders. The ratings of the pre-selected bidders should not be taken into account at the stage of evaluation of proposals (see model provision 15), at which all pre-selected bidders should start out on an equal standing.”

58. It was pointed out that although there was no specific legislative recommendation reflecting the substance of paragraph 1 of the draft model provision, that provision was deemed necessary to clarify the manner in which a decision on the qualifications of bidders is to be arrived at. The Working Group noted that the draft provision was based on article 7, paragraph 5, of the UNCITRAL Model Procurement Law.

59. The Working Group noted that paragraph 2 of the draft model provision reflected legislative recommendation 17 and paragraph 3 of legislative recommendation 25.



60. In connection with paragraph 2, it was suggested that both the expressions “short list” and “final list”, which appeared in square brackets, were not needed in a legislative text to qualify the list of bidders that would subsequently be invited by the contracting authority to submit proposals. The Working Group concurred with that suggestion and requested the secretariat to make any consequential changes that might be required.

61. The view was expressed that paragraph 3 might be better placed elsewhere in the draft model legislative provisions, since requests by the contracting authority that bidders demonstrated again their qualifications typically occurred at a later stage during the selection proceedings. The Working Group took note of that view and decided to revert to the matter once it had completed its consideration of the draft model provisions dealing with the selection of the concessionaire.

62. Subject to those comments and suggestions, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

## 2. Procedure for requesting proposals

### Model provision 10. Single-stage and two-stage procedures for requesting proposals

63. The text of the draft model provision was as follows:

“1. The contracting authority shall provide a set of the [final] request for proposals and related documents issued in accordance with [model provision 11] to each pre-selected bidder that pays the price, if any, charged for those documents.

“2. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when [it is not feasible for the contracting authority] [the contracting authority does not deem it to be feasible] to describe in the request for proposals the characteristics of the project such as project specifications, performance indicators, financial arrangements or contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

“3. Where a two-stage procedure is used, the following provisions apply:

“(a) The initial request for proposals shall call upon the bidders to submit, in the first stage of the procedure, initial proposals relating to project specifications, performance indicators, financing requirements or other characteristics of the project as well as to the main contractual terms proposed by the contracting authority;<sup>15</sup>

“(b) The contracting authority may convene meetings and hold discussions with any of the bidders to clarify questions concerning the initial request for proposals or the initial proposals and accompanying documents submitted by the bidders;

“(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial request for proposals by deleting or modifying any aspect of the initial project

specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the initial request for proposals, as well as by adding characteristics or criteria to it. Any such deletion, modification or addition shall be communicated in the invitation to submit final proposals;

“(d) In the second stage of the proceedings, the contracting authority shall invite the bidders to submit final proposals with respect to a single set of project specifications, performance indicators or contractual terms in accordance with [model provisions 11-16].

<sup>15</sup>In many cases, in particular for new types of project, the contracting authority may not be in a position, at this stage, to have formulated a detailed draft of the contractual terms envisaged by it. Also, the contracting authority may find it preferable to develop such terms only after an initial round of consultations with the pre-selected bidders. In any event, however, it is important for the contracting authority, at this stage, to provide some indication of the key contractual terms of the concession agreement, in particular the way in which the project risks should be allocated between the parties under the concession agreement. If this allocation of contractual rights and obligations is left entirely open until after the issuance of the final request for proposals, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project (see chap. III, ‘Selection of the concessionaire’, paras. 67-70; see further chap. II, ‘Project risks and government support’, paras. 8-29).”

64. The Working Group noted that paragraph 1, which reflected the purpose of legislative recommendation 18, was based on article 26 of the UNCITRAL Model Procurement Law, and that paragraphs 2 and 3 reflected legislative recommendation 19.

65. It was pointed out that paragraph 3 (a) referred to “main contractual terms proposed by the contracting authority” rather than simply to “proposed contractual terms” to avoid the impression that a contracting authority would be expected to have developed detailed contract documents at that early stage of the selection process. Paragraph 3 (b) showed a slightly modified version of subparagraph (b) of legislative recommendation 19, which had been aligned with the discussion in paragraph 57 of chapter III of the *Legislative Guide*, to make clear that meetings convened at that stage might not necessarily involve all the bidders. Paragraph 3 (c) elaborated further on subparagraph (c) of legislative recommendation 19 by spelling out the elements referred to in paragraph 58 of chapter III of the *Legislative Guide*. Paragraph 3 (d), which was based on article 46, paragraph 4, of the UNCITRAL Model Procurement Law, had been added to clarify the sequence of actions during the first stage of the proceedings.

66. The Working Group agreed that the word “final” was not needed before the words “request for proposals”, in paragraph 1 and elsewhere in the draft model legislative provisions.

67. In connection with paragraph 2, it was agreed that the words in square brackets “it is not feasible for the contracting authority” should be deleted and that the words “the contracting authority does not deem it to be feasible” should be retained without the square brackets.

68. It was suggested that, for purposes of transparency and accountability, the contracting authority should be required to keep minutes of any meeting convened or discussion held with bidders, indicating the questions raised by bidders and clarifications provided by the contracting authority. The Working Group agreed with that suggestion and requested the drafting group to formulate appropriate additional language to that effect to be included in paragraph 3, subparagraph (b).

69. Also for purposes of transparency and accountability, and in order to limit the scope for unfair changes meant to favour particular bidders, it was suggested that the contracting authority should be required to state in the record of the selection proceedings, to be kept pursuant to draft model provision 25, the reasons for any amendment to, or modification in, the elements of the request for proposal under paragraph 3, subparagraph (c). The Working Group agreed with that suggestion and requested the drafting group to formulate appropriate additional language to that effect to be included in paragraph 3, subparagraph (c).

70. With those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 11. Content of the final request for proposals**

71. The text of the draft model provision was as follows:

“To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of requests for proposals],<sup>16</sup> the final request for proposals shall include at least the following information:

“(a) General information as may be required by the bidders in order to prepare and submit their proposals;<sup>17</sup>

“(b) Project specifications and performance indicators, as appropriate, including the contracting authority’s requirements regarding safety and security standards and environmental protection;<sup>18</sup>

“(c) The contractual terms proposed by the contracting authority, including an indication of which terms are deemed to be non-negotiable;

“(d) The criteria for evaluating proposals and the thresholds, if any, set by the contracting authority for identifying non-responsive proposals; the relative weight to be accorded to each evaluation criterion; and the manner in which the criteria and thresholds are to be applied in the evaluation and rejection of proposals.”

<sup>16</sup>A list of elements typically contained in a request for proposals for services can be found in article 38 of the Model Procurement Law.

<sup>17</sup>A list of elements that should be provided can be found in chapter III, ‘Selection of the concessionaire’, paragraphs 61 and 62, of the *Legislative Guide*.

<sup>18</sup>See chapter III, ‘Selection of the concessionaire’, paragraphs 64-66.”

72. The Working Group noted that the draft model provision reflected legislative recommendation 20. It was pointed out that, in line with the second sentence of legislative recommendation 26 and the discussion in chapter

III, paragraph 69, of the *Legislative Guide*, subparagraph (c) required the request for proposals to contain an indication of which contractual terms were deemed non-negotiable by the contracting authority. Subparagraph (d) contained a specific reference to thresholds for evaluation of proposals, which were referred to in legislative recommendation 24.

73. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **[Model provision 12. Bid security]**

74. The text of the draft model provision was as follows:

“1. [The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required tender security.]

“2. [A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>19</sup>

“(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;

“(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 16];

“(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 16, para. 2];

“(d) Failure to sign the concession agreement, if required by the contracting authority to do so, after the proposal has been accepted;

“(e) Failure to provide required security for the fulfilment of the concession agreement after the proposal has been accepted or to comply with any other condition prior to signing the project agreement specified in the request for proposals.]

<sup>19</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.”

75. The Working Group was informed that, following consultations by the secretariat with experts, it had been suggested that it might be useful to include a draft model provision dealing with bid securities, along the lines of the discussion in chapter III, paragraph 62, of the *Legislative Guide* and article 37, paragraph 1 (f), of the UNCITRAL Model Procurement Law. It was pointed out that the draft model provision had been put in square brackets, as there was no specific legislative recommendation on that topic.

76. The Working Group was of the view that the draft model provision was useful, since the circumstances under which such securities might be forfeited in a selection procedure concerning the execution of a privately financed infrastructure project might differ from the circumstances under which bid securities might be forfeited in other types of procurement. Thus, the Working Group agreed to remove the square brackets around the draft model provision.

77. For purposes of clarity, the Working Group agreed that the cross-reference in subparagraph (b) of paragraph 2 should be to paragraph 1 of draft model provision 16.

78. With those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### **Model provision 13. Clarifications and modifications**

79. The text of the draft model provision was as follows:

“The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise the final request for proposals by deleting or modifying any aspect of the project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the final request for proposals, as well as by adding characteristics or criteria to it. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the final request for proposals at a reasonable time prior to the deadline for submission of proposals.”

80. The Working Group noted that the draft model provision reflected legislative recommendation 21 and that the additional language was intended to clarify the scope of modifications to the request for proposals.

81. The view was expressed that the additional language included in the draft model provision, as compared with legislative recommendation 21, seemed to expand excessively the contracting authority’s power to amend the request for proposals. While that power, in and of itself, was regarded as necessary in a proceeding as complex as the selection of a concessionaire for an infrastructure project, it was suggested that the draft provisions required additional language so as to make it clear that changes made by the contracting authority should be based on objective grounds. Such a qualification was said to be important so as to reduce the risk of changes being made solely for the purpose of favouring particular bidders.

82. The Working Group was generally in agreement with the importance of ensuring that the formulation of the draft model provision promoted transparency and did not lend itself to abuse by the contracting authority. However, it was felt that adding a requirement that any change in the request for proposals needed to be “objectively justifiable” would not be desirable, as such a qualification might invite challenges by bidders. Having considered those views, and mindful of the desirability of reminding contracting authorities of the need to refrain from making unnecessary changes to the essential elements in the request for proposals, the Working Group agreed that a cross-reference to draft model provision 11 should substitute for the full list of elements contained in the first sentence of the draft model provision. The Working Group also agreed that, for purposes of transparency, the contracting authority should

be required to state in the record of the selection proceedings to be kept pursuant to draft model provision 25 the reasons for any amendment to, or modification in, the elements of the request for proposal under the draft model provision.

83. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### **Model provision 14. Evaluation criteria**

84. The text of the draft model provision was as follows:

“1. The criteria for the evaluation and comparison of the technical proposals<sup>20</sup> shall include at least the following:

“(a) Technical and environmental soundness;

“(b) Operational feasibility;

“(c) Quality of services and measures to ensure their continuity.

“2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>21</sup> shall include, as appropriate:

“(a) The present value of the proposed tolls, unit prices and other charges over the concession period;

“(b) The present value of the proposed direct payments by the contracting authority, if any;

“(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

“(d) The extent of financial support, if any, expected from a public authority of [*this State*];

“(e) Soundness of the proposed financial arrangements;

“(f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;

“(g) The social and economic development potential offered by the proposals.”

<sup>20</sup>See chapter III, ‘Selection of the concessionaire’, paragraph 74.

<sup>21</sup>*Ibid.*, paragraphs 75-77.”

85. The Working Group noted that the draft model provision reflected legislative recommendations 22 and 23, which had been combined for ease of reading.

86. It was pointed out that, following consultations with experts, the suggestion had been made that subparagraph (d) of recommendation 22, “social and economic development potential offered by the proposals”, would be more appropriately placed among the commercial aspects of the proposals (recommendation 23). Accordingly, the subparagraph was placed as paragraph 2 (g) in draft model provision 14, even though the *Legislative Guide* referred to “social and economic development potential offered by the proposals” in connection with the criteria for the evaluation of the technical aspects of the proposal (see chap. III, para. 74 (f)).

87. The Working Group noted that subparagraph (*f*) of paragraph 2 had been aligned with subparagraph (*c*) of draft model provision 11.

88. Subject to editorial changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 15. Comparison and evaluation of proposals**

89. The text of the draft model provision was as follows:

“1. The contracting authority shall compare and evaluate each proposal in accordance with the evaluation criteria, the relative weight accorded to each such criterion and the evaluation process set forth in the request for proposals.

“2. For the purposes of paragraph 1, the contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects. Proposals that fail to achieve the thresholds shall be regarded as non-responsive and rejected from the selection procedure.<sup>22</sup>”

<sup>22</sup>This model provision offers an example of an evaluation process that a contracting authority may wish to apply to compare and evaluate proposals for privately financed infrastructure projects. Alternative evaluation processes are described in chapter III, ‘Selection of the concessionaire’, paragraphs 79-82, of the Legislative Guide, such as a two-step evaluation process or the two-envelope system. In contrast to the process set forth in this model provision, the processes described in the Legislative Guide are designed to allow the contracting authority to compare and evaluate the non-financial criteria separately from the financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. In order to ensure the integrity, transparency and predictability of the evaluation stage of the selection proceedings, it is recommended that the enacting State set forth in its law the evaluation processes that contracting authorities may use to compare and evaluate proposals and the details of the application of this process.”

90. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 24. It was pointed out that the title had been changed to reflect more accurately the scope of the draft model provision. A new provision, in paragraph 1, had been added to clarify the sequence of actions by the contracting authority in evaluating proposals.

91. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 15 bis. Further demonstration of fulfilment of qualification criteria**

92. The Working Group agreed that paragraph 3 of draft model legislative provision 9 should be placed in a separate model legislative provision between model law provisions 15 and 16, so as to emphasize that requests by the contracting authority for a further demonstration of the bidder’s fulfilment of the qualification criteria would often be made after the completion of the pre-selection phase. In order to clarify which qualification criteria the contracting authority should use in that situation, it was

suggested that a footnote reflecting the substance of the last sentence of article 34, paragraph 6, of the Procurement Model Law should be added to the new model legislative provision.

93. The Working Group concurred with that suggestion, approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 16. Final negotiations**

94. The text of the draft model provision was as follows:

“1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession contract the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.

“2. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a concession contract, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the bidder that has attained the second best rating; if the negotiations with that bidder do not result in a concession contract, the contracting authority shall thereafter invite for negotiations the other bidders in the order of their ranking until it arrives at a concession contract or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with whom negotiations have been terminated pursuant to this paragraph.”

95. The Working Group noted that the draft model provision reflected legislative recommendations 26 and 27, which had been combined for ease of reading. The Working Group also noted that following suggestions made in the secretariat’s consultations with outside experts, paragraph 2 had been drafted to include the requirement that bidders should be given notice and be requested to submit a “best and final offer” by a specified date before the contracting authority terminated the negotiations. It was pointed out that that requirement reflected article 48, paragraph 8, and article 49, paragraph 4, of the Model Procurement Law.

96. With respect to the third sentence of paragraph 2, it was suggested that the words “the bidder that has attained the second best rating; if the negotiations with that bidder do not result in a concession contract, the contracting authority shall thereafter invite for negotiations” should be deleted in order to increase the readability of the provision without reducing its substance.

97. The Working Group concurred with that suggestion, approved, with that amendment, the substance of the draft model provision and referred it to the drafting group.

### 3. Negotiation of concession agreements without competitive procedures

#### Model provision 17. Circumstances authorizing award without competitive procedures

98. The text of the draft model provision was as follows:

“[Subject to approval by ... [*the enacting State indicates the relevant authority*]]<sup>23</sup>the contracting authority is authorized to negotiate a concession contract without using the procedure set forth in [*model provisions 6-16*], in the following cases:

“(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in the procedures set forth in [*model provisions 6-16*] would be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

“(b) Where the project is of short duration and the anticipated initial investment value does not exceed the amount [of ...] [*the enacting State specifies a monetary ceiling*] [set forth in ...] [*the enacting State indicates the provisions of its laws that specify the monetary threshold below which a privately financed infrastructure project may be awarded without competitive procedures*];<sup>24</sup>

“(c) Where the project involves national defence or national security;

“(d) Where there is only one source capable of providing the required service, such as when the provision of the service requires the use of intellectual property right or other exclusive right owned or possessed by a certain person or persons;

“(e) In cases of unsolicited proposals falling under [*model provision 22*];

“(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria [set forth in the request for proposals], and if, in the judgement of the contracting authority, issuing a new invitation to the pre-selection proceedings and a new request for proposals would be unlikely to result in a project award, within a required time frame, provided that the terms of any concession contract so negotiated between the parties must [be consistent with] [not depart from] the project specifications and contractual terms originally transmitted with the request for proposals;

“(g) In other cases where the [*the enacting State indicates the relevant authority*] authorizes such an exception for [compelling] reasons of public interest [or other cases of the same exceptional nature, as defined in the law].<sup>25</sup>

<sup>23</sup>The rationale for subjecting the award of the concession contract without competitive procedures to the approval of a higher authority is to ensure that the contracting authority engages in direct negotiations with bidders only in the appropriate circumstances (see chap. III, ‘Selection of the concessionaire’, paras. 85-96). The model provision therefore suggests that the enacting State indicate a relevant authority that is competent to authorize negotiations in all cases set forth in the model provision. The enacting State may provide, however, for different approval requirements for each subparagraph of the model pro-

vision. In some cases, for instance, the enacting State may provide that the authority to engage in such negotiations derives directly from the law. In other cases, the enacting State may make the negotiations subject to the approval of different higher authorities, depending on the nature of the services to be provided or the infrastructure sector concerned. In those cases, the enacting State may need to adapt the model provision to these approval requirements by adding the particular approval requirement to the subparagraph concerned, or by adding a reference to provisions of its law where these approval requirements are set forth.

<sup>24</sup>As an alternative to the exclusion provided in subparagraph (b), the enacting State may consider devising a simplified procedure for request for proposals for projects falling thereunder, for instance by applying the procedures described in article 48 of the Model Procurement Law.

<sup>25</sup>Enacting States that deem it desirable to authorize the use of negotiated procedures on an ad hoc basis may wish to retain subparagraph (g) when implementing the model provision. Enacting States wishing to limit exceptions to the competitive selection procedures may in turn prefer not to include the subparagraph.”

99. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 28.

100. As a safeguard against abuse in the recourse to direct negotiations, the Working Group agreed that the square brackets in the first line of the draft model provision should be deleted, so that approval by an authority would be required in all cases covered by the draft model legislative provision.

101. With respect to subparagraph (a), it was pointed out that the additional language contained in that provision was included so as to align the provision with the discussion in chapter III, paragraph 89 (a), of the *Legislative Guide*.

102. With respect to subparagraph (b), the Working Group agreed that both alternatives in square brackets should be retained.

103. With respect to subparagraph (f), it was pointed out that, following the secretariat’s consultations with outside experts, additional language had been included in the provision to the effect that negotiations following unsuccessful attempts to begin competitive procedures should not depart from the original project specifications and contract terms. The additional language was designed as an additional safeguard against manipulation of the selection process. It was noted, however, that the new text would render the provision unworkable since the additional language would significantly reduce the scope of application of the provision. It was also suggested that the goal of preventing abuse of direct negotiations could be best achieved if the subparagraph were to be deleted altogether. The Working Group, however, preferred to retain the subparagraph with the deletion of the additional language. Among the options available to ensure transparency in the negotiations under that subparagraph, wide support was expressed for the suggestion that the contracting authority should be required to state the reasons for any departure from the original project specifications and contractual terms in the record which it was required to keep under model legislative provision 25. The Working Group agreed that a footnote should be added to subparagraph (f) to that effect.

104. With respect to subparagraph (g), it was suggested at the last session of the Working Group that the provision should be expanded by adding the words “or other cases of the same exceptional nature, as defined by the law” (see A/CN.9/505, para. 63). The Working Group was invited to consider whether such an addition, which was reflected in the draft model provision, would strictly be necessary, or whether such a possibility would already be covered under the first phrase of subparagraph (g). The Working Group agreed that those words should be kept, but that they should be put in the footnote to the subparagraph rather than to the main text. The Working Group also agreed that the square brackets around the word “compelling” should be deleted.

105. Subject to those changes and amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 18. Procedures for negotiation of a concession agreement**

106. The text of the draft model provision was as follows:

“Where a concession contract is negotiated without using the procedures set forth in [*model provisions 6-16*] the contracting authority shall:<sup>26</sup>

“(a) Except for concession contracts negotiated pursuant to [*model provision 17, para. (c)*], cause a notice of its intention to commence negotiations in respect of a concession contract to be published in accordance with [*the enacting State indicates the provisions of any relevant laws on procurement proceedings that govern the publication of notices*];

“(b) Engage in negotiations with as many persons as the contracting authority judges capable of carrying out the project as circumstances permit;

“(c) Establish evaluation criteria against which proposals shall be evaluated and ranked.

<sup>26</sup>A number of elements to enhance transparency in negotiations under this model provision are discussed in chapter III, ‘Selection of the concessionaire’, paragraphs 90-96, of the *Legislative Guide*.”

107. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 29. It was pointed out that the original subparagraph (c) of legislative recommendation 29 had been subsumed in the general provision on notice of project awards under draft model provision 24.

108. In order to enhance transparency in the award of a concession contract without competitive procedures, the Working Group agreed that the language of subparagraph (b) implied that the bidder with whom the contracting authority engaged in direct negotiations would have to demonstrate the fulfilment of certain qualification requirements. It was agreed that a footnote should be added to the subparagraph to that effect.

109. Subject to that change, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### *4. Unsolicited proposals<sup>27</sup>*

#### **Model provision 19. Admissibility of unsolicited proposals**

110. The text of the draft model provision was as follows:

“As an exception to [*model provisions 6-16*], the contracting authority<sup>28</sup> is authorized to consider unsolicited proposals pursuant to the procedures set forth in [*model provisions 20-22*], provided that such proposals do not relate to a project for which selection procedures have been initiated or announced.

<sup>27</sup>The policy considerations on the advantages and disadvantages of unsolicited proposals are discussed in chapter III, ‘Selection of the concessionaire’, paragraphs 98-100, of the *Legislative Guide*. States that wish to allow contracting authorities to handle such proposals may wish to use the procedures set forth in model provisions 22-24.

<sup>28</sup>The model provision assumes that the power to entertain unsolicited proposals lies with the contracting authority. However, depending on the regulatory system of the enacting State, a body separate from the contracting authority may have the responsibility for entertaining unsolicited proposals or for considering, for instance, whether an unsolicited proposal is in the public interest. In such a case, the manner in which the functions of such a body may need to be coordinated with those of the contracting authority should be carefully considered by the enacting State (see footnotes 1, 3 and 23 and the references cited therein).”

111. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 30, approved its substance and referred it to the drafting group.

#### **Model provision 20. Procedures for determining the admissibility of unsolicited proposals**

112. The text of the draft model provision was as follows:

“1. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority shall promptly inform the proponent whether or not the project is considered to be in the public interest.<sup>29</sup>

“2. If the project is considered to be in the public interest under paragraph 1, the contracting authority shall invite the proponent to submit as much information on the proposed project as is feasible at this stage to allow the contracting authority to make a proper evaluation of the proponent’s qualifications and the technical and economic feasibility of the project and to determine whether the project is likely to be successfully implemented in the manner proposed in terms acceptable to the contracting authority. For this purpose, the proponent shall submit a technical and economic feasibility study, an environment impact study and satisfactory information regarding the concept or technology contemplated in the proposal.

“3. In considering an unsolicited proposal, the contracting authority shall respect the intellectual property, trade secrets or other exclusive rights contained in, arising from or referred to in the proposal. In particular, the contracting authority shall not make use of any information issued or provided by or on behalf of the proponent in connection with its unsolicited proposal other than

for the evaluation of that proposal, except with the consent of the proponent. [Except as otherwise agreed by the parties], the contracting authority shall, in the event that the proposal is rejected, return to the proponent the original and any copies of documents that the proponent submitted and prepared [, whether in hard copy or in electronic format,] throughout the procedure.

<sup>29</sup>The determination that a proposed project is in the public interest entails a considered judgement regarding the potential benefits to the public that are offered by the project, as well as its relationship to the Government's policy for the infrastructure sector concerned. In order to ensure the integrity, transparency and predictability of the procedures for determining the admissibility of unsolicited proposals, it may be advisable for the enacting State to provide guidance, in regulations or other documents, concerning the criteria that will be used to determine whether an unsolicited proposal is in the public interest, which may include criteria for assessing the appropriateness of the contractual arrangements and the reasonableness of the proposed allocation of project risks."

113. The Working Group noted that the draft model provision reflected legislative recommendations 31 and 32. It was pointed out that paragraph 3 elaborated on legislative recommendation 32 with a view to clarifying the relationship between the proponent's intellectual property rights and the contracting authority's use of information provided by the proponent.

114. In connection with paragraph 1, it was pointed out that at such an early stage of examination of an unsolicited proposal there could not be a final determination as to whether or not a project was in the public interest. It would be more appropriate for paragraphs 1 and 2 to refer to a preliminary conclusion of the contracting authority that the proposal was regarded as being "potentially" in the public interest. The Working Group concurred with that suggestion.

115. The Working Group agreed to include a footnote to paragraph 2 to the effect that the enacting State might wish to set forth, possibly in special regulations, the criteria to be used in assessing the qualifications of the proponent, which could be modelled upon the qualification criteria mentioned in draft model provision 7.

116. The Working Group was of the view that the relationship between the duty to protect the proponent's intellectual property, trade secrets or other exclusive rights, under the first sentence of paragraph 3, and the contracting authority's duty not to use proprietary information disclosed by the proponent, under the second sentence, should be expressed more clearly. The Working Group thus agreed that the words "in particular" at the beginning of the second sentence should be replaced with the word "therefore". The Working Group further agreed to remove the square brackets around the words "except as otherwise agreed by the parties" in the third sentence and to delete the words in square brackets "whether in hard copy or in electronic format", which were not felt to be needed.

117. Subject to those amendments and other editorial changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### **Model provision 21. Unsolicited proposals that do not involve proprietary concepts or technology**

118. The text of the draft model provision was as follows:

"1. Except in the circumstances set forth in [*model provision 17*], the contracting authority shall, if it decides to implement the project, initiate a selection procedure in accordance with [*model provisions 6-16*] if the contracting authority considers that:

"(a) The envisaged output of the project can be achieved without the use of an intellectual property right or other exclusive right owned or possessed by the proponent; or

"(b) The proposed concept or technology is not truly unique or new.

"2. The proponent shall be invited to participate in the selection proceedings initiated by the contracting authority pursuant to paragraph 1 and may be given an incentive or a similar benefit [in a manner described by the contracting authority in the request for proposals] in consideration for the development and submission of the proposal."

119. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 33.

120. For purposes of consistency, the Working Group decided that the words "intellectual property, trade secrets or other exclusive rights", which appeared in paragraph 3 of draft model provision 20, should also be used in the title and elsewhere in the text of the draft model provisions. The Working Group also agreed that the conjunction "and" should be used instead of "or" to connect subparagraphs (a) and (b) of paragraph 1, since those conditions needed to be cumulative.

121. Subject to those amendments and other editorial changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### **Model provision 22. Unsolicited proposals involving proprietary concepts or technology**

122. The text of the draft model provision was as follows:

"1. If the contracting authority determines that the conditions of [*model provision 21, para. 1 (a) or (b)*] are not met, it shall not be required to carry out a selection procedure pursuant to [*model provisions 6-16*]. However, the contracting authority may still seek to obtain elements of comparison for the unsolicited proposal in accordance with the provisions set out in paragraphs 2-4.<sup>30</sup>

"2. Where the contracting authority intends to obtain elements of comparison for the unsolicited proposal, the contracting authority shall publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals within [a reasonable period] [*the enacting State indicates a certain amount of time*].

"3. If no proposals in response to an invitation issued pursuant to paragraph 2 are received within [a

reasonable period] [the amount of time specified in paragraph 2 above], the contracting authority may engage in negotiations with the original proponent.

“4. If the contracting authority receives proposals in response to an invitation issued pursuant to paragraph 2, the contracting authority shall invite the proponents to negotiations in accordance with the provisions set forth in [model provision 18]. In the event that the contracting authority receives a sufficiently large number of proposals, which appear prima facie to meet its infrastructure needs, the contracting authority shall request the submission of proposals pursuant to [model provisions 10-16], subject to any incentive or other benefit that may be given to the person who submitted the unsolicited proposal in accordance with [model provision 21, para. 2].

<sup>30</sup>The enacting State may wish to consider adopting a special procedure for handling unsolicited proposals falling under this model provision, which may be modelled, mutatis mutandis, on the request-for-proposals procedure set forth in article 48 of the Model Procurement Law.”

123. The Working Group noted that the draft model provision reflected the substance of legislative recommendations 34 and 35.

124. The Working Group agreed that the title and the text of the draft model provision should be aligned with draft model provision 21.

125. With those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

##### 5. Miscellaneous provisions

###### Model provision 23. Confidentiality of negotiations

126. The text of the draft model provision was as follows:

“The contracting authority shall treat proposals in such a manner as to avoid the disclosure of any information contained therein to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, para. 3, 16, 17, 18 or 22, para. 3] shall be confidential. [Unless required by law or by a court order,] Each party to the negotiations shall not disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.”

127. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 36. It was pointed out that the first sentence of the draft model provision was drawn from article 45 of the UNCITRAL Model Procurement Law. The reference to “agents, subcontractors, lenders, advisers or consultants” had been added with a view to avoiding an excessively restrictive interpretation of the draft model provision.

128. The Working Group agreed to remove the square brackets around the words “unless required by law or by a court order” in the second sentence of the draft model provision. In connection with that sentence, the question was asked as to whether the word “court” was meant only to include judicial bodies or whether it could also encompass arbitral tribunals. It was pointed out, in that connection, that some institutions that administered arbitration proceedings were sometimes referred to as “arbitration courts” and that some legal systems admitted arbitration of procurement-related disputes. In response, it was noted that nothing in the draft model provision limited the enacting State’s ability to expressly expand the scope of the draft model provision to arbitral tribunals or to interpret it in that manner, when such an interpretation would be admissible under its own laws. As currently drafted, however, the draft model provision was meant to refer to state courts, and not to arbitral tribunals.

129. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

###### Model provision 24. Notice of project award

130. The text of the draft model provision was as follows:

“Except for infrastructure projects awarded pursuant to [model provision 17, subpara. (c)], the contracting authority shall cause a notice of the award of the project to be published in accordance with [the enacting State indicates the provisions of its laws on procurement proceedings that govern the publication of contract award notices]. The notice shall identify the concessionaire and include a summary of the essential terms of the concession agreement.”

131. The Working Group noted that the draft model provision reflected legislative recommendation 37.

132. Subject to editorial changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

###### Model provision 25. Record of selection and award proceedings

133. The text of the draft model provision was as follows:

“The contracting authority shall keep an appropriate record of information pertaining to the selection and award proceedings in accordance with [the enacting State indicates the provisions of its laws on public procurement that govern a record of procurement proceedings].<sup>31</sup>

<sup>31</sup>The contents of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, may need to be set forth in regulations issued by the enacting State to implement the model provision, where no such rules exist under the enacting State’s procurement laws. These issues are discussed in chapter III, ‘Selection of the concessionaire’, paragraphs 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award contemplated is set out in article 11 of the Model Procurement Law.”



134. The Working Group noted that the draft model provision reflected legislative recommendation 38.

135. The view was expressed that legal requirements on record of selection and award proceedings were essential elements for ensuring transparency and accountability in the selection process. It was recognized that including all the elements referred to in paragraphs 120-126 of chapter III of the *Legislative Guide* would render the draft model provision excessively detailed. Nevertheless, it was said, the draft model provision should be more emphatic in recommending that enacting States review their legislation with a view to ensuring that it reflected internationally recognized standards of transparency. The Working Group considered various proposals that were made to achieve that result and eventually agreed that the text of the draft model provisions should be essentially kept as it was, but that the footnote should be redrafted along the following lines:

“The contents of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, are discussed in chapter III, ‘Selection of the concessionaire’, paragraphs 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award is further set out in article 11 of the Model Procurement Law. If the laws of the enacting State do not adequately address these matters, the enacting State should adopt appropriate legislation to that effect.”

136. With those additions, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 26. Review procedures**

137. The text of the draft model provision was as follows:

“A bidder who claims to have suffered, or who may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority’s acts or failures to act in accordance with [*the enacting State indicates the provisions of its laws governing the review of decisions made in procurement proceedings*].<sup>32</sup>

<sup>32</sup>Elements for the establishment of an adequate review system are discussed in chapter III, ‘Selection of the concessionaire’, paragraphs 127-131, of the *Legislative Guide*. They are also contained in chapter VI of the Model Procurement Law.”

138. The Working Group noted that the draft model provision reflected legislative recommendation 39.

139. For the purpose of stressing the importance of appropriate review procedures, which were felt to be an indispensable component of a fair selection process, the Working Group agreed to add, at the end of the footnote, a sentence stating that if the laws of the enacting State did not provide such an adequate review system, the enacting State should consider adopting appropriate legislation to that effect.

140. With those additions, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### **III. Construction and operation of infrastructure**

#### **Model provision 27. Contents of the concession agreement**

141. The text of the draft model provision was as follows:

“The concession contract shall provide for such matters as the parties deem appropriate, including:

“(a) The nature and scope of works to be performed and services to be provided by the concessionaire [*see chap. IV, para. 1*];

“(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire’s rights under the concession contract [*see recommendation 5*];

“(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project [*see recommendation 6*];

“(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [*model provision 29*] [*see recommendation 42 and draft model provision 29*];

“(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [*model provisions 30-32*] [*see recommendations 44 and 45 and draft model provisions 30-32*];

“(f) The remuneration of the concessionaire, in particular and as appropriate, the concessionaire’s right to charge, receive or collect tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of those tariffs or fees; and any payments, if any, that may be made by the contracting authority or other public authority [*see recommendations 46 and 48*];

“(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility [*see recommendation 52*];

“(h) The extent of the concessionaire’s obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users [*see recommendation 53 and draft model provision 37*];

“(i) The contracting authority’s or other public authority’s right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect

of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements [*see recommendation 54 (b)*];

“(j) The extent of the concessionaire’s obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations [*see recommendation 54 (a)*];

“(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled [*see chap. IV, paras. 73-76*];

“(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the concessionaire, in particular with the concessionaire’s own shareholders or other affiliated persons [*see recommendation 56*];

“(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project [*see recommendation 58 (a) and (b)*];

“(n) Remedies available in the event of default of either party [*see recommendation 58 (e)*];

“(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession contract owing to circumstances beyond its reasonable control [*see recommendation 58 (d)*];

“(p) The duration of the concession contract and the rights and obligations of the parties upon its expiry or termination [*see recommendation 61*];

“(q) The manner for calculating compensation pursuant to [*model provision 46*] [*see recommendation 67*];

“(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire [*see recommendations 41 and 69 and draft model provisions 28 and 48*].”

142. At its fourth session, the Working Group had requested the secretariat to prepare an initial draft of a model provision that listed essential issues that needed to be addressed in the project agreement (see A/CN.9/505, para. 114).

143. In order to implement that request, the draft model provision listed a number of issues that should be addressed in the project agreement. Some of those issues were also the subject of specific draft model provisions. Other issues listed therein, however, related to legislative recommendations on which the Working Group did not request that specific draft model provisions should be drafted.

144. Support was expressed for the view that the list of matters for possible inclusion in the concession contract should be of an indicative rather than exhaustive nature. It was pointed out that the elements listed in the draft model provision might not cater for all types of concession under all circumstances. It was also pointed out that the parties should be free to agree on the matters most appropriate for the particular needs and requirements of the specific infrastructure project and that the draft model provision contained a valuable indication of essential elements of the concession contract.

145. In response to that view, it was observed that the underlying purpose of a concession contract, as envisaged by the draft model provision, was the provision of services to the public through a private entity. As the concession contract thus touched upon issues of public interest, it was suggested that the draft model provision should prescribe at least those matters on which variation by agreement were not admitted for reasons of public interest. That issue gave rise to the question, however, as to whether contracts not containing all the elements contained in the draft model provision could be challenged or declared void, a result that was largely felt to be undesirable.

146. After some discussion, it was suggested that the chapeau should be reformulated so as to express more closely the idea that the list, albeit relating to essential matters, was not meant to be mandatory in its full length. In order to reflect that intention and to align the various language versions, the Working Group agreed that the word “including” in the chapeau of the draft model provision should be replaced with the words “such as”. The Working Group agreed that that text was not meant to suggest that a contract not containing any of the elements listed in the draft model provision would be void, without prejudice to the possible internal accountability of agents of the contracting authority, a matter that was left for the national laws of the enacting States outside the scope of application of the draft model provisions.

147. With respect to subparagraph (f), it was noted that in some jurisdictions the remuneration of the concessionaire by way of collecting tariffs or fees from the users for the use of the facility was a constitutive element of a concession. It was therefore suggested that the words “as appropriate” in the first line of the subparagraph should be deleted. In response to that view, it was observed that the intention of the draft model provision was to give the legislator guidance on the possible content of the concession contract, rather than to restate the elements of the notion concession under any particular legal system. In order to clarify the indicative nature of the subparagraph, it was agreed that the words “in particular and as appropriate, the concessionaire’s right to charge, receive, or collect” should be replaced with the words “whether consisting of”.

148. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 28. Governing law**

149. The text of the draft model provision was as follows:

“The concession contract is governed by the law of this State [unless otherwise provided in the concession contract].<sup>33</sup>

<sup>33</sup>Legal systems provide varying answers to the question as to whether the parties to a concession contract may choose as the governing law of the agreement a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 5-8), in some countries the concession contract may be subject to administrative law, while in others the concession contract may be governed by private law (see also *Legislative Guide*, chap. VII, ‘Other relevant areas of law’, paras. 24-27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally *Legislative Guide*, chap. VII, ‘Other relevant areas of law’, sect. B).”

150. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 41.

151. The Working Group agreed to delete the brackets in the draft model provision.

152. It was noted that in some cases, in particular in the case of concession contracts concluded under bilateral investment treaties, the contract between the contracting authority and the concessionaire might be governed by public international law instead of the law of the enacting State. It was suggested that the wording of the draft model provision should also cover those cases. The Working Group, however, did not concur with that suggestion. It was agreed that the last sentence of the footnote to the draft model provision referring to chapter VII of the *Legislative Guide* would provide sufficient guidance to enacting States on that matter.

153. Subject to that amendment, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 29. Organization of the concessionaire**

154. The text of the draft model provision was as follows:

“The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [*this State*], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession contract.”

155. The Working Group noted that the draft model provision reflected the substance of legislative recommendations 42 and 43.

156. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 30. Ownership of assets<sup>34</sup>**

157. The text of the draft model provision was as follows:

“The concession contract shall specify, [where necessary and] [as appropriate], which assets are or shall be public property and which assets are or shall be the private property of the concessionaire. The concession contract shall in particular identify which assets belong to the following categories:

“(a) Assets, if any, that the concessionaire is required, as appropriate, to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the concession contract;

“(b) Assets, if any, that the contracting authority, at its option, may purchase from the concessionaire; and

“(c) Assets, if any, that the concessionaire may retain or dispose of upon expiry or termination of the concession contract.

<sup>34</sup>Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see ‘Introduction and background information on privately financed infrastructure projects’, paras. 47-53). Those general policy options typically determine the legislative approach for ownership of project-related assets (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 20-26). Irrespective of the host country’s general or sectoral policy, the ownership regime of the various assets involved should be clearly defined and based on sufficient legislative authority. Clarity in this respect is important, as it will directly affect the concessionaire’s ability to create security interests in project assets for the purpose of raising financing for the project (*ibid.*, paras. 52-61). Consistent with the flexible approach taken by various legal systems, the model provision does not contemplate an unqualified transfer of all assets to the contracting authority but allows a distinction between assets that must be transferred to the contracting authority, assets that may be purchased by the contracting authority, at its option, and assets that remain the private property of the concessionaire.”

158. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 44.

159. The Working Group agreed to delete the words “[where necessary and]”, as it was felt that the phrase was redundant. For the same reason, the Working Group also agreed to delete the words “as appropriate” in subparagraph (a).

160. Some support was expressed for the view that the phrase “upon expiry or termination of the concession contract” should be added to subparagraphs (b) and (c). In response to that view, however, it was pointed out that the new wording might reduce the flexibility inherent in the original text. The situation dealt with in subparagraph (b), for instance, might also arise during the execution of the concession contract. The Working Group therefore agreed that the text of the draft model provision should be preserved and that the words “upon expiry or termination of the concession contract” should be added at the end of the footnote to the provision, followed by the words “or at any other time”, although it was understood that the appropriate place for the new words might need to be considered further.

161. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 31. Acquisition of project site**

162. The text of the draft model provision was as follows:

“1. The contracting authority or other public authority under the terms of the law and the concession contract shall [obtain] [make available to the concessionaire] or, as appropriate, assist the concessionaire in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.

“2. Any compulsory acquisition of land that may be required for the execution of the project shall be carried out in accordance with [*the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest*] and the terms of the concession contract.”

163. In order to clarify the wording of paragraph 1 and streamline the number of options given to enacting States without reducing the substance of the provision, the Working Group agreed to delete the word “obtain” and the brackets in the paragraph and to add the word “shall” before the word “assist”. In order to reflect those changes in the heading of the draft model provision, the Working Group agreed to replace the original text of the heading by the words “Acquisition of rights related to the project site”.

164. With respect to paragraph 2, the Working Group agreed that the words “and the terms of the concession contract” should be deleted, as there was wide agreement that any compulsory acquisition should only be carried out in accordance with the law of the enacting State, rather than the terms of the concession contract.

**Model provision 32. Easements<sup>35</sup>**

165. The text of the draft model provision was as follows:

“The concessionaire shall [have] [be granted] the power to enter upon, transit through, do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project [in accordance with (*the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws*)].

<sup>35</sup>The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the concessionaire directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 30-32). The alternative wording offered within the first set of square brackets in the model provision is intended to reflect those options.”

166. For reasons of consistency, the Working Group agreed that the word “power” should be replaced by the word “right”. The Working Group further agreed to delete the brackets in the draft model provision.

**Model provision 33. Financial arrangements**

167. The text of the draft model provision was as follows:

“The concessionaire has the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession agreement shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [in accordance with the rules established by the competent regulatory agency].<sup>36</sup>

<sup>36</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as ‘tariffs’, may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, ‘Project risks and government support’, paras. 30-60). The cost at which public services are provided is typically an element of the Government’s infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of ‘reasonableness’, ‘fairness’ or ‘equity’ (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 36-46).”

168. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 46.

169. The question was asked as to whether a separate provision on the matter was needed, in view of the fact that subparagraph (f) of draft model provision 27 already dealt with the remuneration of the concessionaire, which was one of the elements to be provided in the project agreement. In response, it was noted that the Working Group, at its fourth session, had decided that a specific provision affirming the concessionaire’s right to charge or collect fees for the use of the infrastructure facility was needed (see A/CN.9/505, para. 129). Such a provision was particularly important as in a number of countries prior legislative authorization might be necessary in order for a concessionaire to do so.

170. Subject to replacing the words “has the right” with the words “shall have the right” in the first sentence, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 34. Security interests**

171. The text of the draft model provision was as follows:

“1. Subject to any restriction that may be contained in the concession agreement,<sup>37</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

“(a) Security over movable or immovable property owned by the concessionaire or its interests in project assets;

“(b) A pledge of the proceeds and receivables owed to the concessionaire for the use of the facility or the services it provides.

“2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire.

“3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is not permitted by the law of [this State].

“<sup>37</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.”

172. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 49.

173. The Working Group agreed to replace the words “is not permitted” with the words “is prohibited” in paragraph 3. With those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 35. Assignment of the concession agreement**

174. The text of the draft model provision was as follows:

“Except as otherwise provided in [model provision 34], the rights and obligations of the concessionaire under the concession agreement may not [, in whole or in part,] be assigned to third parties without the consent of the contracting authority. The concession agreement shall set forth the conditions under which the contracting authority [may] [shall] give its consent to an assignment of the rights and obligations of the concessionaire under the concession agreement, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire’s technical and financial capability as necessary for providing the service.”

175. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 50.

176. The Working Group agreed to delete the words in square brackets “in whole or in part”, which were considered to be more appropriate in a contractual, rather than legislative text. The Working Group further agreed to delete the word “may” and to remove the square brackets around the word “shall” in the second sentence of the draft model provision.

177. With those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 36. Transfer of controlling interest<sup>38</sup> in the concessionaire**

178. The text of the draft model provision was as follows:

“Except as otherwise provided in the concession agreement, a controlling interest in the concessionaire may not be transferred to third parties without the consent of the contracting authority. The concession agreement shall set forth the conditions under which consent of the contracting authority [may] [shall] be given.

“<sup>38</sup>The notion of ‘controlling interest’ generally refers to the power to appoint the management of a corporation and influence or determine its business. Different criteria may be used in various legal systems or even in different bodies of law within the same legal system, ranging from formal criteria attributing a controlling interest to the ownership of a certain amount (typically more than 50 per cent) of the total combined voting power of all classes of stock of a corporation to more complex criteria that take into account the actual management structure of a corporation. Enacting States that do not have a statutory definition of ‘controlling interest’ may need to define the term in regulations issued to implement the model provision.”

179. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 51.

180. The Working Group agreed to delete the word “may” and to remove the square brackets around the word “shall” in the second sentence. With that change, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 37. Operation of infrastructure**

181. The text of the draft model provision was as follows:

“1. The concession agreement shall set forth, as appropriate, the extent of the concessionaire’s obligations to ensure:

“(a) The modification of the service so as to meet the demand for the service;

“(b) The continuity of the service;

“(c) The provision of the service under essentially the same conditions for all users;

“(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

“[2. The concessionaire shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.]”

182. The Working Group noted that paragraph 1 of the draft model provision reflected the substance of legislative recommendation 53. It was pointed out that paragraph 2, reflecting the substance of legislative recommendation 55, had been added in square brackets following suggestions by outside experts, even though the Working Group, at its fourth session, had taken the view that a model provision on the matter was not needed (see A/CN.9/505, para. 144).

183. The Working Group reconsidered the question of the desirability of including a model provision dealing with the concessionaire’s right to issue and enforce rules

concerning the use of the infrastructure facility. It was noted that some countries with a well-established tradition of awarding concessions for the provision of public services recognized the concessionaire's power to establish rules designed to facilitate the provision of the service (such as instructions to users or safety rules), take reasonable measures to ensure compliance with those rules and suspend the provision of service for emergency or safety reasons. However, given the essential nature of certain public services, the exercise of that power by an entity other than a Government sometimes required legislative authority. The Working Group therefore agreed that it was useful to retain the provision contained in paragraph 3 without the square brackets.

184. The Working Group thus approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 38. Compensation for specific changes in legislation**

185. The text of the draft model provision was as follows:

“The concession agreement shall set forth the extent to which the concessionaire is entitled to compensation in the event that the cost of the concessionaire's performance of the concession agreement has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the service it provides.”

186. The Working Group noted that the draft model provision reflected legislative recommendation 58 (c). It was pointed out that a number of elements had been added in the draft model provision to reflect the depth of the discussion in paragraphs 121-130 of chapter IV of the *Legislative Guide*.

187. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 39. Revision of the concession agreement**

188. The text of the draft model provision was as follows:

##### *Variant A*

“1. Without prejudice to [*model provision 38*], the concession contract may further set forth the extent to which the concessionaire is entitled to request a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:

“(a) Changes in economic or financial conditions; or

“(b) Changes in legislation or regulation other than those referred to in [*model provision 38*].

“2. [Except as otherwise provided in the concession contract] a request for revision of the concession contract pursuant to paragraph 1 may not be granted unless the economic, financial, legislative or regulatory changes:

“(a) Occur after the conclusion of the contract;

“(b) Are beyond the control of the concessionaire; and

“(c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the concession contract was negotiated or to have avoided or overcome their consequences.

“3. The concession contract shall establish procedures for revising the terms of the concession contract following the occurrence of any such changes.”

##### *Variant B*

“Without prejudice to [*model provision 38*], the concession contract may further set forth the extent to which the concessionaire is entitled to request a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in economic or financial conditions or changes in legislation or regulation other than those referred to in [*model provision 38*].”

189. The Working Group noted that the draft model provision reflected legislative recommendation 58 (c). It was pointed out that a number of elements had been added in the draft model provision to reflect the depth of the discussion in paragraphs 121-130 of chapter IV of the *Legislative Guide*.

190. It was noted that paragraph 1 of variant A was substantially identical to variant B. As the substance of paragraph 2 of variant A, it was said, was normally dealt with in the concession contract, rather than in legislation, it was suggested that only variant B should be kept. Variant A should be deleted, and paragraph 3 of variant A be added to the new provision as paragraph 2. It was felt that changing the provisions in that fashion would simplify the text without reducing the substance of the provision or omitting its essential elements.

191. Although it was acknowledged that variant B presented the substance of variant A in a more succinct form, it was suggested that both variants should be preserved. In any event paragraph 2 of variant A should be kept, as it provided important guidance to enacting States regarding the circumstances that might trigger a revision of the concession contract. That guidance was even more important, given the exceptional nature of contract revision following a hardship situation.

192. After some discussion, it was suggested that both views might be accommodated if variant B were deleted and subparagraphs (a), (b) and (c) of paragraph 2 of variant A were merged into paragraph 1 of variant A, preceded by the words “and provided that”. It was felt that that amendment would simplify the draft model provision, clarify the relationship between paragraphs 1 and 2 of variant A and preserve the substance of paragraph 2 of variant A. The Working Group agreed with that suggestion.

193. With respect to paragraph 1, it was suggested that the word “request” in the second line should be deleted and the word “may” in the first line be replaced with “shall”. It was noted that that wording would simplify the draft model provision and would more closely correspond to the substance and wording of the underlying recommendation 58 (c). The Working Group agreed with that suggestion.

194. In order to highlight the difference between draft model provision 38 and draft model provision 39, it was suggested that in paragraph 1 (b) of the latter the words “other than those referred to in [model provision 38]” should be replaced with the words “changes in legislation or regulations not specifically applicable to the infrastructure facility or the service it provides”. The Working Group agreed with that suggestion.

195. It was noted that the draft model provision did not address the issue of the consequences of a disagreement between the contracting authority and the concessionaire on a revision of the concession contract. It was pointed out that that issue was addressed in draft model provision 44. The Working Group agreed to revert to the issue during its consideration of that provision.

196. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 40. Takeover of an infrastructure project by the contracting authority**

197. The text of the draft model provision was as follows:

“Under the circumstances set forth in the concession contract, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.”

198. The Working Group noted that the draft model provision reflected legislative recommendation 59.

199. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

#### **Model provision 41. Substitution of the concessionaire**

200. The text of the draft model provision was as follows:

“The contracting authority and the entities extending financing for an infrastructure project may agree on procedures for the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession contract upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession contract or other similar circumstances, as may be agreed by the contracting authority and the entities extending financing for an infrastructure project.<sup>39</sup>”

<sup>39</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession contract (see chap. IV, ‘Construction and operation of infrastructure: legislative framework and project agreement’, paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders’ security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority.”

201. The Working Group noted that the draft model provision reflected legislative recommendation 60.

202. It was suggested that the provision should also refer to the concessionaire as a party to the agreement that set forth the terms and conditions of the concessionaire’s substitution. It was also suggested that the circumstances triggering such a substitution should be limited to a serious breach of the concessionaire’s obligations under the concession contract. The Working Group did not agree with those suggestions, as it was felt that they departed from the policy embodied in the *Legislative Guide*.

203. It was suggested that, for purposes of completeness, the words “right of such entities” could be added before the words “procedures for” and that the words “may agree” should be moved from the second line to the first line and be included after the words “contracting authority” so as to stress the authorizing nature of the draft model provision. In order to simplify the draft model provision, the Working Group also agreed to delete the last segment of the provision, as it was felt that the “other similar circumstances” would in any case be defined in the concession contract and that the deletion would thus not diminish the substance of the draft model provision.

204. The Working Group approved the substance of the draft model provision and referred it with the proposed changes to the drafting group.

#### IV. Duration, extension and termination of the concession agreement

##### 1. Duration and extension of the concession agreement

###### Model provision 42. Duration and extension of the concession agreement

205. The text of the draft model provision was as follows:

“1. The term of the concession agreement, as stipulated in accordance with [*model provision 27 (p)*] shall not be extended except as a result of the following circumstances:

“(a) Completion delay or interruption of operation due to circumstances beyond either party’s reasonable control; or

“(b) Project suspension brought about by acts of the contracting authority or other public authorities;

“(c) [*Other circumstances, as specified by the enacting State.*]

“2. The term of the concession contract may further be extended to allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the concession contract, if the concessionaire would not be able to recover such costs during the original term.”

206. The Working Group noted that the draft model provision reflected the substance of legislative recommendations 61 and 62.

207. It was observed that the substance of the draft model provision, in particular subparagraph (c), was too stringent, as it did not provide for the possibility for the contracting authority and the concessionaire to agree on the extension of the term of the concession in the concession contract. In response to that view, it was pointed out that the provision reflected the advice of the *Legislative Guide* according to which such an extension should only be permissible if that possibility was set forth in the law of the enacting State. For that reason, the Working Group agreed to preserve the body of the text of the provision.

208. It was then suggested that a footnote should be added to the provision for the purpose of reminding enacting States that they might wish to consider the possibility for an extension of the concession contract by mutual agreement between the contracting authority and the concessionaire for compelling reasons of public interest. The Working Group agreed with that suggestion.

209. Subject to those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

##### 2. Termination of the concession agreement

###### Model provision 43. Termination of the concession agreement by the contracting authority

210. The text of the draft model provision was as follows:

“The contracting authority may terminate the concession contract:

“(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

“(b) For reasons of public interest, subject to payment of compensation to the concessionaire, as agreed in the concession contract;

“(c) [*Other circumstances that the enacting State might wish to add in the law.*]

211. The Working Group noted that the model provision reflected the substance of legislative recommendation 63.

212. It was suggested that the word “compelling” should be added before the word “reasons” in subparagraph (b). It was pointed out that that amendment would align the provision more closely with the *Legislative Guide* and would also ensure consistency with the footnote added to the preceding draft model provision 42. In order to provide guidance to enacting States as to the meaning of the notion of “compelling” public interest, it was suggested that a footnote should be added to subparagraph (b) referring to the relevant section of the *Legislative Guide*.

213. The Working Group agreed with those suggestions, approved the substance of the draft model provision and referred it to the drafting group.

###### Model provision 44. Termination of the concession agreement by the concessionaire

214. The text of the draft model provision was as follows:

“The concessionaire may not terminate the concession contract except under the following circumstances:

“(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession contract;

“(b) In the event that the concessionaire’s performance is rendered substantially more onerous as a result of acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the concession contract.”

215. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 64.

216. It was suggested that the wording of the provision, in particular of subparagraph (b), should be redrafted so as to make it consistent with the amended text of draft model provision 39. It was felt that the new text should in particular reflect the idea that the concessionaire should only be able to terminate the concession contract where all the conditions of draft model provision 39, as amended, were met and negotiations on an appropriate revision of the concession contract had failed.



217. A redraft of subparagraph (b) was also suggested on the ground that the nature of the acts of other public authorities that might trigger the concessionaire's right to terminate the concession contract was unclear. In response, it was noted that those acts related to acts such as those which had been included in subparagraphs (h) and (i) of draft model provision 27. It might thus suffice to add a cross-reference to those provisions in draft model provision 44 so as to clarify the provision in that respect.

218. After a discussion of various options, including amendments borrowing language from draft model provision 39, it was suggested that the words "or omissions" should be added after the word "acts". It was also suggested that the word "appropriate" in the phrase "appropriate revision" should be deleted, so as not to give the impression that the agreed revision of the concession contract was subject to judicial review. The Working Group agreed with those suggestions.

219. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 45. Termination of the concession agreement by either party**

220. The text of the draft model provision was as follows:

"Either party has the right to terminate the concession contract in the event that the performance of its obligations is rendered impossible by circumstances beyond either party's reasonable control. The parties also have the right to terminate the concession contract by mutual consent."

221. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 65.

222. For reasons of consistency, the Working Group agreed to replace the word "has" in the first line with "shall have", and to add the word "shall" before the words "also have" in the third line of the provision.

223. It was suggested that the meaning of the word "impossible" should be clarified by way of reformulating the provision, as the word could be read to mean permanent or temporary failure by a party to perform its duties under the concession contract. The Working Group, however, did not concur with that suggestion as it was felt that the *Legislative Guide* provided sufficient guidance to enacting States on the matter.

224. Subject to those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

3. *Arrangements upon expiry or termination of the concession agreement*

**Model provision 46. Financial arrangements upon expiry or termination of the concession agreement**

225. The text of the draft model provision was as follows:

"The concession agreement shall stipulate how compensation due to either party is calculated in the event of termination of the concession agreement, providing, where appropriate, for compensation for the fair value of works performed under the concession agreement, costs incurred or losses sustained by either party, including, as appropriate, lost profits."

226. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 67.

227. The Working Group approved the substance of the draft model provision and referred it to the drafting group.

**Model provision 47. Wind-up and transfer measures**

228. The text of the draft model provision was as follows:

"The concession agreement [may] [shall] set forth, as appropriate, the rights and obligations of the parties with respect to:

"(a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;

"(b) The transfer of technology required for the operation of the facility;

"(c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

"(d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire."

229. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 68, with the addition of subparagraph (a) so as to cover the generality of the matters referred to in paragraphs 37-42 of chapter V of the *Legislative Guide*.

230. Subject to deleting the word "may" and retaining the word "shall" without the square brackets in the first sentence, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

## V. Settlement of disputes

### Model provision 48. Disputes between the contracting authority and the concessionaire

231. The text of the draft model provision was as follows:

#### *Variant A*

“Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession agreement [in accordance with the law of this State].”

#### *Variant B*

“The contracting authority shall be free to agree upon mechanisms for the settlement of disputes that may arise between the parties to the concession agreement, as best suited to the needs of the infrastructure project.”

232. The Working Group noted that the draft model provision offered two variants to reflect the policy stated in legislative recommendation 69.

233. Some support was expressed to retaining variant B, which was felt by some delegations to adequately emphasize the need for an enabling legislative provision for the contracting authority’s freedom to choose the dispute settlement mechanisms. The prevailing view, however, was in favour of deleting variant B and retaining variant A, with some adjustments.

234. It was pointed out that, once enacted, the draft model provision would become an integral part of the enacting State’s laws. Therefore, the reference, in variant A, to other laws of the enacting State was considered to potentially deprive the draft model provision of its usefulness. While there was wide support to deleting the words “in accordance with the law of this State” in variant A, it was also pointed out that it would be inappropriate to suggest that the enacting State’s laws on the matter, if any, could be ignored. It was noted that the laws of some countries already provided dispute settlement mechanisms that were regarded as well suited to the needs of privately financed infrastructure projects. The parties to the concession contract should not be discouraged from choosing those mechanisms, where they existed. As currently drafted, however, variant A appeared to suggest that appropriate dispute settlement mechanisms needed in every case to be created by the parties themselves.

235. After considering various proposals to address those concerns, the Working Group agreed to delete the words “in accordance with the law of this State” in variant A and to include a footnote to the draft model provision to the effect that the enacting State might provide in its legislation dispute settlement mechanisms that were best suited to the needs of privately financed infrastructure projects.

236. With those amendments, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 49. Disputes involving the concessionaire and its lenders, contractors and suppliers

237. The text of the draft model provision was as follows:

“1. The concessionaire and its shareholders shall be free to choose the appropriate mechanisms for settling disputes among themselves.

“2. The concessionaire shall be free to agree on the appropriate mechanisms for settling disputes between itself and its lenders, contractors, suppliers and other business partners.”

238. The Working Group noted that the draft model provision reflected the substance of legislative recommendation 70.

239. The Working Group agreed that the draft model provision should be placed after draft model provision 50 and that its title should be changed to “other disputes”. With those changes, the Working Group approved the substance of the draft model provision and referred it to the drafting group.

### Model provision 50. Disputes involving customers or users of the infrastructure facility

240. The text of the draft model provision was as follows:

“[Where the concessionaire provides services to the public or operates infrastructure facilities accessible to the public, the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.]”

241. It was pointed out that the draft model provision, which had been suggested for inclusion by experts consulted by the secretariat, appeared in square brackets, as no draft model provision had been requested by the Working Group with respect to legislative recommendation 71 (see A/CN.9/505, para. 174).

242. The Working Group heard expressions of strong support for retaining the draft model provision, which was felt to be essential in a legislative text dealing with infrastructure projects. The draft model provision, it was noted, emphasized the need for appropriate measures to protect the rights of the users of public services and infrastructure facilities, an important concern in many legal systems.

243. The Working Group thus agreed to remove the square brackets around the draft model provision, approved its substance and referred it to the drafting group.

## ANNEX

DRAFT MODEL LEGISLATIVE PROVISIONS ON PRIVATELY FINANCED  
INFRASTRUCTURE PROJECTS

## I. GENERAL PROVISIONS

**Foreword**

*The following model legislative provisions (hereinafter referred to as “model provisions”) have been prepared by the United Nations Commission on International Trade Law (UNCITRAL) as an addition to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (hereinafter referred to as “the Legislative Guide”), which was adopted by the Commission in 2000. The model provisions are intended to further assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects. The user is advised to read the model provisions together with the legislative recommendations and the notes contained in the Legislative Guide, which offer an analytical explanation to the financial, regulatory, legal, policy and other issues raised in the subject area.*

*The model provisions consist of a set of core provisions dealing with matters that deserve attention in legislation specifically concerned with privately financed infrastructure projects. While most model provisions relate to specific legislative recommendations contained in the Legislative Guide, they do not cover the entire range of issues dealt with in the legislative recommendations. In particular, no specific model provisions have been formulated on administrative or institutional matters, such as those dealt with in legislative recommendations 1 and 5-13.*

*The model provisions are designed to be implemented and supplemented by the issuance of regulations providing further details. Areas suitable for being addressed by regulations rather than by statutes are identified accordingly. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical, legal and financial expertise, appropriate human and financial resources and economic stability.*

*It should be noted that the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure projects but on which no specific legislative recommendations are made in the Legislative Guide. Those other areas of law include, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, general contract law, rules on government contracts and administrative law, tax law, and environmental protection and consumer protection laws.*

*For the user’s ease of reference, the model provisions are preceded by headings and bear titles that follow as closely as possible the headings of relevant sections of the Legislative Guide and the titles of its legislative recommendations. However, with a view to ensuring uniformity of style throughout the model provisions, a few headings and titles have been added and some of the original headings and titles have been modified so as to reflect the content of the model provisions to which they relate.*

**Model provision 1. Preamble**

[see recommendation 1 and chap. I, paras. 2-14]

WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a favourable legislative framework to promote and facilitate the implementation of privately financed in-

frastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;

WHEREAS the [Government] [Parliament] of ... considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;

[Other objectives that the enacting State might wish to state;].

Be it therefore enacted as follows:

**Model provision 2. Definitions**

[see introduction, paras. 9-20]

For the purposes of this law:

(a) “Infrastructure facility” means physical facilities and systems that directly or indirectly provide services to the general public;

(b) “Infrastructure project” means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

(c) “Contracting authority” means the public authority that has the power to enter into a concession contract for the implementation of an infrastructure project [under the provisions of this law];<sup>a</sup>

(d) “Concessionaire” means the person that carries out an infrastructure project under a concession contract entered into with a contracting authority;

(e) “Concession contract” means the mutually binding agreement or agreements between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;

(f) “Bidder” and “bidders” mean persons, including groups thereof, that participate in selection proceedings concerning an infrastructure project;<sup>b</sup>

(g) “Unsolicited proposal” means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;

(h) “Regulatory agency” means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>c</sup>

<sup>a</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession contracts. Depending on the regulatory regime of the enacting State, a separate body, referred to as “regulatory agency” in subparagraph (h), may have the responsibility for issuing rules and regulations governing the provision of the relevant service.

<sup>b</sup>The term “bidder” or “bidders” encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings or persons that have submitted a proposal in response to a contracting authority’s request for proposals.

<sup>c</sup>The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, “General legislative and institutional framework”, paras. 30-53).

### Model provision 3. Authority to enter into concession contracts

[see recommendation 2 and chap. I, paras. 15-18]

The following public authorities have the power to enter into concession contracts<sup>d</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [the enacting State lists the relevant public authorities of the host country that may enter into concession contracts by way of an exhaustive or indicative list of public authorities, a list of types or categories of public authorities or a combination thereof].<sup>e</sup>

### Model provision 4. Eligible infrastructure sectors

[see recommendation 4 and chap. I, paras. 19-22]

Concession contracts may be entered into by the relevant authorities in the following sectors: [the enacting State indicates the relevant sectors by way of an exhaustive or indicative list].<sup>f</sup>

## II. SELECTION OF THE CONCESSIONAIRE

### Model provision 5. Rules governing the selection proceedings

[see recommendation 14 and chap. III, paras. 1-33]

The selection of the concessionaire shall be conducted in accordance with [model provisions 6-26] and, for matters not provided herein, in accordance with [the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts].<sup>g</sup>

<sup>d</sup>It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, "General legislative and institutional framework", paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, "Project risks and government support").

<sup>e</sup>Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession contracts, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those contracts, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to "the Union, the States [or provinces] and the municipalities". In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>f</sup>It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>g</sup>The user's attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are based largely on the features of the principal

## 1. PRE-SELECTION OF BIDDERS

### Model provision 6. Purpose and procedure of pre-selection

[see recommendation 15 and chap. III, paras. 34-50]

1. The contracting authority shall engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.

2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the pre-qualification of suppliers and contractors].

3. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the pre-qualification of suppliers and contractors],<sup>h</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:

(a) A description of the infrastructure facility to be built or renovated;

(b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire);

(c) Where already known, a summary of the main required terms of the concession contract to be entered into;

(d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications; and

(e) The manner and place for solicitation of the pre-selection documents.

4. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors in proceedings for the pre-qualification of suppliers and contractors],<sup>i</sup> the pre-selection documents shall include at least the following information:

method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (hereinafter referred to as the "Model Procurement Law"). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for the selection of the concessionaire. The model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following matters: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, *mutatis mutandis*, supplement the practical elements of the selection procedure described herein.

<sup>h</sup>A list of elements typically contained in an invitation to participate in pre-qualification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

<sup>i</sup>A list of elements typically contained in pre-qualification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

(a) The pre-selection criteria in accordance with [model provision 7];

(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [model provision 8];

(c) Whether the contracting authority intends to request only a limited number<sup>j</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [model provision 9, para. 2], and, if applicable, the manner in which this selection will be carried out;

(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [this State] in accordance with [model provision 29].

5. For matters not provided in this [model provision], the pre-selection proceedings shall be conducted in accordance with [the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the pre-qualification of suppliers and contractors].<sup>k</sup>

#### Model provision 7. Pre-selection criteria

[see recommendation 15 and chap. III, paras. 34-40, 43 and 44]

In order to qualify for the selection proceedings, interested bidders must meet objectively justifiable criteria<sup>l</sup> that the contracting authority considers appropriate in the particular proceedings, as stated in the pre-selection documents. These criteria shall include at least the following:

(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, including design, construction, operation and maintenance;

(b) Sufficient ability to manage the financial aspects of the project and capability to sustain its financing requirements;

(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating similar infrastructure facilities.

#### Model provision 8. Participation of consortia

[see recommendation 16 and chap. III, paras. 41 and 42]

1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in

<sup>l</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 48 and 49). See also footnote 14.

<sup>j</sup>Procedural steps on pre-qualification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority's decision on the bidders' qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.

<sup>k</sup>The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. The various issues raised by domestic preferences are discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 43 and 44). The *Legislative Guide* suggests that countries that wish to provide some incentive to national suppliers may wish to apply such preferences in the form of special evaluation criteria, rather than by a blanket exclusion of foreign suppliers. In any event, where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.

2. Unless otherwise [authorized by ... [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>m</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.

3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

#### Model provision 9. Decision on pre-selection

[see recommendations 17 (for para. 2) and 25 (for para. 3) and chap. III, paras. 47-50]

1. The contracting authority shall make a decision with respect to the qualifications of each bidder that has submitted an application for pre-selection. In reaching that decision, the contracting authority shall apply only the criteria that are set forth in the pre-selection documents. All pre-selected bidders shall thereafter be invited by the contracting authority to submit proposals in accordance with [model provisions 10-16].

2. Notwithstanding paragraph 1, the contracting authority may, provided that it has made an appropriate statement in the pre-selection documents to that effect, reserve the right to request proposals upon completion of the pre-selection proceedings only from a limited number<sup>n</sup> of bidders that best meet the pre-selection criteria. For this purpose, the contracting authority shall rate the bidders that meet the pre-selection criteria on the basis of the criteria applied to assess their qualifications and draw up the list of bidders that will be invited to submit proposals upon completion of the pre-selection proceedings. In drawing up the list, the contracting authority shall apply only the manner of rating that is set forth in the pre-selection documents.

## 2. PROCEDURE FOR REQUESTING PROPOSALS

#### Model provision 10. Single-stage and two-stage procedures for requesting proposals

[see recommendations 18 and 19 and chap. III, paras. 51-58]

1. The contracting authority shall provide a set of the request for proposals and related documents issued in accordance with [model provision 11] to each pre-selected bidder that pays the price, if any, charged for those documents.

<sup>m</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.

<sup>n</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", para. 48). It should be noted that the rating system is used solely for the purpose of the pre-selection of bidders. The ratings of the pre-selected bidders should not be taken into account at the stage of evaluation of proposals (see model provision 15), at which all pre-selected bidders should start out on an equal standing.

2. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when the contracting authority does not deem it to be feasible to describe in the request for proposals the characteristics of the project such as project specifications, performance indicators, financial arrangements or contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

3. Where a two-stage procedure is used, the following provisions apply:

(a) The initial request for proposals shall call upon the bidders to submit, in the first stage of the procedure, initial proposals relating to project specifications, performance indicators, financing requirements or other characteristics of the project as well as to the main contractual terms proposed by the contracting authority;<sup>o</sup>

(b) The contracting authority may convene meetings and hold discussions with any of the bidders to clarify questions concerning the initial request for proposals or the initial proposals and accompanying documents submitted by the bidders. The contracting authority shall prepare minutes of any such meeting or discussion containing the questions raised and the clarifications provided by the contracting authority;

(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial request for proposals by deleting or modifying any aspect of the initial project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the initial request for proposals, as well as by adding characteristics or criteria to it. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 25] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated in the invitation to submit final proposals;

(d) In the second stage of the proceedings, the contracting authority shall invite the bidders to submit final proposals with respect to a single set of project specifications, performance indicators or contractual terms in accordance with [model provisions 11-16].

#### Model provision 11. Content of the request for proposals

[see recommendation 20 and chap. III, paras. 59-70]

To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of requests for proposals],<sup>p</sup> the request for proposals shall include at least the following information:

<sup>o</sup>In many cases, in particular for new types of project, the contracting authority may not be in a position, at this stage, to have formulated a detailed draft of the contractual terms envisaged by it. Also, the contracting authority may find it preferable to develop such terms only after an initial round of consultations with the pre-selected bidders. In any event, however, it is important for the contracting authority, at this stage, to provide some indication of the key contractual terms of the concession contract, in particular the way in which the project risks should be allocated between the parties under the concession contract. If this allocation of contractual rights and obligations is left entirely open until after the issuance of the final request for proposals, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project (see chap. III, "Selection of the concessionaire", paras. 67-70; see further chap. II, "Project risks and government support", paras. 8-29).

<sup>p</sup>A list of elements typically contained in a request for proposals for services can be found in article 38 of the Model Procurement Law.

(a) General information as may be required by the bidders in order to prepare and submit their proposals;<sup>q</sup>

(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;<sup>r</sup>

(c) The contractual terms proposed by the contracting authority, including an indication of which terms are deemed to be non-negotiable;

(d) The criteria for evaluating proposals and the thresholds, if any, set by the contracting authority for identifying non-responsive proposals; the relative weight to be accorded to each evaluation criterion; and the manner in which the criteria and thresholds are to be applied in the evaluation and rejection of proposals.

#### Model provision 12. Bid securities

[see chap. III, para. 62]

1. The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required bid security.

2. A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>s</sup>

(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;

(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 16, para. 1];

(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 16, para. 2];

(d) Failure to sign the concession contract, if required by the contracting authority to do so, after the proposal has been accepted;

(e) Failure to provide required security for the fulfilment of the concession contract after the proposal has been accepted or to comply with any other condition prior to signing the concession contract specified in the request for proposals.

#### Model provision 13. Clarifications and modifications

[see recommendation 21 and chap. III, paras. 71 and 72]

The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise any element of the request for proposals as set forth in [model provision 11]. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 25] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the request for proposals at a reasonable time prior to the deadline for submission of proposals.

<sup>q</sup>A list of elements that should be provided can be found in chapter III, "Selection of the concessionaire", paragraphs 61 and 62, of the *Legislative Guide*.

<sup>r</sup>See chapter III, "Selection of the concessionaire", paragraphs 64-66.

<sup>s</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.

**Model provision 14. Evaluation criteria**

[see recommendations 22-23 and chap. III, paras. 73-77]

1. The criteria for the evaluation and comparison of the technical proposals<sup>f</sup> shall include at least the following:

- (a) Technical soundness;
- (b) Compliance with environmental standards;
- (c) Operational feasibility;
- (d) Quality of services and measures to ensure their continuity.

2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>g</sup> shall include, as appropriate:

- (a) The present value of the proposed tolls, unit prices and other charges over the concession period;
- (b) The present value of the proposed direct payments by the contracting authority, if any;
- (c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;
- (d) The extent of financial support, if any, expected from a public authority of [this State];
- (e) Soundness of the proposed financial arrangements;
- (f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;
- (g) The social and economic development potential offered by the proposals.

**Model provision 15. Comparison and evaluation of proposals**

[see recommendation 24 and chap. III, paras. 78-82]

1. The contracting authority shall compare and evaluate each proposal in accordance with the evaluation criteria, the relative weight accorded to each such criterion and the evaluation process set forth in the request for proposals.

2. For the purposes of paragraph 1, the contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects. Proposals that fail to achieve the thresholds shall be regarded as non-responsive and rejected from the selection procedure.<sup>v</sup>

<sup>f</sup>See chapter III, "Selection of the concessionaire", paragraph 74.

<sup>g</sup>See chapter III, "Selection of the concessionaire", paragraphs 75-77.

<sup>v</sup>This model provision offers an example of an evaluation process that a contracting authority may wish to apply to compare and evaluate proposals for privately financed infrastructure projects. Alternative evaluation processes are described in chapter III, "Selection of the concessionaire", paragraphs 79-82, of the *Legislative Guide*, such as a two-step evaluation process or the two-envelope system. In contrast to the process set forth in this model provision, the processes described in the *Legislative Guide* are designed to allow the contracting authority to compare and evaluate the non-financial criteria separately from the financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. In order to ensure the integrity, transparency and predictability of the evaluation stage of the selection proceedings, it is recommended that the enacting State set forth in its law the evaluation processes that contracting authorities may use to compare and evaluate proposals and the details of the application of this process.

**Model provision 15 bis. Further demonstration of fulfilment of qualification criteria**

[see recommendation 25 and chap. III, paras. 78-82]

The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so.<sup>w</sup>

**Model provision 16. Final negotiations**

[see recommendations 26 and 27 and chap. III, paras. 83 and 84]

1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession contract the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.

2. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a concession contract, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the other bidders in the order of their ranking until it arrives at a concession contract or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with which negotiations have been terminated pursuant to this paragraph.

**3. NEGOTIATION OF CONCESSION CONTRACTS WITHOUT COMPETITIVE PROCEDURES****Model provision 17. Circumstances authorizing award without competitive procedures**

[see recommendation 28 and chap. III, para. 89]

Subject to approval by ... [the enacting State indicates the relevant authority],<sup>x</sup> the contracting authority is authorized to

<sup>w</sup>Where pre-qualification proceedings have been engaged in, the criteria shall be the same as those used in the pre-qualification proceedings.

<sup>x</sup>The rationale for subjecting the award of the concession contract without competitive procedures to the approval of a higher authority is to ensure that the contracting authority engages in direct negotiations with bidders only in the appropriate circumstances (see chap. III, "Selection of the concessionaire", paras. 85-96). The model provision therefore suggests that the enacting State indicates a relevant authority that is competent to authorize negotiations in all cases set forth in the model provision. The enacting State may provide, however, for different approval requirements for each subparagraph of the model provision. In some cases, for instance, the enacting State may provide that the authority to engage in such negotiations derives directly from the law. In other cases, the enacting State may make the negotiations subject to the approval of different higher authorities, depending on the nature of the services to be provided or the infrastructure sector concerned. In those cases, the enacting State may need to adapt the model provision to these approval requirements by adding the particular approval requirement to the subparagraph concerned, or by adding a reference to provisions of its law where these approval requirements are set forth.

negotiate a concession contract without using the procedure set forth in [model provisions 6-16], in the following cases:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in the procedures set forth in [model provisions 6-16] would be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

(b) Where the project is of short duration and the anticipated initial investment value does not exceed the amount [of ...] [the enacting State specifies a monetary ceiling] [set forth in ...] [the enacting State indicates the provisions of its laws that specify the monetary threshold below which a privately financed infrastructure project may be awarded without competitive procedures];<sup>y</sup>

(c) Where the project involves national defence or national security;

(d) Where there is only one source capable of providing the required service, such as when the provision of the service requires the use of intellectual property, trade secrets or other exclusive rights owned or possessed by a certain person or persons;

(e) In cases of unsolicited proposals falling under [model provision 22];

(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals and if, in the judgement of the contracting authority, issuing a new invitation to the pre-selection proceedings and a new request for proposals would be unlikely to result in a project award within a required time frame;<sup>z</sup>

(g) In other cases where the [the enacting State indicates the relevant authority] authorizes such an exception for compelling reasons of public interest.<sup>aa</sup>

#### **Model provision 18. Procedures for negotiation of a concession contract**

[see recommendation 29 and chap. III, para. 90]

Where a concession contract is negotiated without using the procedures set forth in [model provisions 6-16] the contracting authority shall.<sup>bb</sup>

(a) Except for concession contracts negotiated pursuant to [model provision 17, subpara. (c)], cause a notice of its intention to commence negotiations in respect of a concession contract to be published in accordance with [the enacting State indicates the

<sup>y</sup>As an alternative to the exclusion provided in subparagraph (b), the enacting State may consider devising a simplified procedure for request for proposals for projects falling thereunder, for instance by applying the procedures described in article 48 of the Model Procurement Law.

<sup>z</sup>The enacting State may wish to require that the contracting authority include in the record to be kept pursuant to [model provision 26] a summary of the results of the negotiations and indicate the extent to which those results differed from the project specifications and contractual terms of the original request for proposals, and that it state the reasons therefor.

<sup>aa</sup>Enacting States that deem it desirable to authorize the use of negotiated procedures on an ad hoc basis may wish to retain subparagraph (g) when implementing the model provision. Enacting States wishing to limit exceptions to the competitive selection procedures may in turn prefer not to include the subparagraph. In any event, for purposes of transparency, the enacting State may wish to indicate here or elsewhere in the model provision other exceptions, if any, authorizing the use of negotiated procedures that may be provided under specific legislation.

<sup>bb</sup>A number of elements to enhance transparency in negotiations under this model provision are discussed in chapter III, "Selection of the concessionaire", paragraphs 90-96, of the *Legislative Guide*.

provisions of any relevant laws on procurement proceedings that govern the publication of notices];

(b) Engage in negotiations with as many persons as the contracting authority judges capable<sup>cc</sup> of carrying out the project as circumstances permit;

(c) Establish evaluation criteria against which proposals shall be evaluated and ranked.

## **4. UNSOLICITED PROPOSALS<sup>dd</sup>**

### **Model provision 19. Admissibility of unsolicited proposals**

[see recommendation 30 and chap. III, paras. 97-109]

As an exception to [model provisions 6-16], the contracting authority<sup>ee</sup> is authorized to consider unsolicited proposals pursuant to the procedures set forth in [model provisions 20-22], provided that such proposals do not relate to a project for which selection procedures have been initiated or announced.

### **Model provision 20. Procedures for determining the admissibility of unsolicited proposals**

[see recommendations 31 and 32 and chap. III, paras. 110-112]

1. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority shall promptly inform the proponent whether or not the project is considered to be potentially in the public interest.<sup>ff</sup>

2. If the project is considered to be potentially in the public interest under paragraph 1, the contracting authority shall invite the proponent to submit as much information on the proposed project as is feasible at this stage to allow the contracting authority to make a proper evaluation of the proponent's qualifications<sup>gg</sup> and the technical and economic feasibility of the project and to determine whether the project is likely to be successfully implemented in the manner proposed in terms ac-

<sup>cc</sup>Enacting States wishing to enhance transparency in the use of negotiated procedures may establish, by specific regulations, qualification criteria to be met by persons invited to negotiations pursuant to [model provisions 18 and 19]. An indication of possible qualification criteria is contained in [model provision 7].

<sup>dd</sup>The policy considerations on the advantages and disadvantages of unsolicited proposals are discussed in chapter III, "Selection of the concessionaire", paragraphs 98-100, of the *Legislative Guide*. States that wish to allow contracting authorities to handle such proposals may wish to use the procedures set forth in model provisions 22-24.

<sup>ee</sup>The model provision assumes that the power to entertain unsolicited proposals lies with the contracting authority. However, depending on the regulatory system of the enacting State, a body separate from the contracting authority may have the responsibility for entertaining unsolicited proposals or for considering, for instance, whether an unsolicited proposal is in the public interest. In such a case, the manner in which the functions of such a body may need to be coordinated with those of the contracting authority should be carefully considered by the enacting State (see footnotes 1, 3 and 24 and the references cited therein).

<sup>ff</sup>The determination that a proposed project is in the public interest entails a considered judgement regarding the potential benefits to the public that are offered by the project, as well as its relationship to the Government's policy for the infrastructure sector concerned. In order to ensure the integrity, transparency and predictability of the procedures for determining the admissibility of unsolicited proposals, it may be advisable for the enacting State to provide guidance, in regulations or other documents, concerning the criteria that will be used to determine whether an unsolicited proposal is in the public interest, which may include criteria for assessing the appropriateness of the contractual arrangements and the reasonableness of the proposed allocation of project risks.

<sup>gg</sup>The enacting State may wish to provide in regulations the qualification criteria that need to be met by the proponent. Elements to be taken into account for that purpose are indicated in [model provision 7].



ceptable to the contracting authority. For this purpose, the proponent shall submit a technical and economic feasibility study, an environmental impact study and satisfactory information regarding the concept or technology contemplated in the proposal.

3. In considering an unsolicited proposal, the contracting authority shall respect the intellectual property, trade secrets or other exclusive rights contained in, arising from or referred to in the proposal. Therefore, the contracting authority shall not make use of information provided by or on behalf of the proponent in connection with its unsolicited proposal other than for the evaluation of that proposal, except with the consent of the proponent. Except as otherwise agreed by the parties, the contracting authority shall, if the proposal is rejected, return to the proponent the original and any copies of documents that the proponent submitted and prepared throughout the procedure.

**Model provision 21. Unsolicited proposals that do not involve intellectual property, trade secrets or other exclusive rights**

[see recommendation 33 and chap. III, paras. 113 and 114]

1. Except in the circumstances set forth in [model provision 17], the contracting authority shall, if it decides to implement the project, initiate a selection procedure in accordance with [model provisions 6-16] if the contracting authority considers that:

(a) The envisaged output of the project can be achieved without the use of intellectual property, trade secrets or other exclusive rights owned or possessed by the proponent; and

(b) The proposed concept or technology is not truly unique or new.

2. The proponent shall be invited to participate in the selection proceedings initiated by the contracting authority pursuant to paragraph 1 and may be given an incentive or a similar benefit in a manner described by the contracting authority in the request for proposals in consideration for the development and submission of the proposal.

**Model provision 22. Unsolicited proposals involving intellectual property, trade secrets or other exclusive rights**

[see recommendations 34 and 35 and chap. III, paras. 115-117]

1. If the contracting authority determines that the conditions of [model provision 21, para. 1 (a) and (b)] are not met, it shall not be required to carry out a selection procedure pursuant to [model provisions 6-16]. However, the contracting authority may still seek to obtain elements of comparison for the unsolicited proposal in accordance with the provisions set out in paragraphs 2-4.<sup>hh</sup>

2. Where the contracting authority intends to obtain elements of comparison for the unsolicited proposal, the contracting authority shall publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals within [a reasonable period] [the enacting State indicates a certain amount of time].

3. If no proposals in response to an invitation issued pursuant to paragraph 2 are received within [a reasonable period] [the amount of time specified in paragraph 2 above], the contracting authority may engage in negotiations with the original proponent.

<sup>hh</sup>The enacting State may wish to consider adopting a special procedure for handling unsolicited proposals falling under this model provision, which may be modelled, mutatis mutandis, on the request-for-proposals procedure set forth in article 48 of the Model Procurement Law.

4. If the contracting authority receives proposals in response to an invitation issued pursuant to paragraph 2, the contracting authority shall invite the proponents to negotiations in accordance with the provisions set forth in [model provision 18]. In the event that the contracting authority receives a sufficiently large number of proposals, which appear prima facie to meet its infrastructure needs, the contracting authority shall request the submission of proposals pursuant to [model provisions 10-16], subject to any incentive or other benefit that may be given to the person who submitted the unsolicited proposal in accordance with [model provision 21, para. 2].

## 5. MISCELLANEOUS PROVISIONS

**Model provision 23. Confidentiality of negotiations**

[see recommendation 36 and chap. III, para. 118]

The contracting authority shall treat proposals in such a manner as to avoid the disclosure of their content to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, paras. 3, 16, 17, 18 or 22, para. 3] shall be confidential. Unless required by law or by a court order, no party to the negotiations shall disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.

**Model provision 24. Notice of contract award**

[see recommendation 37 and chap. III, para. 119]

Except for concession contracts awarded pursuant to [model provision 17, subpara. (c)], the contracting authority shall cause a notice of the contract award to be published in accordance with [the enacting State indicates the provisions of its laws on procurement proceedings that govern the publication of contract award notices]. The notice shall identify the concessionaire and include a summary of the essential terms of the concession contract.

**Model provision 25. Record of selection and award proceedings**

[see recommendation 38 and chap. III, paras. 120-126]

The contracting authority shall keep an appropriate record of information pertaining to the selection and award proceedings in accordance with [the enacting State indicates the provisions of its laws on public procurement that govern a record of procurement proceedings].<sup>ii</sup>

**Model provision 26. Review procedures**

[see recommendation 39 and chap. III, paras. 127-131]

A bidder that claims to have suffered, or that may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts or failures to act in accordance with [the enacting State

<sup>ii</sup>The content of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, are discussed in chapter III, "Selection of the concessionaire", paragraphs 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award is further set out in article 11 of the Model Procurement Law. If the laws of the enacting State do not adequately address these matters, the enacting State should adopt legislation or regulations to that effect.

indicates the provisions of its laws governing the review of decisions made in procurement proceedings].<sup>jj</sup>

### III. CONSTRUCTION AND OPERATION OF INFRASTRUCTURE

#### Model provision 27. Contents of the concession contract

[see recommendation 40 and chap. IV, paras. 1-11]

The concession contract shall provide for such matters as the parties deem appropriate, such as:

(a) The nature and scope of works to be performed and services to be provided by the concessionaire [see chap. IV, para. 1];

(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire's rights under the concession contract [see recommendation 5];

(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project [see recommendation 6];

(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [model provision 29] [see recommendation 42 and draft model provision 29];

(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [model provisions 30-32] [see recommendations 44 and 45 and draft model provisions 30-32];

(f) The remuneration of the concessionaire, whether consisting of tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of any such tariffs or fees; and payments, if any, that may be made by the contracting authority or other public authority [see recommendations 46 and 48];

(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility [see recommendation 52];

(h) The extent of the concessionaire's obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users [see recommendation 53 and draft model provision 37];

(i) The contracting authority's or other public authority's right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements [see recommendation 54, subpara. (b)];

<sup>jj</sup>Elements for the establishment of an adequate review system are discussed in chapter III, "Selection of the concessionaire", paragraphs 127-131, of the *Legislative Guide*. They are also contained in chapter VI of the Model Procurement Law. If the laws of the enacting State do not provide such an adequate review system, the enacting State should consider adopting legislation to that effect.

(j) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations [see recommendation 54, subpara. (a)];

(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled [see chap. IV, paras. 73-76];

(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the concessionaire, in particular with the concessionaire's own shareholders or other affiliated persons [see recommendation 56];

(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project [see recommendation 58, subparas. (a) and (b)];

(n) Remedies available in the event of default of either party [see recommendation 58, subpara. (e)];

(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession contract owing to circumstances beyond its reasonable control [see recommendation 58, subpara. (d)];

(p) The duration of the concession contract and the rights and obligations of the parties upon its expiry or termination [see recommendation 61];

(q) The manner for calculating compensation pursuant to [model provision 46] [see recommendation 67];

(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire [see recommendations 41 and 69 and draft model provisions 28 and 48].

#### Model provision 28. Governing law

[see recommendation 41 and chap. IV, paras. 5-8]

The concession contract is governed by the law of this State unless otherwise provided in the concession contract.<sup>kk</sup>

#### Model provision 29. Organization of the concessionaire

[see recommendations 42 and 43 and chap. IV, paras. 12-18]

The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [this State], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession contract.

<sup>kk</sup>Legal systems provide varying answers to the question as to whether the parties to a concession contract may choose as the governing law of the contract a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 5-8), in some countries the concession contract may be subject to administrative law, while in others the concession contract may be governed by private law (see also *Legislative Guide*, chap. VII, "Other relevant areas of law", paras. 24-27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally *Legislative Guide*, chap. VII, "Other relevant areas of law", sect. B).

**Model provision 30. Ownership of assets<sup>ll</sup>**

[see recommendation 44 and chap. IV, paras. 20-26]

The concession contract shall specify, as appropriate, which assets are or shall be public property and which assets are or shall be the private property of the concessionaire. The concession contract shall in particular identify which assets belong to the following categories:

(a) Assets, if any, that the concessionaire is required to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the concession contract;

(b) Assets, if any, that the contracting authority, at its option, may purchase from the concessionaire; and

(c) Assets, if any, that the concessionaire may retain or dispose of upon expiry or termination of the concession contract.

**Model provision 31. Acquisition of rights related to the project site**

[see recommendation 45 and chap. IV, paras. 27-29]

1. The contracting authority or other public authority under the terms of the law and the concession contract shall make available to the concessionaire or, as appropriate, shall assist the concessionaire in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.

2. Any compulsory acquisition of land that may be required for the execution of the project shall be carried out in accordance with [the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest].

**Model provision 32. Easements<sup>mm</sup>**

[see recommendation 45 and chap. IV, para. 30]

The concessionaire shall [have] [be granted] the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the imple-

<sup>ll</sup>Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see “Introduction and background information on privately financed infrastructure projects”, paras. 47-53). Those general policy options typically determine the legislative approach for ownership of project-related assets (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 20-26). Irrespective of the host country’s general or sectoral policy, the ownership regime of the various assets involved should be clearly defined and based on sufficient legislative authority. Clarity in this respect is important, as it will directly affect the concessionaire’s ability to create security interests in project assets for the purpose of raising financing for the project (ibid., paras. 52-61). Consistent with the flexible approach taken by various legal systems, the model provision does not contemplate an unqualified transfer of all assets to the contracting authority but allows a distinction between assets that must be transferred to the contracting authority, assets that may be purchased by the contracting authority, at its option, and assets that remain the private property of the concessionaire, upon expiry or termination of the concession contract or at any other time.

<sup>mm</sup>The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the concessionaire directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 30-32). The alternative wording offered within the first set of square brackets in the model provision is intended to reflect those options.

mentation of the project in accordance with [the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws].

**Model provision 33. Financial arrangements**

[see recommendation 46 and chap. IV, paras. 33-51]

The concessionaire shall have the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession contract shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [in accordance with the rules established by the competent regulatory agency].<sup>nn</sup>

**Model provision 34. Security interests**

[see recommendation 49 and chap. IV, paras. 52-61]

1. Subject to any restriction that may be contained in the concession contract,<sup>oo</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

(a) Security over movable or immovable property owned by the concessionaire or its interests in project assets;

(b) A pledge of the proceeds of, and receivables owed to the concessionaire for, the use of the facility or the services it provides.

2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire.

3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is prohibited by the law of [this State].

**Model provision 35. Assignment of the concession contract**

[see recommendation 50 and chap. IV, paras. 62 and 63]

Except as otherwise provided in [model provision 34], the rights and obligations of the concessionaire under the concession contract may not be assigned to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which the contracting authority shall give its consent to an assignment of the rights and obligations of the concessionaire under the concession contract, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire’s technical and financial capability as necessary for providing the service.

<sup>nn</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as “tariffs”, may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, “Project risks and government support”, paras. 30-60). The cost at which public services are provided is typically an element of the Government’s infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of “reasonableness”, “fairness” or “equity” (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 36-46).

<sup>oo</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.

**Model provision 36. Transfer of controlling interest<sup>pp</sup> in the concessionaire**

[see recommendation 51 and chap. IV, paras. 64-68]

Except as otherwise provided in the concession contract, a controlling interest in the concessionaire may not be transferred to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which consent of the contracting authority shall be given.

**Model provision 37. Operation of infrastructure**

[see recommendation 53 and chap. IV, paras. 80-93 (for para. 1) and recommendation 55 and chap. IV, paras. 96 and 97 (for para. 2)]

1. The concession contract shall set forth, as appropriate, the extent of the concessionaire's obligations to ensure:

(a) The modification of the service so as to meet the demand for the service;

(b) The continuity of the service;

(c) The provision of the service under essentially the same conditions for all users;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

2. The concessionaire shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.

**Model provision 38. Compensation for specific changes in legislation**

[see recommendation 58, subpara. (c) and chap. IV, paras. 122-125]

The concession contract shall set forth the extent to which the concessionaire is entitled to compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the services it provides.

**Model provision 39. Revision of the concession contract**

[see recommendation 58, subpara. (c) and chap. IV, paras. 126-130]

1. Without prejudice to [model provision 38], the concession contract shall further set forth the extent to which the concessionaire is entitled to a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:

(a) Changes in economic or financial conditions; or

(b) Changes in legislation or regulations not specifically applicable to the infrastructure facility or the services it provides; provided that the economic, financial, legislative or regulatory changes:

(a) Occur after the conclusion of the contract;

(b) Are beyond the control of the concessionaire; and

(c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the concession contract was negotiated or to have avoided or overcome their consequences.

2. The concession contract shall establish procedures for revising the terms of the concession contract following the occurrence of any such changes.

**Model provision 40. Takeover of an infrastructure project by the contracting authority**

[see recommendation 59 and chap. IV, paras. 143-146]

Under the circumstances set forth in the concession contract, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.

**Model provision 41. Substitution of the concessionaire**

[see recommendation 60 and chap. IV, paras. 147-150]

The contracting authority may agree with the entities extending financing for an infrastructure project on the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession contract upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession contract or other similar circumstances.<sup>qq</sup>

**IV. DURATION, EXTENSION AND TERMINATION OF THE CONCESSION CONTRACT****1. Duration and extension of the concession contract****Model provision 42. Duration and extension of the concession contract**

[see recommendation 62 and chap. V, paras. 2-8]

1. The term of the concession contract, as stipulated in accordance with [model provision 27, subpara. (p)] shall not be extended except as a result of the following circumstances:

(a) Completion delay or interruption of operation due to circumstances beyond either party's reasonable control;

(b) Project suspension brought about by acts of the contracting authority or other public authorities; or

<sup>pp</sup>The notion of "controlling interest" generally refers to the power to appoint the management of a corporation and influence or determine its business. Different criteria may be used in various legal systems or even in different bodies of law within the same legal system, ranging from formal criteria attributing a controlling interest to the ownership of a certain amount (typically more than 50 per cent) of the total combined voting power of all classes of stock of a corporation to more complex criteria that take into account the actual management structure of a corporation. Enacting States that do not have a statutory definition of "controlling interest" may need to define the term in regulations issued to implement the model provision.

<sup>qq</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession contract (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority.

(c) [Other circumstances, as specified by the enacting State.]<sup>r</sup>

2. The term of the concession contract may further be extended to allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the concession contract, if the concessionaire would not be able to recover such costs during the original term.

## 2. TERMINATION OF THE CONCESSION CONTRACT

### Model provision 43. Termination of the concession contract by the contracting authority

[see recommendation 63 and chap. V, paras. 14-27]

The contracting authority may terminate the concession contract:

(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

(b) For [compelling]<sup>ss</sup> reasons of public interest, subject to payment of compensation to the concessionaire, the terms of the compensation to be as agreed in the concession contract;

(c) [Other circumstances that the enacting State might wish to add in the law.]

### Model provision 44. Termination of the concession contract by the concessionaire

[see recommendation 64 and chap. V, paras. 28-33]

The concessionaire may not terminate the concession contract except under the following circumstances:

(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession contract;

(b) If the conditions for a revision of the concession contract under [model provision 39, para. 1] are met, but the parties have failed to agree on a revision of the concession contract; or

(c) If the cost of the concessionaire's performance of the concession contract has substantially increased or the value that the concessionaire receives for such performance has substantially diminished as a result of acts or omissions of the contracting authority or other public authorities, such as those referred to in [model provision 27, subparagraphs. (h) and (i)], and the parties have failed to agree on a revision of the concession contract.

### Model provision 45. Termination of the concession contract by either party

[see recommendation 65 and chap. V, paras. 34 and 35]

Either party shall have the right to terminate the concession contract in the event that the performance of its obligations is rendered impossible by circumstances beyond either party's reasonable control. The parties shall also have the right to terminate the concession contract by mutual consent.

<sup>r</sup>The enacting State may wish to consider the possibility of authorizing a consensual extension of the concession contract pursuant to its terms, for compelling reasons of public interest.

<sup>ss</sup>[Possible situations of a compelling reason of public interest are discussed in chapter V, "Duration, extension and termination of the project agreement", paragraph 27, of the *Legislative Guide*.]

## 3. ARRANGEMENTS UPON EXPIRY OR TERMINATION OF THE CONCESSION CONTRACT

### Model provision 46. Financial arrangements upon expiry or termination of the concession contract

[see recommendation 67 and chap. V, paras. 43-49]

The concession contract shall stipulate how compensation due to either party is calculated in the event of termination of the concession contract, providing, where appropriate, for compensation for the fair value of works performed under the concession contract, costs incurred or losses sustained by either party, including, as appropriate, lost profits.

### Model provision 47. Wind-up and transfer measures

[see recommendation 68 and chap. V, paras. 50-62]

The concession contract shall set forth, as appropriate, the rights and obligations of the parties with respect to:

(a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;

(b) The transfer of technology required for the operation of the facility;

(c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

(d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.

## V. SETTLEMENT OF DISPUTES

### Model provision 48. Disputes between the contracting authority and the concessionaire

[see recommendation 69 and chap. VI, paras. 3-41]

Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession contract.<sup>tt</sup>

### Model provision 49. Disputes involving customers or users of the infrastructure facility

[see recommendation 71 and chap. VI, paras. 43-45]

Where the concessionaire provides services to the public or operates infrastructure facilities accessible to the public, the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.

### Model provision 50. Other disputes

[see recommendation 70 and chap. VI, para. 42]

1. The concessionaire and its shareholders shall be free to choose the appropriate mechanisms for settling disputes among themselves.

2. The concessionaire shall be free to agree on the appropriate mechanisms for settling disputes between itself and its lenders, contractors, suppliers and other business partners.

<sup>tt</sup>The enacting State may provide in its legislation dispute settlement mechanisms that are best suited to the needs of privately financed infrastructure projects.

## A/CN.9/WG.I/WP.29

**B. Working paper submitted to the Working Group on Privately Financed Infrastructure Projects at its fifth session: draft addendum to the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects***

(A/CN.9/WG.I/WP.29 and Add. 1 and Add. 2) [Original: English]

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I. INTRODUCTION

1. At its thirty-third session (New York, 12 June-7 July 2000), the United Nations Commission on International Trade Law (UNCITRAL) adopted the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, consisting of the legislative recommendations (A/CN.9/471/Add.9), with the amendments adopted by the Commission at that session and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the secretariat was authorized to finalize in the light of the deliberations of the Commission.<sup>1</sup> The *Legislative Guide* was published in all official languages in 2001.

2. At the same session, the Commission also considered a proposal for future work in that area. It was suggested that, although the *Legislative Guide* would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure, it would nevertheless be desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues.<sup>2</sup>

3. After consideration of that proposal, the Commission decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the *Legislative Guide* should

<sup>1</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 195-368.

<sup>2</sup>Ibid., para. 375.

be considered by the Commission at its thirty-fourth session. In order to assist the Commission in making an informed decision on the matter, the Secretariat was requested to organize a colloquium, in cooperation with other interested international organizations or international financial institutions, to disseminate knowledge about the *Legislative Guide*.<sup>3</sup>

4. The Colloquium on Privately Financed Infrastructure: Legal Framework and Technical Assistance was organized with the co-sponsorship and organizational assistance of the Public-Private Infrastructure Advisory Facility (PPIAF), a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. It was held in Vienna from 2 to 4 July 2001, during the second week of the thirty-fourth session of the Commission.

5. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the results of the Colloquium as summarized in a note by the secretariat (A/CN.9/488). The Commission expressed its gratitude to PPIAF for its financial and organizational support, to the various international intergovernmental and non-governmental organizations represented and to the speakers who participated at the Colloquium.

6. The various views that were expressed as to the desirability and feasibility of further work of the Commission in the field of privately financed infrastructure projects are reflected in the Commission's report on the work of its thirty-fourth session.<sup>4</sup> The Commission agreed that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work in the field of privately financed infrastructure projects was to be accomplished within reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the *Legislative Guide*. Accordingly, it was agreed that the first session of such working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the Guide, could be formulated.<sup>5</sup>

7. The Working Group (previously named Working Group on Time-Limits and Limitations (Prescription) in the international sale of goods) held its fourth session in Vienna from 24 to 28 September 2001. The Working Group had before it the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. The Working Group decided to use the legislative recommendations contained in the *Legislative Guide* as a basis for its deliberations.

8. In accordance with a suggestion that had been made at the Colloquium (A/CN.9/488, para. 19), the Working Group was invited to devote its attention to a specific phase of infrastructure projects, namely the selection of the concessionaire, with a view to formulating specific

drafting proposals for legislative provisions. Nevertheless, the Working Group was of the view that model legislative provisions on various other topics might be desirable (see A/CN.9/505, paras. 18-174). The Working Group requested the secretariat to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on those deliberations and decisions, to be presented to the fifth session of the Working Group for review and further discussion.

9. The addenda to the present document contain a first set of draft model legislative provisions (hereinafter referred to as "draft model provisions"). Section II of the present document contains short explanatory notes on the draft model provisions, including an indication of the relationship between each model provision and the relevant portion of the *UNCITRAL Legislative Guide*, for the purpose of assisting the Working Group in its deliberations. Section III refers to matters dealt with in the *UNCITRAL Legislative Guide* on which no draft model provisions have been drafted.

## II. DRAFT ADDENDUM TO THE *UNCITRAL LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS*: DRAFT MODEL LEGISLATIVE PROVISIONS

10. The draft model provisions were prepared by the secretariat following consultations with outside experts, as requested by the Commission and the Working Group. The draft model provisions develop further the legislative principles underlying those legislative recommendations contained in the *UNCITRAL Legislative Guide* on which the Working Group, at its fourth session, decided that draft model legislative provisions should be drafted. A few draft model provisions offer alternatives for legislators in enacting States. They are, on occasion, followed by footnotes intended to provide specific advice and guidance to legislators in enacting States regarding the policy issues relating to the relevant draft model provisions and options available for their implementation. For the user's ease of reference, the arrangement of the draft model provisions follows as closely as possible the sequence of legislative recommendations in the *UNCITRAL Legislative Guide*.

### A. General provisions

#### **Model provision 1. Preamble (see *UNCITRAL Legislative Guide*, legislative recommendation 1, and chap. I, "General legislative and institutional framework", paras. 2-14)**

11. At its fourth session, the Working Group acknowledged that both provisions contained in legislative recommendation 1 were of a general nature and as such were not suitable for translation into legislative language. However, it was agreed that the substance of the recommendation might usefully be retained as a reminder of the broad objectives to be pursued in the field of privately financed infrastructure, possibly in a preamble or in explanatory notes to the model legislative provisions that the Working Group might decide to prepare (A/CN.9/505, para. 91).

<sup>3</sup>Ibid., para. 379.

<sup>4</sup>Ibid., *Fifty-sixth Session, Supplement No. 17 (A/55/17)*, paras. 366-369.

<sup>5</sup>Ibid., para. 369.

12. Variant A reflects the substance of legislative recommendation 1 only. Variant B is more elaborate and includes a preambular paragraph reflecting the substance of legislative recommendation 14, which the Working Group also found worthy of being formulated in legislative language.

### Model provision 2. Definitions

13. Unless otherwise indicated, all definitions included in the draft model provision are derived from or based upon the *UNCITRAL Legislative Guide* (see, in particular, *UNCITRAL Legislative Guide*, “Introduction and background information on privately financed infrastructure projects”, paras. 9-20).

#### *Contracting authority*

14. By linking the notion of “contracting authority” to “concession agreement”, the proposed definition aims at avoiding the difficulty of referring to the entity having actual responsibility for the implementation of infrastructure projects.

#### *Concession agreement*

15. In view of the difficulty of offering a definition of “concession” that would be acceptable to various legal systems, the secretariat suggests combining the notions of “project agreement” and “concession” in one single definition. The use of the words “concession agreement”, as compared to the corresponding notion of “project agreement”, which is used in the *UNCITRAL Legislative Guide*, would have the advantage of facilitating the incorporation of the draft model provisions in domestic legal systems, since the term “concession agreement”, which in the past was more widely used in civil law jurisdictions only, is being increasingly used in common law jurisdictions as well.

### Model provision 3. Authority to enter into concession agreements, and model provision 4. Eligible infrastructure sectors (see *UNCITRAL Legislative Guide*, legislative recommendations 2-5, and chap. I, “General legislative and institutional framework”, paras. 15-22)

16. Draft model provision 3 reflects legislative recommendation 2 and draft model provision 4 reflects legislative recommendation 4.

## B. Selection of the concessionaire

### Model provision 5. Rules governing the selection proceedings (see *UNCITRAL Legislative Guide*, legislative recommendation 14, and chap. III, “Selection of the concessionaire”, paras. 1-33)

17. The draft model provision reflects the principles underlying legislative recommendation 14. The accompanying footnotes highlight the close relationship between the procedures for selecting a concessionaire and the enacting State’s general laws on government procurement.

### 1. Pre-selection of bidders (for all draft Model provisions in this section, see *UNCITRAL Legislative Guide*, legislative recommendation 15-17, and chap. III, “Selection of the concessionaire”, paras. 34-50)

#### Model provision 6. Purpose and procedure of pre-selection

18. Although there is no specific legislative recommendation reflecting the substance of model provision 6, paragraph 1, this provision seems to be necessary to complement the remaining provisions on pre-selection so as to clarify the purpose of the exercise and provide for the basic rules governing the proceedings. The model provision is based on article 7, paragraph 1, of the *UNCITRAL Model Law on Procurement of Goods, Construction and Services* (hereinafter referred to as the “*UNCITRAL Model Procurement Law*”).

19. Paragraph 3 contains a few additional elements drawn from chapter III, paragraph 36, of the *Legislative Guide*. The elements referred to in paragraph 4 have been added to ensure the transparency as regards important information referred to in draft model provisions 7, 8, 9 and 29.

#### Model provision 7. Pre-selection criteria

20. Model provision 7 reflects the substance of legislative recommendation 15.

#### Model provision 8. Participation of consortia

21. Paragraph 1 of the draft model provision reflects legislative recommendation 16. Paragraph 2 reaffirms essentially the restrictive approach taken by the Commission in the *UNCITRAL Legislative Guide* to the effect that each of the members of a qualified consortium may participate, either directly or through subsidiary companies, in only one bid for the project. However, the reference, in paragraph 2, to the possibility of an exception is intended to render the rule more flexible, as there may be cases where no project could be carried out without a certain company, in view of its particular expertise.

22. Paragraphs 1 and 2 have been added to reflect the advice contained in chapter III, “Selection of the concessionaire”, paragraph 40, of the *UNCITRAL Legislative Guide*.

#### Model provision 9. Decision on pre-selection

23. Although there is no specific legislative recommendation reflecting the substance of paragraph 1 of the draft model provision, this provision seems necessary to clarify the manner in which a decision on the qualifications of bidders is arrived at. This provision is based on article 7, paragraph 5, of the *UNCITRAL Model Procurement Law*.

24. Paragraph 2 of the draft model provision reflects legislative recommendation 17, and paragraph 3 reflects legislative recommendation 25.



## 2. Procedure for requesting proposals

25. For all draft model provisions in this section, see *UNCITRAL Legislative Guide*, legislative recommendations 18-27 and chapter III, “Selection of the concessionaire”, paragraphs 51-84.

### Model provision 10. Single-stage and two-stage procedure for requesting proposals

26. Paragraph 1, which reflects the purpose of legislative recommendation 18, is based on article 26 of the UNCITRAL Model Procurement Law.

27. Paragraphs 2 and 3 reflect legislative recommendation 19. Paragraph 3 (a) refers to “main contractual terms proposed by the contracting authority”, rather than simply to “proposed contractual terms” to avoid the impression that a contracting authority would be expected to have developed detailed contract documents at this early stage of the selection process. Paragraph 3 (b) shows a slightly modified version of subparagraph (b) of legislative recommendation 19, which has been aligned with the discussion in paragraph 57 of chapter III of the *UNCITRAL Legislative Guide*, to make it clear that meetings convened at this stage may not necessarily involve all the bidders. Paragraph 3 (c) further elaborates subparagraph (c) of legislative recommendation 19 by spelling out the elements referred to in paragraph 58 of chapter III of the *Legislative Guide*. Paragraph 3 (d), which is based on article 46, paragraph 4, of the UNCITRAL Model Procurement Law, has been added to clarify the sequence of actions during the first stage of the proceedings.

### Model provision 11. Content of the final request for proposals

28. Model provision 11 reflects legislative recommendation 20. In line with the second sentence of legislative recommendation 26, and the discussion in chapter III, paragraph 69, of the *UNCITRAL Legislative Guide*, subparagraph (c) requires the request for proposals to contain an indication of which contractual terms are deemed non-negotiable by the contracting authority. Subparagraph (d) contains a specific reference to thresholds for evaluation of proposals, which are referred to in legislative recommendation 24.

### Model provision 12. Bid securities

29. In consultations with experts, it was suggested that it might be useful to include a draft model provision dealing with bid securities, along the lines of the discussion in chapter III, paragraph 62, of the *UNCITRAL Legislative Guide* and article 37 (1) (f) of the UNCITRAL Model Procurement Law. The draft model provision appears in square brackets, as there was no specific legislative recommendation on this topic.

### Model provision 13. Clarifications and modifications

30. The draft model provision reflects legislative recommendation 21. The additional language is intended to clarify the scope of modifications to the request for proposals.

### Model provision 14. Evaluation criteria

31. The draft model provision reflects legislative recommendations 22 and 23, which have been combined for ease of reading.

32. In consultations with experts, it was suggested that subparagraph (d) of recommendation 22, “social and economic development potential offered by the proposals”, would be more appropriately placed among the commercial aspects of the proposals (recommendation 23). It therefore appears as paragraph 2 (g) in model provision 14. The Working Group may wish to consider this matter, in view of the fact that the *UNCITRAL Legislative Guide* refers to “social and economic development potential offered by the proposals” in connection with the criteria for the evaluation of the technical aspects of the proposal (see chap. III, para. 74 (f)).

33. Subparagraph (f) of paragraph 2 has been aligned with subparagraph (c) of draft model provision 11.

### Model provision 15. Comparison and evaluation of proposals

34. The draft model provision reflects the substance of legislative recommendation 24. The title has been changed to reflect more accurately the scope of the model provision. A new provision, in paragraph 1, has been added to clarify the sequence of actions by the contracting authority in evaluating proposals.

### Model provision 16. Final negotiations

35. The draft model provision reflects legislative recommendations 26 and 27, which have been combined for ease of reading. Following suggestions made in the secretariat’s consultations with outside experts, paragraph 2 includes the requirement that bidders should be given notice and be requested to submit a “best and final offer” by a specified date before the contracting authority terminates the negotiations. The procedure prescribed in the draft model provision to that end follows article 48, paragraph 8, and article 49, paragraph 4, of the UNCITRAL Model Procurement Law.

36. At the last session of the Working Group, it was suggested that a model legislative provision based on legislative recommendation 27 should explicitly identify the circumstances under which the contracting authority might consider it “apparent” that negotiations with the selected bidder would not result in entering into an agreement (see A/CN.9/505, para. 59). Such a level of detail is not contained in article 44, subparagraph (e) of the UNCITRAL Model Procurement Law, on which the draft model provision is based. In the secretariat’s consultations with outside experts, it was suggested that no additional language was needed. The Working Group may wish to consider whether additional language is nevertheless desirable.

3. *Concession award without competitive procedures (for all draft Model provisions in this section, see UNCITRAL Legislative Guide, legislative recommendations 28-29, and chap. III, "Selection of the concessionaire", paras. 85-96)*

**Model provision 17. Circumstances authorizing award without competitive procedures**

37. The draft model provision reflects the substance of legislative recommendation 28.

38. The additional language contained in subparagraph (a) was included so as to align the provision with the discussion in chapter III, paragraph 89 (a), of the *UNCITRAL Legislative Guide*.

39. Subparagraph (f) includes a suggestion that was made in the secretariat's consultations with outside experts to the effect that negotiations following unsuccessful attempts to begin competitive procedures should not depart from the original project specifications and contract terms.

40. At the last session of the Working Group, it was suggested that subparagraph (g) should be expanded by adding the words "or other cases of the same exceptional nature, as defined by the law" (see A/CN.9/505, para. 63). The Working Group may wish to consider whether such an addition, which is reflected in the draft model provision, is strictly necessary, or whether such a possibility is already covered under the first phrase of subparagraph (g).

**Model provision 18. Procedures for negotiation of a concession agreement**

41. The draft model provision reflects the substance of legislative recommendation 29. The original subparagraph (c) of legislative recommendation 29 is now subsumed in the general provision on notice of project awards under draft model provision 24.

4. *Unsolicited proposals (for all draft Model provisions in this section, see UNCITRAL Legislative Guide, legislative recommendations 30-35, and chap. III, "Selection of the concessionaire", paras. 97-117)*

**Model provision 19. Admissibility of unsolicited proposals**

42. The draft model provision reflects the substance of legislative recommendation 30.

**Model provision 20. Procedures for determining the admissibility of unsolicited proposals**

43. The draft model provision reflects legislative recommendations 31 and 32. Paragraph 3 of the draft model provision elaborates on legislative recommendation 32 with a view to clarifying the relationship between the proponent's intellectual property rights and the contracting authority's use of information provided by the proponent.

**Model provision 21. Unsolicited proposals that do not involve proprietary concepts or technology**

44. The draft model provision reflects the substance of legislative recommendation 33.

**Model provision 22. Unsolicited proposals involving proprietary concepts or technology**

45. The draft model provision reflects the substance of legislative recommendations 34 and 35.

5. *Miscellaneous provisions*

**Model provision 23. Confidentiality of negotiations (see UNCITRAL Legislative Guide, legislative recommendation 36, and chap. III, "Selection of the concessionaire", para. 118)**

46. Model provision 23 reflects the substance of legislative recommendation 36. The first sentence is drawn from article 45 of the UNCITRAL Model Procurement Law. The reference to "agents, subcontractors, lenders, advisers or consultants" has been added with a view to avoiding an excessively restrictive interpretation of the model provision.

**Model provision 24. Notice of project award (see UNCITRAL Legislative Guide, legislative recommendation 37 and chap. III, "Selection of the concessionaire", para. 119)**

47. The draft model provision reflects legislative recommendation 37.

**Model provision 25. Record of selection and award proceedings (see UNCITRAL Legislative Guide, legislative recommendation 38, and chap. III, "Selection of the concessionaire", paras. 120-126)**

48. The draft model provision reflects legislative recommendation 38.

**Model provision 26. Review procedures (see UNCITRAL Legislative Guide, legislative recommendation 39, and chap. III, "Selection of the concessionaire", paras. 127-131)**

49. The draft model provision reflects legislative recommendation 39.

C. **Construction and operation of infrastructure**

**Model provision 27. Contents of the concession agreement (see UNCITRAL Legislative Guide, legislative recommendations 40-41, and chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 1-11)**

50. The Working Group was of the view that various matters dealt with in chapter IV of the *UNCITRAL Legislative Guide* were contractual in nature and did not require specific draft model provisions (see A/CN.9/505, paras. 110-116). At the same time, however, the Working Group agreed that it would be useful to formulate a model legislative provision that listed essential issues that needed to be addressed in the project agreement. It requested the secretariat to prepare an initial draft of such a model provision on the basis of the headings that preceded recommendations 41-68, with the adjustments that might be required so as to spell out clearly, but without unnecessary details, the various topics that needed to be covered by project agreements (para. 114).

51. In order to implement that request, the draft model provision lists a number of issues that should be addressed in the project agreement. Some of those issues are also the subject of specific draft model provisions. Other issues listed therein, however, relate to legislative recommendations on which the Working Group did not request that specific draft model provisions should be drafted. The sources are indicated below:

(a) Subparagraph (a) is partly based on chapter IV, paragraph 1 of the *UNCITRAL Legislative Guide*;

(b) Subparagraph (b) refers, in part, to the matters dealt with in legislative recommendation 5;

(c) Subparagraph (c) refers to matters dealt with in legislative recommendation 6;

(d) Subparagraph (d) refers to matters dealt with in legislative recommendations 42 and 43 and in draft model provision 29;

(e) Subparagraph (e) refers to matters dealt with in legislative recommendations 44 and 45 and in draft model provisions 30 to 32;

(f) Subparagraph (f) refers to matters dealt with in legislative recommendations 46 and 48;

(g) Subparagraph (g) reflects the substance of legislative recommendation 52;

(h) Subparagraph (h) refers to matters dealt with in legislative recommendation 53 and in draft model provision 37;

(i) Subparagraph (i) reflects legislative recommendations 52 and 54 (b);

(j) Subparagraph (j) reflects legislative recommendation 54 (a);

(k) Subparagraph (k) summarizes the advice on contractual arrangements that is contained in chapter IV, paragraphs 73 to 76, of the *Legislative Guide* and is a natural complement of subparagraphs (h) and (i);

(l) Subparagraph (l) reflects the substance of legislative recommendation 56;

(m) Subparagraph (m) reflects the substance of legislative recommendation 58 (a) and (b);

(n) Subparagraph (n) reflects the substance of legislative recommendation 58 (e);

(o) Subparagraph (o) reflects the substance of legislative recommendation 58 (d);

(p) Subparagraph (p) reflects the substance of legislative recommendation 61;

(q) Subparagraph (q) reflects the substance of legislative recommendation 67;

(r) Subparagraph (r) refers to matters dealt with in legislative recommendations 41 and 69 and in draft model provisions 28 and 48.

**Model provision 28. Governing law (see *UNCITRAL Legislative Guide*, legislative recommendation 41, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 1-11)**

52. The draft model provision reflects the substance of legislative recommendation 41.

**Model provision 29. Organization of the concessionaire (see *UNCITRAL Legislative Guide*, legislative recommendations 42-43, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 12-18)**

53. The draft model provision reflects the substance of legislative recommendations 42 and 43.

**Model provision 30. Ownership of assets; model provision 31. Acquisition of project site; and model provision 32. Easements (see *UNCITRAL Legislative Guide*, legislative recommendations 44-45, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 19-32)**

54. Draft model provision 30 reflects the substance of legislative recommendation 44. Draft model provisions 31 and 32 reflect the substance of legislative recommendation 45, which have been reformulated in two separate provisions for ease of reading.

**Model provision 33. Financial arrangements (see *UNCITRAL Legislative Guide*, legislative recommendations 46-48, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 33-51)**

55. The draft model provision reflects the substance of legislative recommendation 46.

**Model provision 34. Security interests (see *UNCITRAL Legislative Guide*, legislative recommendation 49, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 52-61)**

56. The draft model provision reflects the substance of legislative recommendation 49.

**Model provision 35. Assignment of the concession agreement (see *UNCITRAL Legislative Guide*, legislative recommendation 50, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 62-63)**

57. The draft model provision reflects the substance of legislative recommendation 50.

**Model provision 36. Transfer of controlling interest in the concessionaire (see *UNCITRAL Legislative Guide*, legislative recommendation 51, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 64-68)**

58. The draft model provision reflects the substance of legislative recommendation 51.

**Model provision 37. Operation of infrastructure** (see *UNCITRAL Legislative Guide*, legislative recommendations 53 and 55, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 80-93 and 96-97, respectively)

59. Model provision 37, paragraph 1, reflects the substance of legislative recommendation 53. Paragraph 2, reflecting the substance of legislative recommendation 55, has been added following suggestions by outside experts (see also para. 79).

**Model provision 38. Compensation for specific changes in legislation; model provision 39. Revision of the concession agreement; model provision 40. Takeover of an infrastructure project by the contracting authority; and model provision 41. Substitution of the concessionaire** (see *UNCITRAL Legislative Guide*, legislative recommendations 56-60, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 98-150)

60. Draft model provisions 38 and 39 reflect legislative recommendation 58 (c). A number of elements have been added in both model provisions, however, so as to reflect the depth of the discussion in paragraphs 121 to 130 of chapter IV of the *UNCITRAL Legislative Guide*.

61. Draft model provision 40 reflects legislative recommendation 59 and draft model provision 41 reflects legislative recommendation 60.

#### D. Duration, extension and termination of the concession agreement

**Model provision 42. Duration and extension of the concession agreement** (see *UNCITRAL Legislative Guide*, legislative recommendations 61-62, and chap. V, “Duration, extension and termination of the project agreement”, paras. 2-8)

62. The draft model provision reflects the substance of legislative recommendations 61 and 62.

**Model provision 43. Termination of the concession agreement by the contracting authority; model provision 44. Termination of the concession agreement by the concessionaire; and model provision 45. Termination of the concession agreement by either party** (see *UNCITRAL Legislative Guide*, legislative recommendations 63-65, and chap. V, “Duration, extension and termination of the project agreement”, paras. 9-35)

63. Draft model provision 43 reflects the substance of legislative recommendation 63, draft model provision 44 reflects the substance of legislative recommendation 64 and draft model provision 45 reflects the substance of legislative recommendation 65.

**Model provision 46. Financial arrangements upon expiry or termination of the concession agreement; and model provision 47. Wind-up and transfer measures** (see *UNCITRAL Legislative Guide*, legislative recommendations 66-68, and chap. V, “Duration, extension and termination of the project agreement”, paras. 36-62)

64. Model provision 46 reflects the substance of legislative recommendation 67 and model provision 47 reflects the substance of legislative recommendation 68, with the addition of subparagraph (a) so as to cover the generality of the matters referred to in paragraphs 37 to 42 of chapter V of the *UNCITRAL Legislative Guide*.

#### E. Settlement of disputes

**Model provision 48. Disputes between the contracting authority and the concessionaire** (see *UNCITRAL Legislative Guide*, legislative recommendation 69, chap. VI, “Settlement of disputes”, paras. 3-41)

65. The draft model provision offers two variants to reflect the policy stated in legislative recommendation 69.

**Model provision 49. Disputes involving the concessionaire and its lenders, contractors and suppliers** (see *UNCITRAL Legislative Guide*, legislative recommendation 70, and chap. VI, “Settlement of disputes”, para. 42)

66. Model provision 49 reflects the substance of legislative recommendation 70.

**Model provision 50. Disputes involving customers or users of the infrastructure facility** (see *UNCITRAL Legislative Guide*, legislative recommendation 71, and chap. VI, “Settlement of disputes”, paras. 43-45)

67. This draft model provision, which was suggested for inclusion by experts consulted by the secretariat, appears in square brackets, as no model provision had been requested by the Working Group with respect to legislative recommendation 71 (see A/CN.9/505, para. 174).

### III. MATTERS NOT COVERED IN THE DRAFT MODEL LEGISLATIVE PROVISIONS

#### A. Matters dealt with in chapter I, “General legislative and institutional framework”, of the *UNCITRAL Legislative Guide*

**Scope and authority to award concessions** (see *UNCITRAL Legislative Guide*, legislative recommendations 2-5, and chap. I, “General legislative and institutional framework”, paras. 15-22)

68. No model provision was drafted to implement legislative recommendation 5, which provides as follows:

“The law should specify the extent to which a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.”

69. Although the Working Group, at its last session, found that a model provision on the matter would be useful, the experts agreed that it was not feasible to transform the legislative recommendation into a model legislative provision. As an alternative, the issue of the degree of exclusivity of the concession might be mentioned among the contents of the concession agreement (see model provision 27 (a)).

70. Given the complexity of the issues and the various policy options mentioned in the legislative recommendation, the experts agreed that it would be better to keep it as a footnote to the text of the model provision dealing with the authority to enter into concession agreements (see model provision 3).

**Administrative coordination (see *UNCITRAL Legislative Guide*, legislative recommendation 6, and chap. I, “General legislative and institutional framework”, paras. 23-29)**

71. Legislative recommendation 6 provides as follows:

“Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.”

72. At its last session, the Working Group found that a model provision on the matter would be useful. Given the complexity of the issues and the various policy options mentioned in the legislative recommendation, the experts agreed that it would be better to keep it as a footnote to the text of the model provision dealing with the authority to enter into concession agreements (see proposed footnote to draft model provision 3).

**Authority to regulate infrastructure services (see *UNCITRAL Legislative Guide*, legislative recommendations 7-11, and chap. I, “General legislative and institutional framework”, paras. 30-53)**

73. No model provision was requested by the Working Group (see A/CN.9/505, para. 102).

**B. Matters dealt with in chapter II, “Project risks and government support”, of the *UNCITRAL Legislative Guide***

**Project risks and risk allocation (see *UNCITRAL Legislative Guide*, legislative recommendation 12, and chap. II, “Project risks and government support”, paras. 8-29)**

74. No model provision was requested by the Working Group (see A/CN.9/505, para. 104).

**Government support (see *UNCITRAL Legislative Guide*, legislative recommendation 13, and chap. II, “Project risks and government support”, paras. 30-60)**

75. Legislative recommendation 13 provides as follows:

“The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.”

76. At its last session, the Working Group found that a model provision on the matter would be useful (see A/CN.9/505, paras. 106-108). However, in view of the complexity of the issues and the various policy options mentioned in the legislative recommendation, the experts agreed that it would be better to keep it as a footnote to the text of the model provision dealing with the authority to enter into concession agreements (see proposed footnote to model provision 3). The matter is, however, referred to in draft model provision 27, subparagraph (f).

**C. Matters dealt with in chapter IV, “Construction and operation of infrastructure: legislative framework and project agreement”, of the *UNCITRAL Legislative Guide***

**Financial arrangements (see *UNCITRAL Legislative Guide*, legislative recommendations 46-48, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 33-51)**

77. No specific model provision was requested by the Working Group with respect to legislative recommendations 47 and 48 (see A/CN.9/505, para. 129).

**Construction works (see *UNCITRAL Legislative Guide*, legislative recommendation 52, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 69-79)**

78. No specific provision was requested by the Working Group (see A/CN.9/505, para. 138). The matter is, however, referred to in draft model provision 27, subparagraph (g).

**Infrastructure operation (see *UNCITRAL Legislative Guide*, legislative recommendations 53-55, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 80-97)**

79. No specific provision was requested by the Working Group with respect to legislative recommendations 54 and 55 (see A/CN.9/505, paras. 142 and 144). Those matters are, however, referred to in draft model provision 27, subparagraphs (h)-(j).

**General contractual arrangements (see *UNCITRAL Legislative Guide*, legislative recommendations 56-60, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 98-150)**

80. No specific provision was requested by the Working Group with respect to legislative recommendations 56 and 57 (see A/CN.9/505, para. 146). However, the subject referred to in legislative recommendation 56 is mentioned in draft model provision 27, subparagraph (l).

81. Furthermore, no specific provision was further requested by the Working Group with respect to legislative recommendation 58 (a), (b), (d) and (e) (see A/CN.9/505, para. 148). Nevertheless, for the sake of ensuring the completeness of the list contained in draft model provision 27, the matters referred to in legislative recommendation 58 (a) and (b) are mentioned in subparagraph (m) of the draft model provision. Likewise, the matters referred to in legislative recommendation 58 (d) and (e) are mentioned in subparagraphs (n) and (o) of draft model provision 27.

**D. Matters dealt with in chapter V, “Duration, extension and termination of the project agreement”, of the *UNCITRAL Legislative Guide* (see *UNCITRAL Legislative Guide*, legislative recommendations 66-68, and chap. V, “Duration, extension and termination of the project agreement”, paras. 36-62)**

82. No specific provision was requested by the Working Group with respect to legislative recommendation 66 (see A/CN.9/505, para. 160).

A/CN.9/WG.I/WP.29/Add.1

**Draft model legislative provisions 1 to 26**

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## FOREWORD

*The following model legislative provisions (hereinafter referred to as “model provisions”) have been prepared by the United Nations Commission on International Trade Law (UNCITRAL) as an addition to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (hereinafter referred to as “the Legislative Guide”), which was adopted by the Commission in 2000. The model provisions are intended to further assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects. The user is advised to read the model provisions together with the legislative recommendations and the notes contained in the Legislative Guide, which offer an analytical explanation to the financial, regulatory, legal, policy and other issues raised in the subject area.*

*The model provisions consist of a set of core provisions dealing with matters that deserve attention in legislation specifically concerned with privately financed infrastructure projects. While most model provisions relate to specific legislative recommendations contained in the Legislative Guide, they do not cover the entire range of issues dealt with in the legislative recommendations. In particular, no specific model provisions have been formulated on administrative or institutional matters, such as those dealt with in legislative recommendations 1, 5 and 6 to 13.*

*The model provisions are designed to be implemented and supplemented by the issuance of regulations providing fur-*

*ther details. Areas suitable for being addressed by regulations rather than by statutes are identified accordingly. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources and economic stability.*

*It should be noted that the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure projects but on which no specific legislative recommendations are made in the Legislative Guide. Those other areas of law include, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, rules on government contracts and administrative law, tax law, environmental protection and consumer protection laws.*

*For the user’s ease of reference, the model provisions are preceded by headings and bear titles that follow as closely as possible the headings of relevant sections of the Legislative Guide and the titles of its legislative recommendations. However, with a view to ensuring uniformity of style throughout the model provisions, a few headings and titles have been added and some of the original headings and titles have been modified so as to reflect the content of the model provisions to which they relate.*

## I. GENERAL PROVISIONS

### Model provision 1. Preamble

[see recommendation 1 and chap. I, paras. 2-14]

#### Variant A

WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a legislative framework to promote and facilitate private investment in infrastructure development,

Be it therefore enacted as follows:

#### Variant B

WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a favourable framework for the implementation of privately financed infrastructure projects by promoting transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;

WHEREAS the [Government] [Parliament] of ... considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;

[Other objectives that the enacting State might wish to state].

Be it therefore enacted as follows:

### Model provision 2. Definitions

[see introduction, paras. 9-20]

For the purposes of this law:

(a) “Infrastructure facility” means physical facilities and systems that directly or indirectly provide services to the general public;

(b) “Infrastructure project” means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

(c) “Contracting authority” means the public authority that has the power to enter into a concession agreement for the implementation of an infrastructure project [under the provisions of this law];<sup>1</sup>

(d) “Concessionaire” means the person that carries out an infrastructure project under a concession agreement entered into with a contracting authority;

(e) “Concession agreement” means the legally binding contract or contracts between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;

<sup>1</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession agreements. Depending on the regulatory regime of the enacting State, a separate body, referred to as “regulatory agency” in subparagraph (h), may have the responsibility for issuing rules and regulations governing the provision of the relevant service.

(f) “Bidder” and “bidders” mean persons, including groups thereof, that participate in selection proceedings for the award of infrastructure projects;<sup>2</sup>

(g) “Unsolicited proposal” means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;

(h) “Regulatory agency” means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>3</sup>

### Model provision 3. Authority to enter into concession agreements

[see recommendation 2 and chap. I, paras. 15-18]

The following public authorities have the power to enter into concession agreements<sup>4</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [the enacting State lists the relevant public authorities of the host country that may enter into concession agreements by way of an exhaustive or indicative list of public authorities, a list of types of categories of public authorities or a combination thereof].<sup>5</sup>

### Model provision 4. Eligible infrastructure sectors

[see recommendation 4 and chap. I, paras. 19-22]

Concession agreements may be entered into by the relevant authorities in the following sectors: [the enacting State indicates the relevant sectors by way of an exhaustive or indicative list].<sup>6</sup>

<sup>2</sup>The term “bidder” or “bidders” encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings, or persons that have submitted a proposal in response to a contracting authority’s request for proposals.

<sup>3</sup>The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, “General legislative and institutional framework”, paras. 30-53).

<sup>4</sup>It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, “General legislative and institutional framework”, paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, “Project risks and government support”).

<sup>5</sup>Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession agreements, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those agreements, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to “the Union, the States [or provinces] and the municipalities”. In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>6</sup>It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.



## II. SELECTION OF THE CONCESSIONAIRE

### Model provision 5. Rules governing the selection proceedings

[see recommendation 14 and chap. III, paras. 1-33]

The award of infrastructure projects shall be conducted in accordance with [model provisions 6 to 26] and, for matters not provided herein, in accordance with [the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts].<sup>7</sup>

#### 1. Pre-selection of bidders

### Model provision 6. Purpose and procedure of pre-selection

[see recommendation 15 and chap. III, paras. 34-50]

1. The contracting authority [may] [shall] engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.

2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the prequalification of suppliers and contractors].

3. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the prequalification of suppliers and contractors],<sup>8</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:

<sup>7</sup>The user's attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are largely based on the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (hereinafter referred to as the "Model Procurement Law"). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for the selection of the concessionaire. The draft model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following matters: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, mutatis mutandis, supplement the practical elements of the selection procedure described herein.

<sup>8</sup>A list of elements typically contained in an invitation to participate in prequalification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

(a) A description of the infrastructure facility to be built or renovated;

(b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire); and

(c) Where already known, a summary of the main required terms of the concession agreement to be entered into;

(d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications;

(e) The manner and place for solicitation of the pre-selection documents.

4. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors],<sup>9</sup> the pre-selection documents shall include at least the following information:

(a) The pre-selection criteria in accordance with [model provision 7];

(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [model provision 8];

(c) Whether the contracting authority intends to request only a limited number<sup>10</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [model provision 9, paragraph 2], and, if applicable, the manner in which this selection will be carried out;

(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [this State] in accordance with [model provision 29].

5. The pre-selection proceedings shall be conducted in accordance with [the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the prequalification of suppliers and contractors].<sup>11</sup>

<sup>9</sup>A list of elements typically contained in prequalification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

<sup>10</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 48-49). See also footnote 13.

<sup>11</sup>Procedural steps on prequalification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority's decision on the bidders' qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.

**Model provision 7. Pre-selection criteria**

[see recommendation 15 and chap. III, paras. 34-40 and 43-44]

In order to qualify for the selection proceedings, interested bidders must meet objectively justifiable criteria<sup>12</sup> that the contracting authority considers appropriate in the particular proceedings, as stated in the pre-selection documents. These criteria shall include at least the following:

(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, including design, construction, operation and maintenance;

(b) Sufficient ability to manage the financial aspects of the project and capability to sustain its financing requirements;

(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating similar infrastructure facilities.

**Model provision 8. Participation of consortia**

[see recommendation 16 and chap. III, paras. 41-42]

1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.

2. Unless otherwise [authorized by \_\_\_ [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>13</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.

3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

<sup>12</sup>The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. The various issues raised by domestic preferences are discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 43-44). The *Legislative Guide* suggests that countries that wish to provide some incentive to national suppliers may wish to apply such preferences in the form of special evaluation criteria, rather than by a blanket exclusion of foreign suppliers. In any event, where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

<sup>13</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.

**Model provision 9. Decision on pre-selection**

[see recommendations 17 (for para. 2) and 25 (for para. 3) and chap. III, paras. 47-50]

1. The contracting authority shall make a decision with respect to the qualifications of each bidder that has submitted an application for pre-selection. In reaching that decision, the contracting authority shall apply only the criteria that are set forth in the pre-selection documents. All pre-selected bidders shall thereafter be invited by the contracting authority to submit proposals in accordance with [model provisions 10 to 16].

2. Notwithstanding paragraph 1, the contracting authority may, provided that it has made an appropriate statement in the pre-selection documents to that effect, reserve the right to request proposals upon completion of the pre-selection proceedings only from a limited number<sup>14</sup> of bidders that best meet the pre-selection criteria. For this purpose, the contracting authority shall rate the bidders that meet the pre-selection criteria on the basis of the criteria applied to assess their qualifications and draw up [a short] [the final] list of the bidders that will be invited to submit proposals upon completion of the pre-selection proceedings. In drawing up the short list, the contracting authority shall apply only the manner of rating that is set forth in the pre-selection documents.

3. The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so.

**2. Procedure for requesting proposals****Model provision 10. Single-stage and two-stage procedures for requesting proposals**

[see recommendations 18 and 19 and chap. III, paras. 51-58]

1. The contracting authority shall provide a set of the [final] request for proposals and related documents issued in accordance with [model provision 11] to each pre-selected bidder that pays the price, if any, charged for those documents.

2. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when [it is not feasible for the contracting authority] [the contracting authority does not deem it to be feasible] to describe in the request for proposals the characteristics of the project such as project specifications,

<sup>14</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", para. 48). It should be noted that the rating system is solely used for the purpose of the pre-selection of bidders. The ratings of the pre-selected bidders should not be taken into account at the stage of evaluation of proposals (see model provision 15), at which all pre-selected bidders should start out on equal standing.

performance indicators, financial arrangements or contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

3. Where a two-stage procedure is used, the following provisions apply:

(a) The initial request for proposals shall call upon the bidders to submit, in the first stage of the procedure, initial proposals relating to project specifications, performance indicators, financing requirements or other characteristics of the project as well as to the main contractual terms proposed by the contracting authority;<sup>15</sup>

(b) The contracting authority may convene meetings and hold discussions with any of the bidders to clarify questions concerning the initial request for proposals or the initial proposals and accompanying documents submitted by the bidders;

(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial request for proposals by deleting or modifying any aspect of the initial project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the initial request for proposals, as well as by adding characteristics or criteria to it. Any such deletion, modification or addition shall be communicated in the invitation to submit final proposals;

(d) In the second stage of the proceedings, the contracting authority shall invite the bidders to submit final proposals with respect to a single set of project specifications, performance indicators or contractual terms in accordance with [model provisions 11 to 16].

#### **Model provision 11. Content of the final request for proposals**

[see recommendation 20 and chap. III, paras. 59-70]

To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of requests for proposals],<sup>16</sup> the final request for proposals shall include at least the following information:

(a) General information as may be required by the bidders in order to prepare and submit their proposals;<sup>17</sup>

<sup>15</sup>In many cases, in particular for new types of projects, the contracting authority may not be in a position, at this stage, to have formulated a detailed draft of the contractual terms envisaged by it. Also, the contracting authority may find it preferable to develop such terms only after an initial round of consultations with the pre-selected bidders. In any event, however, it is important for the contracting authority, at this stage, to provide some indication of the key contractual terms of the concession agreement, in particular the way in which the project risks should be allocated between the parties under the concession agreement. If this allocation of contractual rights and obligations is left entirely open until after the issuance of the final request for proposals, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project (see chap. III, "Selection of the concessionaire", paras. 67-70; see further chap. II, "Project risks and government support", paras. 8-29).

<sup>16</sup>A list of elements typically contained in a request for proposals for services can be found in article 38 of the Model Procurement Law.

<sup>17</sup>A list of elements that should be provided can be found in chapter III, "Selection of the concessionaire", paras. 61-62, of the *Legislative Guide*.

(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;<sup>18</sup>

(c) The contractual terms proposed by the contracting authority, including an indication of which terms are deemed to be non-negotiable;

(d) The criteria for evaluating proposals and the thresholds, if any, set by the contracting authority for identifying non-responsive proposals; the relative weight to be accorded to each evaluation criterion; and the manner in which the criteria and thresholds are to be applied in the evaluation and rejection of proposals.

#### **[Model provision 12. Bid security]**

[see chap. III, para. 62]

1. [The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required tender security.]

2. [A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>19</sup>

(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;

(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 16];

(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 16, paragraph 2];

(d) Failure to sign the concession agreement, if required by the contracting authority to do so, after the proposal has been accepted;

(e) Failure to provide required security for the fulfilment of the concession agreement after the proposal has been accepted or to comply with any other condition prior to signing the project agreement specified in the request for proposals.]

#### **Model provision 13. Clarifications and modifications**

[see recommendation 21 and chap. III, paras. 71-72]

The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise the final request for proposals by deleting or modifying any aspect of the project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the final request for proposals, as well as by adding characteristics or criteria to it. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the final request for proposals at a reasonable time prior to the deadline for submission of proposals.

<sup>18</sup>See chapter III, "Selection of the concessionaire", paras. 64-66.

<sup>19</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.

**Model provision 14. Evaluation criteria**

[see recommendations 22-23 and chap. III, paras. 73-77]

1. The criteria for the evaluation and comparison of the technical proposals<sup>20</sup> shall include at least the following:

- (a) Technical and environmental soundness;
- (b) Operational feasibility;
- (c) Quality of services and measures to ensure their continuity.

2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>21</sup> shall include, as appropriate:

- (a) The present value of the proposed tolls, unit prices and other charges over the concession period;
- (b) The present value of the proposed direct payments by the contracting authority, if any;
- (c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;
- (d) The extent of financial support, if any, expected from a public authority of [this State];
- (e) Soundness of the proposed financial arrangements;
- (f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;
- (g) The social and economic development potential offered by the proposals.

**Model provision 15. Comparison and evaluation of proposals**

[see recommendation 24 and chap. III, paras. 78-82]

1. The contracting authority shall compare and evaluate each proposal in accordance with the evaluation criteria, the relative weight accorded to each such criterion and the evaluation process set forth in the request for proposals.

2. For the purposes of paragraph 1, the contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects. Proposals that fail to achieve the thresholds shall be regarded as non-responsive and rejected from the selection procedure.<sup>22</sup>

<sup>20</sup>See chapter III, "Selection of the concessionaire", para. 74.

<sup>21</sup>Ibid., paras. 75-77.

<sup>22</sup>This model provision offers an example of an evaluation process that a contracting authority may wish to apply to compare and evaluate proposals for privately financed infrastructure projects. Alternative evaluation processes are described in chapter III, "Selection of the concessionaire", paras. 79-82, of the *Legislative Guide*, such as a two-step evaluation process or the two-envelope system. In contrast to the process set forth in this model provision, the processes described in the *Legislative Guide* are designed to allow the contracting authority to compare and evaluate the non-financial criteria separately from the financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. In order to ensure the integrity, transparency and predictability of the evaluation stage of the selection proceedings, it is recommended that the enacting State set forth in its law the evaluation processes that contracting authorities may use to compare and evaluate proposals and the details of the application of this process.

**Model provision 16. Final negotiations**

[see recommendations 26-27 and chap. III, paras. 83-84]

1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession agreement the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.

2. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a concession agreement, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the bidder that has attained the second best rating; if the negotiations with that bidder do not result in a concession agreement, the contracting authority shall thereafter invite for negotiations the other bidders in the order of their ranking until it arrives at a concession agreement or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with whom negotiations have been terminated pursuant to this paragraph.

**3. Negotiation of concession agreements without competitive procedures****Model provision 17. Circumstances authorizing award without competitive procedures**

[see recommendation 28 and chap. III, para. 89]

[Subject to approval by \_\_\_ [the enacting State indicates the relevant authority]]<sup>23</sup> the contracting authority is authorized to negotiate a concession agreement without using the procedure set forth in [model provisions 6 to 16], in the following cases:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in the procedures set forth in [model provisions 6 to 16] would be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

<sup>23</sup>The rationale for subjecting the award of the concession agreement without competitive procedures to the approval of a higher authority is to ensure that the contracting authority engages in direct negotiations with bidders only in the appropriate circumstances (see chap. III, "Selection of the concessionaire", paras. 85-96). The model provision therefore suggests that the enacting State indicate a relevant authority that is competent to authorize negotiations in all cases set forth in the model provision. The enacting State may provide, however, for different approval requirements for each subparagraph of the model provision. In some cases, for instance, the enacting State may provide that the authority to engage in such negotiations derives directly from the law. In other cases, the enacting State may make the negotiations subject to the approval of different higher authorities, depending on the nature of the services to be provided or the infrastructure sector concerned. In those cases, the enacting State may need to adapt the model provision to these approval requirements by adding the particular approval requirement to the subparagraph concerned, or by adding a reference to provisions of its law where these approval requirements are set forth.

(b) Where the project is of short duration and the anticipated initial investment value does not exceed the amount [of \_\_\_\_ *the enacting State specifies a monetary ceiling*] [set forth in \_\_\_\_ *the enacting State indicates the provisions of its laws that specify the monetary threshold below which a privately financed infrastructure project may be awarded without competitive procedures*];<sup>24</sup>

(c) Where the project involves national defence or national security;

(d) Where there is only one source capable of providing the required service, such as when the provision of the service requires the use of intellectual property right or other exclusive right owned or possessed by a certain person or persons;

(e) In cases of unsolicited proposals falling under [model provision 22];

(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria [set forth in the request for proposals], and if, in the judgement of the contracting authority, issuing a new invitation to the pre-selection proceedings and a new request for proposals would be unlikely to result in a project award, within a required time frame, provided that the terms of any concession agreement so negotiated between the parties must [be consistent with] [not depart from] the project specifications and contractual terms originally transmitted with the request for proposals;

(g) In other cases where the [*the enacting State indicates the relevant authority*] authorizes such an exception for [compelling] reasons of public interest [or other cases of the same exceptional nature, as defined in the law].<sup>25</sup>

#### **Model provision 18. Procedures for negotiation of a concession agreement**

[see recommendation 29 and chap. III, para. 90]

Where a concession agreement is negotiated without using the procedures set forth in [model provisions 6 to 16] the contracting authority shall:<sup>26</sup>

(a) Except for concession agreements negotiated pursuant to [model provision 17, paragraph (c)], cause a notice of its intention to commence negotiations in respect of a concession agreement to be published in accordance with [*the enacting State indicates the provisions of any relevant laws on procurement proceedings that govern the publication of notices*];

(b) Engage in negotiations with as many persons as the contracting authority judges capable of carrying out the project as circumstances permit;

<sup>24</sup>As an alternative to the exclusion provided in subparagraph (b), the enacting State may consider devising a simplified procedure for request for proposals for projects falling thereunder, for instance by applying the procedures described in article 48 of the Model Procurement Law.

<sup>25</sup>Enacting States that deem it desirable to authorize the use of negotiated procedures on an ad hoc basis may wish to retain subparagraph (g) when implementing the model provision. Enacting States wishing to limit exceptions to the competitive selection procedures may in turn prefer not to include the subparagraph.

<sup>26</sup>A number of elements to enhance transparency in negotiations under this model provision are discussed in chapter III, "Selection of the concessionaire", paras. 90-96, of the *Legislative Guide*.

(c) Establish evaluation criteria against which proposals shall be evaluated and ranked.

#### **4. Unsolicited proposals<sup>27</sup>**

##### **Model provision 19. Admissibility of unsolicited proposals**

[see recommendation 30 and chap. III, paras. 97-109]

As an exception to [model provisions 6 to 16], the contracting authority<sup>28</sup> is authorized to consider unsolicited proposals pursuant to the procedures set forth in [model provisions 20 to 22], provided that such proposals do not relate to a project for which selection procedures have been initiated or announced.

##### **Model provision 20. Procedures for determining the admissibility of unsolicited proposals**

[see recommendations 31-32 and chap. III, paras. 110-112]

1. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority shall promptly inform the proponent whether or not the project is considered to be in the public interest.<sup>29</sup>

2. If the project is considered to be in the public interest under paragraph 1, the contracting authority shall invite the proponent to submit as much information on the proposed project as is feasible at this stage to allow the contracting authority to make a proper evaluation of the proponent's qualifications and the technical and economic feasibility of the project and to determine whether the project is likely to be successfully implemented in the manner proposed in terms acceptable to the contracting authority. For this purpose, the proponent shall submit a technical and economic feasibility study, an environment impact study and satisfactory information regarding the concept or technology contemplated in the proposal.

3. In considering an unsolicited proposal, the contracting authority shall respect the intellectual property, trade se-

<sup>27</sup>The policy considerations on the advantages and disadvantages of unsolicited proposals are discussed in chapter III, "Selection of the concessionaire", paras. 98-100, of the *Legislative Guide*. States that wish to allow contracting authorities to handle such proposals may wish to use the procedures set forth in model provisions 22 to 24.

<sup>28</sup>The model provision assumes that the power to entertain unsolicited proposals lies with the contracting authority. However, depending on the regulatory system of the enacting State, a body separate from the contracting authority may have the responsibility for entertaining unsolicited proposals or for considering, for instance, whether an unsolicited proposal is in the public interest. In such a case, the manner in which the functions of such a body may need to be coordinated with those of the contracting authority should be carefully considered by the enacting State (see footnotes 1, 3 and 23 and the references cited therein).

<sup>29</sup>The determination that a proposed project is in the public interest entails a considered judgement regarding the potential benefits to the public that are offered by the project, as well as its relationship to the Government's policy for the infrastructure sector concerned. In order to ensure the integrity, transparency and predictability of the procedures for determining the admissibility of unsolicited proposals, it may be advisable for the enacting State to provide guidance, in regulations or other documents, concerning the criteria that will be used to determine whether an unsolicited proposal is in the public interest, which may include criteria for assessing the appropriateness of the contractual arrangements and the reasonableness of the proposed allocation of project risks.

crets or other exclusive rights contained in, arising from or referred to in the proposal. In particular, the contracting authority shall not make use of any information issued or provided by or on behalf of the proponent in connection with its unsolicited proposal other than for the evaluation of that proposal, except with the consent of the proponent. [Except as otherwise agreed by the parties], the contracting authority shall, in the event that the proposal is rejected, return to the proponent the original and any copies of documents that the proponent submitted and prepared [, whether in hard copy or in electronic format,] throughout the procedure.

**Model provision 21. Unsolicited proposals that do not involve proprietary concepts or technology**

[see recommendation 33 and chap. III, paras. 113-114]

1. Except in the circumstances set forth in [model provision 17], the contracting authority shall, if it decides to implement the project, initiate a selection procedure in accordance with [model provisions 6 to 16] if the contracting authority considers that:

(a) The envisaged output of the project can be achieved without the use of an intellectual property right or other exclusive right owned or possessed by the proponent; or

(b) The proposed concept or technology is not truly unique or new.

2. The proponent shall be invited to participate in the selection proceedings initiated by the contracting authority pursuant to paragraph 1 and may be given an incentive or a similar benefit [in a manner described by the contracting authority in the request for proposals] in consideration for the development and submission of the proposal.

**Model provision 22. Unsolicited proposals involving proprietary concepts or technology**

[see recommendations 34-35 and chap. III, paras. 115-117]

1. If the contracting authority determines that the conditions of [model provision 21, paragraph 1, subparagraphs (a) or (b)] are not met, it shall not be required to carry out a selection procedure pursuant to [model provisions 6 to 16]. However, the contracting authority may still seek to obtain elements of comparison for the unsolicited proposal in accordance with the provisions set out in paragraphs 2 to 4.<sup>30</sup>

2. Where the contracting authority intends to obtain elements of comparison for the unsolicited proposal, the contracting authority shall publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals within [a reasonable period] [the enacting State indicates a certain amount of time].

3. If no proposals in response to an invitation issued pursuant to paragraph 2 are received within [a reasonable period] [the amount of time specified in paragraph 2 above], the contracting authority may engage in negotiations with the original proponent.

<sup>30</sup>The enacting State may wish to consider adopting a special procedure for handling unsolicited proposals falling under this model provision, which may be modelled, mutatis mutandis, on the request-for-proposals procedure set forth in article 48 of the Model Procurement Law.

4. If the contracting authority receives proposals in response to an invitation issued pursuant to paragraph 2, the contracting authority shall invite the proponents to negotiations in accordance with the provisions set forth in [model provision 18]. In the event that the contracting authority receives a sufficiently large number of proposals, which appear prima facie to meet its infrastructure needs, the contracting authority shall request the submission of proposals pursuant to [model provisions 10-16], subject to any incentive or other benefit that may be given to the person who submitted the unsolicited proposal in accordance with [model provision 21, paragraph 2].

**5. Miscellaneous provisions**

**Model provision 23. Confidentiality of negotiations**

[see recommendation 36 and chap. III, para. 118]

The contracting authority shall treat proposals in such a manner as to avoid the disclosure of any information contained therein to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, paragraphs 3, 16, 17, 18 or 22, paragraph 3] shall be confidential. [Unless required by law or by a court order,] Each party to the negotiations shall not disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.

**Model provision 24. Notice of project award**

[see recommendation 37 and chap. III, para. 119]

Except for infrastructure projects awarded pursuant to [model provision 17, subparagraph (c)], the contracting authority shall cause a notice of the award of the project to be published in accordance with [the enacting State indicates the provisions of its laws on procurement proceedings that govern the publication of contract award notices]. The notice shall identify the concessionaire and include a summary of the essential terms of the concession agreement.

**Model provision 25. Record of selection and award proceedings**

[see recommendation 38 and chap. III, paras. 120-126]

The contracting authority shall keep an appropriate record of information pertaining to the selection and award proceedings in accordance with [the enacting State indicates the provisions of its laws on public procurement that govern a record of procurement proceedings].<sup>31</sup>

<sup>31</sup>The contents of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, may need to be set forth in regulations issued by the enacting State to implement the model provision, where no such rules exist under the enacting State's procurement laws. These issues are discussed in chapter III, "Selection of the concessionaire", paras. 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award contemplated is set out in article 11 of the Model Procurement Law.

**Model provision 26. Review procedures**

[see recommendation 39 and chap. III, paras. 127-131]

A bidder who claims to have suffered, or who may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review the contracting authority's acts or failures to act in accord-

ance with [the enacting State indicates the provisions of its laws governing the review of decisions made in procurement proceedings].<sup>32</sup>

<sup>32</sup>Elements for the establishment of an adequate review system are discussed in chapter III, "Selection of the concessionaire", paras. 127-131, of the *Legislative Guide*. They are also contained in chapter VI of the Model Procurement Law.

**A/CN.9/WG.I/WP.29/Add.2****Draft model legislative provisions 27 to 50**

## ADDENDUM

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### III. CONSTRUCTION AND OPERATION OF INFRASTRUCTURE

#### **Model provision 27. Contents of the concession agreement**

[see recommendation 40 and chap. IV, paras. 1-11]

The concession agreement shall provide for such matters as the parties deem appropriate, including:

(a) The nature and scope of works to be performed and services to be provided by the concessionaire [see chap. IV, para. 1];

(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire's rights under the concession agreement [see recommendation 5];

(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project [see recommendation 6];

(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [model provision 29] [see recommendation 42 and draft model provision 29];

(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [model provisions 30-32] [see recommendations 44 and 45 and draft model provisions 30-32];

(f) The remuneration of the concessionaire, in particular and as appropriate, the concessionaire's right to charge, receive or collect tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of those tariffs or fees; and any payments, if any, that may be made by the contracting authority or other public authority [see recommendations 46 and 48];

(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility [see recommendation 52];

(h) The extent of the concessionaire's obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users [see recommendation 53 and draft model provision 37];

(i) The contracting authority's or other public authority's right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements [see recommendation 54 (b)];

(j) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations [see recommendation 54 (a)];

(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled [see chap. IV, paras. 73-76];

(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the concessionaire, in particular with the concessionaire's own shareholders or other affiliated persons [see recommendation 56];

(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project [see recommendation 58 (a) and (b)];

(n) Remedies available in the event of default of either party [see recommendation 58 (e)];

(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession agreement owing to circumstances beyond its reasonable control [see recommendation 58 (d)];

(p) The duration of the concession agreement and the rights and obligations of the parties upon its expiry or termination [see recommendation 61];

(q) The manner for calculating compensation pursuant to [model provision 46] [see recommendation 67];

(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire [see recommendations 41 and 69 and draft model provisions 28 and 48].

#### **Model provision 28. Governing law**

[see recommendation 41 and chap. IV, paras. 5-8]

The concession agreement is governed by the law of this State [unless otherwise provided in the concession agreement].<sup>1</sup>

#### **Model provision 29. Organization of the concessionaire**

[see recommendations 42-43 and chap. IV, paras. 12-18]

The contracting authority may require that the successful bidder establish a legal entity incorporated under the

<sup>1</sup>Legal systems provide varying answers to the question as to whether the parties to a concession agreement may choose as the governing law of the agreement a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chapter IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 5-8), in some countries the concession agreement may be subject to administrative law, while in others the concession agreement may be governed by private law (see also *Legislative Guide*, chap. VII, "Other relevant areas of law", paras. 24-27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally, *Legislative Guide*, chap. VII, "Other relevant areas of law", section B).



laws of [*this State*], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession agreement.

### Model provision 30. Ownership of assets<sup>2</sup>

[see recommendation 44 and chap. IV, paras. 20-26]

The concession agreement shall specify, [where necessary and] [as] appropriate, which assets are or shall be public property and which assets are or shall be the private property of the concessionaire. The concession agreement shall in particular identify which assets belong to the following categories:

(a) Assets, if any, that the concessionaire is required, as appropriate, to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the concession agreement;

(b) Assets, if any, that the contracting authority, at its option, may purchase from the concessionaire; and

(c) Assets, if any, that the concessionaire may retain or dispose of upon expiry or termination of the concession agreement.

### Model provision 31. Acquisition of project site

[see recommendation 45 and chap. IV, paras. 27-29]

1. The contracting authority or other public authority under the terms of the law and the concession agreement shall [obtain] [make available to the concessionaire] or, as appropriate, assist the concessionaire in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.

2. Any compulsory acquisition of land that may be required for the execution of the project shall be carried out in accordance with [*the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest*] and the terms of the concession agreement.

<sup>2</sup>Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see “Introduction and background information on privately financed infrastructure projects”, paras. 47-53). Those general policy options typically determine the legislative approach for ownership of project-related assets (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 20-26). Irrespective of the host country’s general or sectoral policy, the ownership regime of the various assets involved should be clearly defined and based on sufficient legislative authority. Clarity in this respect is important, as it will directly affect the concessionaire’s ability to create security interests in project assets for the purpose of raising financing for the project (*ibid.*, paras. 52-61). Consistent with the flexible approach taken by various legal systems, the model provision does not contemplate an unqualified transfer of all assets to the contracting authority but allows a distinction between assets that must be transferred to the contracting authority, assets that may be purchased by the contracting authority, at its option, and assets that remain the private property of the concessionaire.

### Model provision 32. Easements<sup>3</sup>

[see recommendation 45 and chap. IV, para. 30]

The concessionaire shall [have] [be granted] the power to enter upon, transit through, do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project [in accordance with (*the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws*)].

### Model provision 33. Financial arrangements

[see recommendation 46 and chap. IV, paras. 33-51]

The concessionaire has the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession agreement shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [in accordance with the rules established by the competent regulatory agency].<sup>4</sup>

### Model provision 34. Security interests

[see recommendation 49 and chap. IV, paras. 52-61]

1. Subject to any restriction that may be contained in the concession agreement,<sup>5</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

(a) Security over movable or immovable property owned by the concessionaire or its interests in project assets;

(b) A pledge of the proceeds and receivables owed to the concessionaire for the use of the facility or the services it provides.

<sup>3</sup>The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the concessionaire directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 30-32). The alternative wording offered within the first set of square brackets in the model provision is intended to reflect those options.

<sup>4</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as “tariffs”, may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, “Project risks and government support”, paras. 30-60). The cost at which public services are provided is typically an element of the Government’s infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of “reasonableness”, “fairness” or “equity” (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 36-46).

<sup>5</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.

2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire.
3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is not permitted by the law of [*this State*].

**Model provision 35. Assignment of the concession agreement**

[*see recommendation 50 and chap. IV, paras. 62 and 63*]

Except as otherwise provided in [*model provision 34*], the rights and obligations of the concessionaire under the concession agreement may not [, in whole or in part,] be assigned to third parties without the consent of the contracting authority. The concession agreement shall set forth the conditions under which the contracting authority [may] [shall] give its consent to an assignment of the rights and obligations of the concessionaire under the concession agreement, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire's technical and financial capability as necessary for providing the service.

**Model provision 36. Transfer of controlling interest<sup>6</sup> in the concessionaire**

[*see recommendation 51 and chap. IV, paras. 64-68*]

Except as otherwise provided in the concession agreement, a controlling interest in the concessionaire may not be transferred to third parties without the consent of the contracting authority. The concession agreement shall set forth the conditions under which consent of the contracting authority [may] [shall] be given.

**Model provision 37. Operation of infrastructure**

[*see recommendation 53 and chap. IV, paras. 80-93 (for paragraph 1) and recommendation 55 and chap. IV, paras. 96-97 (for paragraph 2)*]

1. The concession agreement shall set forth, as appropriate, the extent of the concessionaire's obligations to ensure:
  - (a) The modification of the service so as to meet the demand for the service;
  - (b) The continuity of the service;
  - (c) The provision of the service under essentially the same conditions for all users;
  - (d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

<sup>6</sup>The notion of "controlling interest" generally refers to the power to appoint the management of a corporation and influence or determine its business. Different criteria may be used in various legal systems or even in different bodies of law within the same legal system, ranging from formal criteria attributing a controlling interest to the ownership of a certain amount (typically more than fifty per cent) of the total combined voting power of all classes of stock of a corporation to more complex criteria that take into account the actual management structure of a corporation. Enacting States that do not have a statutory definition of "controlling interest" may need to define the term in regulations issued to implement the model provision.

2. [The concessionaire shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.]

**Model provision 38. Compensation for specific changes in legislation**

[*see recommendation 58 (c) and chap. IV, paras. 122-125*]

The concession agreement shall set forth the extent to which the concessionaire is entitled to compensation in the event that the cost of the concessionaire's performance of the concession agreement has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared to the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the service it provides.

**Model provision 39. Revision of the concession agreement**

[*see recommendation 58 (c) and chap. IV, paras. 126-130*]

*Variant A*

1. Without prejudice to [*model provision 38*], the concession agreement may further set forth the extent to which the concessionaire is entitled to request a revision of the concession agreement with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession agreement has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared to the costs and the value of performance originally foreseen, as a result of:
  - (a) Changes in economic or financial conditions; or
  - (b) Changes in legislation or regulation other than those referred to in [*model provision 38*].
2. [Except as otherwise provided in the concession agreement] a request for revision of the concession agreement pursuant to paragraph 1 may not be granted unless the economic, financial, legislative or regulatory changes:

- (a) Occur after the conclusion of the contract;
- (b) Are beyond the control of the concessionaire; and
- (c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the project agreement was negotiated or to have avoided or overcome their consequences.

3. The concession agreement shall establish procedures for revising the terms of the concession agreement following the occurrence of any such changes.

*Variant B*

Without prejudice to [*model provision 38*], the concession agreement may further set forth the extent to which the concessionaire is entitled to request a revision of the concession agreement with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession agreement has substantially

increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared to the costs and the value of performance originally foreseen, as a result of changes in economic or financial conditions or changes in legislation or regulation other than those referred to in [model provision 38].

**Model provision 40. Takeover of an infrastructure project by the contracting authority**

[see recommendation 59 and chap. IV, paras. 143-146]

Under the circumstances set forth in the concession agreement, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.

**Model provision 41. Substitution of the concessionaire**

[see recommendation 60 and chap. IV, paras. 147-150]

The contracting authority and the entities extending financing for an infrastructure project may agree on procedures for the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession agreement upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession agreement or other similar circumstances, as may be agreed by the contracting authority and the entities extending financing for an infrastructure project.<sup>7</sup>

**IV. DURATION, EXTENSION AND TERMINATION OF THE PROJECT AGREEMENT**

**1. Duration and extension of the project agreement**

**Model provision 42. Duration and extension of the concession agreement**

[see recommendation 62 and chap. V, paras. 2-8]

1. The term of the concession agreement, as stipulated in accordance with [model provision 27 (p)] shall not be extended except as a result of the following circumstances:

<sup>7</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession agreement (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority.

(a) Completion delay or interruption of operation due to circumstances beyond either party's reasonable control; or

(b) Project suspension brought about by acts of the contracting authority or other public authorities;

(c) [Other circumstances, as specified by the enacting State.]

2. The term of the concession agreement may further be extended to allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the concession agreement, if the concessionaire would not be able to recover such costs during the original term.

**2. Termination of the project agreement**

**Model provision 43. Termination of the concession agreement by the contracting authority**

[see recommendation 63 and chap. V, paras. 14-27]

The contracting authority may terminate the concession agreement:

(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

(b) For reasons of public interest, subject to payment of compensation to the concessionaire, as agreed in the concession agreement;

(c) [Other circumstances that the enacting State might wish to add in the law.]

**Model provision 44. Termination of the concession agreement by the concessionaire**

[see recommendation 64 and chap. V, paras. 28-33]

The concessionaire may not terminate the concession agreement except under the following circumstances:

(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession agreement;

(b) In the event that the concessionaire's performance is rendered substantially more onerous as a result of acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the concession agreement.

**Model provision 45. Termination of the concession agreement by either party**

[see recommendation 65 and chap. V, paras. 34-35]

Either party has the right to terminate the concession agreement in the event that the performance of its obliga-

tions is rendered impossible by circumstances beyond either party's reasonable control. The parties also have the right to terminate the concession agreement by mutual consent.

### 3. Arrangements upon expiry or termination of the concession agreement

#### Model provision 46. Financial arrangements upon expiry or termination of the concession agreement

[see recommendation 67 and chap. V, paras. 43-49]

The concession agreement shall stipulate how compensation due to either party is calculated in the event of termination of the concession agreement, providing, where appropriate, for compensation for the fair value of works performed under the concession agreement, costs incurred or losses sustained by either party, including, as appropriate, lost profits.

#### Model provision 47. Wind-up and transfer measures

[see recommendation 68 and chap. V, paras. 50-62]

The concession agreement [may] [shall] set forth, as appropriate, the rights and obligations of the parties with respect to:

(a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;

(b) The transfer of technology required for the operation of the facility;

(c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

(d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.

## V. SETTLEMENT OF DISPUTES

### Model provision 48. Disputes between the contracting authority and the concessionaire

[see recommendation 69 and chap. VI, paras. 3-41]

#### Variant A

Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession agreement [in accordance with the law of this State].

#### Variant B

The contracting authority shall be free to agree upon mechanisms for the settlement of disputes that may arise between the parties to the concession agreement, as best suited to the needs of the infrastructure project.

### Model provision 49. Disputes involving the concessionaire and its lenders, contractors and suppliers

[see recommendation 70 and chap. VI, para. 42]

1. The concessionaire and its shareholders shall be free to choose the appropriate mechanisms for settling disputes among themselves.

2. The concessionaire shall be free to agree on the appropriate mechanisms for settling disputes between itself and its lenders, contractors, suppliers and other business partners.

### Model provision 50. Disputes involving customers or users of the infrastructure facility

[see recommendation 71 and chap. VI, paras. 43-45]

[Where the concessionaire provides services to the public or operates infrastructure facilities accessible to the public, the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.]

A/CN.9/522

## C. Draft addendum to the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*: note by the Secretariat (A/CN.9/522 and Add.1 and Add.2) [Original: English]

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## I. INTRODUCTION

1. At its thirty-third session, held in New York from 12 June to 7 July 2000, the United Nations Commission on International Trade Law (UNCITRAL) adopted the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, consisting of the legislative recommendations (A/CN.9/471/Add.9), with the amendments adopted by the Commission at that session and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the Secretariat was authorized to finalize in the light of the deliberations of the Commission.<sup>1</sup> The *Legislative Guide* was published in all official languages in 2001.

2. At the same session, the Commission also considered a proposal for future work in that area. It was suggested that, although the *Legislative Guide* would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure, it would nevertheless be desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues.<sup>2</sup>

3. After consideration of that proposal, the Commission decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the *Legislative Guide* should be considered by the Commission at its thirty-fourth session. In order to assist the Commission in making an informed decision on the matter, the secretariat was requested to organize a colloquium, in cooperation with other interested international organizations or international financial institutions, to disseminate knowledge about the *Legislative Guide*.<sup>3</sup>

<sup>1</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 195-368.

<sup>2</sup>Ibid., para. 375.

<sup>3</sup>Ibid., para. 379.

4. The Colloquium on Privately Financed Infrastructure: Legal Framework and Technical Assistance was organized with the co-sponsorship and organizational assistance of the Public-Private Infrastructure Advisory Facility (PPIAF), a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. It was held in Vienna from 2 to 4 July 2001, during the second week of the thirty-fourth session of the Commission.

5. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the results of the Colloquium as summarized in a note by the secretariat (A/CN.9/488). The Commission expressed its gratitude to PPIAF for its financial and organizational support, to the various international intergovernmental and non-governmental organizations represented and to the speakers who participated at the Colloquium.

6. The various views that were expressed as to the desirability and feasibility of further work of the Commission in the field of privately financed infrastructure projects are reflected in the Commission's report on the work of its thirty-fourth session.<sup>4</sup> The Commission agreed that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work in the field of privately financed infrastructure projects was to be accomplished within reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the *Legislative Guide*. Accordingly, it was agreed that the first session of the working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the Guide, could be formulated.<sup>5</sup>

<sup>4</sup>Ibid., Fifty-sixth Session, Supplement No. 17 (A/55/17), paras. 366-369.

<sup>5</sup>Ibid., para. 369.

7. The Working Group (previously named the Working Group on Time-Limits and Limitations (Prescription) in the international sale of goods) held its fourth session in Vienna from 24 to 28 September 2001. The Working Group had before it the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. The Working Group decided to use the legislative recommendations contained in the Legislative Guide as the basis for its deliberations.

8. In accordance with a suggestion that had been made at the Colloquium (A/CN.9/488, para. 19), the Working Group was invited to devote its attention to a specific phase of infrastructure projects, namely, the selection of the concessionaire, with a view to formulating specific drafting proposals for legislative provisions. Nevertheless, the Working Group was of the view that model legislative provisions on various other topics might be desirable (see A/CN.9/505, paras. 18-174). The Working Group requested the secretariat to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on those deliberations and decisions, to be presented to the Working Group at its fifth session for review and further discussion.

9. The Working Group continued its work on the drafting of core model legislative provisions (hereinafter referred to as “draft model provisions”) at its fifth session, held in Vienna from 9 to 13 September 2002. The Working Group reviewed the draft model provisions that had been prepared by the secretariat with the assistance of outside experts and approved their text, as set out in the annex to its report on that session (A/CN.9/521). The Working Group requested the secretariat to circulate the draft model provisions to States for comments and to submit the draft model provisions, together with the comments received from States, to the Commission, for its review and adoption, at its thirty-sixth session, to be held in Vienna from 30 June to 18 July 2003.

10. Section II of the present document contains short explanatory notes on the draft model provisions. Section III refers to matters dealt with in the *UNCITRAL Legislative Guide* on which no draft model provisions have been drafted. Section IV presents the available options to the Commission concerning the relationship between the draft model provisions and the legislative recommendations.

11. Addenda to the present note contain the following texts: (a) the draft model provisions, as they were approved by the Working Group; and (b) a concordance table presenting side by side the draft model provisions and the legislative recommendations to which they relate.

## II. DRAFT ADDENDUM TO THE *UNCITRAL LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS*: DRAFT MODEL LEGISLATIVE PROVISIONS

12. The draft model provisions were prepared by the Secretariat with the assistance of outside experts, as requested by the Commission and the Working Group. The draft model provisions develop further the legislative prin-

ciples underlying those legislative recommendations contained in the *UNCITRAL Legislative Guide* on which the Working Group, at its fourth and fifth sessions, decided that draft model provisions should be drafted. They are, on occasion, followed by footnotes intended to provide specific advice and guidance to legislators in enacting States regarding the policy issues relating to the relevant draft model provisions and options available for their implementation. For the user’s ease of reference, the arrangement of the draft model provisions follows as closely as possible the sequence of legislative recommendations in the *UNCITRAL Legislative Guide*.

### A. General provisions

#### Model provision 1. Preamble

13. At its fourth session, the Working Group acknowledged that both provisions contained in legislative recommendation 1 were of a general nature and as such were not suitable for translation into legislative language. However, it was agreed that the substance of the recommendation might usefully be retained as a reminder of the broad objectives to be pursued in the field of privately financed infrastructure, possibly in a preamble or in explanatory notes to the model legislative provisions that the Working Group might decide to prepare (A/CN.9/505, para. 91).

#### Model provision 2. Definitions

14. Unless otherwise indicated, all definitions included in the draft model provision are derived from or based on the *UNCITRAL Legislative Guide* (see, in particular, *UNCITRAL Legislative Guide*, “Introduction and background information on privately financed infrastructure projects”, paras. 9-20).

#### *Contracting authority*

15. By linking the notion of “contracting authority” to “concession contract”, the proposed definition aims at avoiding the difficulty of referring to the entity having actual responsibility for the implementation of infrastructure projects.

#### *Concession contract*

16. At its fifth session, the Working Group noted that, in view of the difficulty of offering a definition of the term “concession” that would be acceptable to various legal systems, the secretariat had suggested combining the notions of “project agreement” and “concession”, which had been used in the *Legislative Guide*, into one single definition. The use of the words “concession agreement”, as compared with the corresponding notion of “project agreement”, which was used in the *Legislative Guide*, it was said, would have the advantage of facilitating the incorporation of the draft model provisions in domestic legal systems, since the term “concession agreement”, which in the past was more widely used in civil law jurisdictions only, was being used increasingly in common law jurisdictions as well.

17. For those reasons, the Working Group agreed that words such as “concession agreement” or “concession contract” would be preferable to “project agreement”. From the available options, preference was eventually given to the expression “concession contract”, as it was already used in many legal systems and avoided some of the ambiguities of the word “agreement”, which some delegations felt to be more appropriately used in a public law context (A/CN.9/521, paras. 34 and 35).

**Model provision 3. Authority to enter into concession agreements**

**Model provision 4. Eligible infrastructure sectors**

18. Draft model provision 3 reflects legislative recommendation 2 and draft model provision 4 reflects legislative recommendation 4.

**B. Selection of the concessionaire**

**Model provision 5. Rules governing the selection proceedings**

19. The draft model provision reflects the principles underlying legislative recommendation 14. The accompanying footnotes are designed to highlight the close relationship between the procedures for selecting a concessionaire and the enacting State’s general laws on government procurement.

**1. Pre-selection of bidders**

**Model provision 6. Purpose and procedure of pre-selection**

20. Although there is no specific legislative recommendation reflecting the substance of model provision 6, paragraph 1, this provision was felt to be necessary to complement the remaining provisions on pre-selection so as to clarify the purpose of the exercise and provide for the basic rules governing the proceedings (see A/CN.9/521, para. 45). The model provision is based on article 7, paragraph 1, of the UNCITRAL Model Law on Procurement of Goods, Construction and Services (hereinafter referred to as the “UNCITRAL Model Procurement Law”).

21. Paragraph 3 contains a few additional elements drawn from chapter III, paragraph 36, of the *Legislative Guide*. The elements referred to in paragraph 4 have been added to ensure transparency as regards the important information referred to in draft model provisions 7-9 and 30.

22. Paragraph 5 clarifies that general rules of the enacting State on the pre-selection of bidders only apply to the extent that the subject matter is not dealt with in paragraphs 1-4 of the draft model provision.

**Model provision 7. Pre-selection criteria**

23. Model provision 7 reflects the substance of legislative recommendation 15.

**Model provision 8. Participation of consortia**

24. Paragraphs 1 and 2 of the draft model provision reflect legislative recommendation 16. Paragraph 2 reaffirms essentially the restrictive approach taken by the Commission in the *UNCITRAL Legislative Guide* to the effect that each of the members of a qualified consortium may participate, either directly or through subsidiary companies, in only one bid for the project. However, the reference, in paragraph 2, to the possibility of an exception is intended to render the rule more flexible, as there may be cases where no project could be carried out without a certain company, in view of its particular expertise.

25. Paragraphs 1 and 2 have been formulated to reflect the advice contained in chapter III, “Selection of the concessionaire”, paragraphs 41 and 42, of the *UNCITRAL Legislative Guide*.

**Model provision 9. Decision on pre-selection**

26. Although there is no specific legislative recommendation reflecting the substance of paragraph 1 of draft model provision 9, the provision seems necessary to clarify the manner in which a decision on the qualifications of bidders is arrived at. The provision is based on article 7, paragraph 5, of the UNCITRAL Model Procurement Law.

27. Paragraph 2 of the draft model provision reflects legislative recommendation 17.

28. Unlike the *Legislative Guide*, the draft model provision does not use expressions such as “short list” or “final list”. The Working Group was of the view that expressions of that type were not needed in a legislative text to qualify the list of bidders that would subsequently be invited by the contracting authority to submit proposals (see A/CN.9/521, para. 60).

**2. Procedure for requesting proposals**

**Model provision 10. Single-stage and two-stage procedure for requesting proposals**

29. Paragraph 1, which reflects the purpose of legislative recommendation 18, is based on article 26 of the UNCITRAL Model Procurement Law.

30. Paragraphs 2 and 3 reflect legislative recommendation 19. Paragraph 3 (a) refers to “main contractual terms proposed by the contracting authority” rather than simply to “proposed contractual terms” to avoid the impression that a contracting authority would be expected to have developed detailed contract documents at this early stage of the selection process. Paragraph 3 (b) is a slightly modified version of subparagraph (b) of legislative recommendation 19, which has been aligned with the discussion in paragraph 57 of chapter III of the *UNCITRAL Legislative Guide*, to make it clear that meetings convened at this stage may not necessarily involve all the bidders. Paragraph 3 (c) further develops subparagraph (c) of legislative recommendation 19 by spelling out the elements re-

ferred to in paragraph 58 of chapter III of the *Legislative Guide*. Paragraph 3 (*d*), which is based on article 46, paragraph 4, of the UNCITRAL Model Procurement Law, has been added to clarify the sequence of actions during the first stage of the proceedings.

31. For purposes of transparency and accountability, paragraph 3 (*b*) requires the contracting authority to keep minutes of any meeting convened or discussion held with bidders, indicating the questions raised by bidders and clarifications provided by the contracting authority (see A/CN.9/521, para. 68). Also for the same purpose and in order to limit the scope for unfair changes meant to favour particular bidders, paragraph 3 (*c*) requires the contracting authority to state in the record of the selection proceedings to be kept pursuant to draft model provision 26 the reasons for any amendment to, or modification in, the elements of the request for proposals under paragraph 3 (*c*) (A/CN.9/521, para. 69).

#### **Model provision 11. Content of the final request for proposals**

32. Model provision 11 reflects legislative recommendation 20. In line with the second sentence of legislative recommendation 26 and the discussion in chapter III, paragraph 69, of the *UNCITRAL Legislative Guide*, subparagraph (*c*) requires the request for proposals to contain an indication of which contractual terms are deemed non-negotiable by the contracting authority. Subparagraph (*d*) contains a specific reference to thresholds for evaluation of proposals, which are referred to in legislative recommendation 24.

#### **Model provision 12. Bid securities**

33. Although no specific legislative recommendation existed on this topic, the Working Group was of the view that the draft model provision was useful, since the circumstances under which such securities might be forfeited in a selection procedure concerning the execution of a privately financed infrastructure project might differ from the circumstances under which bid securities might be forfeited in other types of procurement (A/CN.9/521, para. 76).

#### **Model provision 13. Clarifications and modifications**

34. The draft model provision reflects legislative recommendation 21. The additional language is intended to clarify the scope of modifications to the request for proposals. The cross-reference to draft model provision 11 is intended to remind contracting authorities of the need to refrain from making unnecessary changes to the essential elements of the request for proposals. For purposes of transparency, the contracting authority is required to state in the record of the selection proceedings to be kept pursuant to draft model provision 26 the reasons for any amendment to, or modification in, the elements of the request for proposal under the draft model provision (A/CN.9/521, para. 82).

#### **Model provision 14. Evaluation criteria**

35. The draft model provision reflects legislative recommendations 22 and 23, which have been combined for ease of reading.

36. The Working Group concurred with the suggestion made by outside experts who had been consulted by the secretariat that subparagraph (*d*) of recommendation 22, on social and economic development potential offered by the proposals, would be more appropriately placed among the commercial aspects of the proposals (recommendation 23). It therefore appears as paragraph 2 (*g*) in model provision 14 (A/CN.9/521, para. 86).

#### **Model provision 15. Comparison and evaluation of proposals**

37. The draft model provision reflects the substance of legislative recommendation 24. The title has been changed to reflect more accurately the scope of the model provision. A new provision, in paragraph 1, has been added to clarify the sequence of actions by the contracting authority in evaluating proposals.

#### **Model provision 16. Further demonstration of fulfilment of qualification criteria**

38. This draft model provision, which previously appeared as paragraph 3 of draft model provision 9, has been placed in a separate model provision, as the Working Group wished to emphasize that requests by the contracting authority for a further demonstration of the bidder's fulfilment of the qualification criteria would often be made after the completion of the pre-selection phase. The draft model provision reflects the substance of recommendation 25. In order to clarify which qualification criteria the contracting authority should use in that situation, the Working Group agreed that a footnote reflecting the substance of the last sentence of article 34, paragraph 6, of the UNCITRAL Model Procurement Law should be added to the new model provision (A/CN.9/521, paras. 92 and 93).

#### **Model provision 17. Final negotiations**

39. The draft model provision reflects legislative recommendations 26 and 27, which have been combined for ease of reading. Following suggestions made in the Secretariat's consultations with outside experts, paragraph 2 includes the requirement that bidders be given notice and be requested to submit a "best and final offer" by a specified date before the contracting authority terminates the negotiations. The procedure prescribed in the draft model provision to that end follows article 48, paragraph 8, and article 49, paragraph 4, of the UNCITRAL Model Procurement Law.

### **3. Concession award without competitive procedures**

#### **Model provision 18. Circumstances authorizing award without competitive procedures**

40. The draft model provision reflects the substance of legislative recommendation 28.



41. With a view to enhancing transparency in negotiations under subparagraph (f), the Working Group agreed that the contracting authority should be required to state the reasons for any departure from the original project specifications and contractual terms in the record that it was required to keep under model legislative provision 26. The Working Group also agreed that a footnote should be added to subparagraph (f) to that effect (A/CN.9/521, para. 103).

42. At the fourth session of the Working Group it had been suggested that the subparagraph should be expanded by adding the words “or other cases of the same exceptional nature, as defined by the law” (see A/CN.9/505, para. 63). At its fifth session, the Working Group agreed that those words should be kept, but that they should be put in the footnote to the subparagraph rather than to the main text. The Working Group also agreed that the square brackets around the word “compelling” should be deleted (A/CN.9/521, para. 104).

**Model provision 19. Procedures for negotiation of a concession agreement**

43. The draft model provision reflects the substance of legislative recommendation 29. The original subparagraph (c) of legislative recommendation 29 is now subsumed in the general provision on notice of project awards under draft model provision 25.

44. In order to enhance transparency in the award of a concession contract without competitive procedures, the Working Group agreed that the language of subparagraph (b) implied that the bidder with whom the contracting authority engaged in direct negotiations would have to demonstrate the fulfilment of certain qualification requirements. It was agreed that a footnote should be added to the subparagraph to that effect (A/CN.9/521, para. 108).

#### 4. Unsolicited proposals

**Model provision 20. Admissibility of unsolicited proposals**

45. The draft model provision reflects the substance of legislative recommendation 30.

**Model provision 21. Procedures for determining the admissibility of unsolicited proposals**

46. The draft model provision reflects legislative recommendations 31 and 32. Paragraph 3 of the draft model provision elaborates on legislative recommendation 32 with a view to clarifying the relationship between the proponent’s intellectual property rights and the contracting authority’s use of information provided by the proponent.

47. The word “potentially” in paragraph 1 has been added in view of the fact that at such an early stage of examination of an unsolicited proposal there could not be a final determination as to whether or not a project was in the public interest. The footnote to this paragraph has been included since enacting States may wish to set forth, possibly in special regulations, the criteria to be used in assessing the qualifications of the proponent, which could be modelled upon the qualification criteria mentioned in draft model provision 7 (A/CN.9/521, paras. 114 and 115).

**Model provision 22. Unsolicited proposals that do not involve proprietary concepts or technology**

48. The draft model provision reflects the substance of legislative recommendation 33.

49. The conjunction “and” is used instead of “or” to connect subparagraphs (a) and (b) of paragraph 1, since the Working Group was of the view that those conditions needed to be cumulative (A/CN.9/521, para. 120).

**Model provision 23. Unsolicited proposals involving proprietary concepts or technology**

50. The draft model provision reflects the substance of legislative recommendations 34 and 35.

#### 5. Miscellaneous provisions

**Model provision 24. Confidentiality of negotiations**

51. Model provision 23 reflects the substance of legislative recommendation 36. The first sentence is drawn from article 45 of the UNCITRAL Model Procurement Law. The reference to “agents, subcontractors, lenders, advisers or consultants” has been added with a view to avoiding an excessively restrictive interpretation of the model provision.

**Model provision 25. Notice of project award**

52. The draft model provision reflects legislative recommendation 37.

**Model provision 26. Record of selection and award proceedings**

53. The draft model provision reflects legislative recommendation 38. The footnote has been added as the Working Group felt that the draft model provision should be more emphatic in recommending that enacting States review their legislation with a view to ensuring that it reflected internationally recognized standards of transparency (A/CN.9/521, para. 135).

**Model provision 27. Review procedures**

54. The draft model provision reflects legislative recommendation 39.

#### C. Construction and operation of infrastructure

**Model provision 28. Contents of the concession agreement**

55. At its fourth session, the Working Group generally took the view that various matters dealt with in chapter IV of the *Legislative Guide* were contractual in nature and did not require specific draft model provisions (see A/CN.9/505, paras. 110-116). At the same time, however, the Working Group agreed that it would be useful to formulate a model legislative provision that listed essential issues that needed to be addressed in the project agreement. It

requested the secretariat to prepare an initial draft of such a model provision on the basis of the headings that preceded recommendations 41-68, with the adjustments that might be required so as to spell out clearly, but without unnecessary details, the various topics that needed to be covered by project agreements (A/CN.9/505, para. 114).

56. In order to implement that request, the draft model provision, which reflects the policy of recommendation 40, lists a number of issues that should be addressed in the project agreement. Some of those issues are also the subject of specific draft model provisions. Other issues listed therein, however, relate to legislative recommendations on which the Working Group did not request that specific draft model provisions be drafted. The sources are indicated below:

(a) Subparagraph (a) is based in part on chapter IV, paragraph 1, of the *UNCITRAL Legislative Guide*;

(b) Subparagraph (b) refers, in part, to matters dealt with in legislative recommendation 5;

(c) Subparagraph (c) refers to matters dealt with in legislative recommendation 6;

(d) Subparagraph (d) refers to matters dealt with in legislative recommendations 42 and 43 and in draft model provision 29;

(e) Subparagraph (e) refers to matters dealt with in legislative recommendations 44 and 45 and in draft model provisions 30-32;

(f) Subparagraph (f) refers to matters dealt with in legislative recommendations 46 and 48. At the Working Group's fifth session it was noted that in some jurisdictions the remuneration of the concessionaire by way of collecting tariffs or fees from users for the use of the facility was a constitutive element of a concession. It was therefore suggested that the words "as appropriate" in the first line of the subparagraph should be deleted. In response to that view, it was observed that the intention of the draft model provision was to give the legislator guidance on the possible content of the concession contract, rather than to restate the elements of the notion of "concession" under any particular legal system. In order to clarify the indicative nature of the subparagraph, it was agreed that the words "in particular and as appropriate, the concessionaire's right to charge, receive, or collect" should be replaced with the words "whether consisting of" (A/CN.9/521, para. 147);

(g) Subparagraph (g) reflects the substance of legislative recommendation 52;

(h) Subparagraph (h) refers to matters dealt with in legislative recommendation 53 and in draft model provision 37;

(i) Subparagraph (i) reflects legislative recommendations 52 and 54 (b);

(j) Subparagraph (j) reflects legislative recommendation 54 (a);

(k) Subparagraph (k) summarizes the advice on contractual arrangements that is contained in chapter IV, paragraphs 73-76, of the *Legislative Guide* and is a natural complement of subparagraphs (h) and (i);

(l) Subparagraph (l) reflects the substance of legislative recommendation 56;

(m) Subparagraph (m) reflects the substance of legislative recommendation 58 (a) and (b);

(n) Subparagraph (n) reflects the substance of legislative recommendation 58 (e);

(o) Subparagraph (o) reflects the substance of legislative recommendation 58 (d);

(p) Subparagraph (p) reflects the substance of legislative recommendation 61;

(q) Subparagraph (q) reflects the substance of legislative recommendation 67;

(r) Subparagraph (r) refers to matters dealt with in legislative recommendation 69 and in draft model provision 49.

57. The words "such as" in the chapeau of the draft model provision have been used by the Working Group to emphasize the idea that the list, albeit relating to essential matters, is not meant to be mandatory in its full length. The Working Group agreed at its fifth session that the text was not meant to suggest that a contract not containing any of the elements listed in the draft model provision would be void, without prejudice to the possible internal accountability of agents of the contracting authority, a matter that was left for the national laws of the enacting States outside the scope of application of the draft model provisions (A/CN.9/521, paras. 144-146).

#### **Model provision 29. Governing law**

58. The draft model provision reflects the substance of legislative recommendation 41, except that, unlike recommendation 41, the draft model provision contemplates the possibility for the parties to agree in the concession contract on the application of a law other than the law of the enacting State (A/CN.9/521, paras. 151-153).

#### **Model provision 30. Organization of the concessionaire**

59. The draft model provision reflects the substance of legislative recommendations 42 and 43.

#### **Model provision 31. Ownership of assets**

60. Draft model provision 31 reflects the substance of legislative recommendation 44.

#### **Model provision 32. Acquisition of project site**

#### **Model provision 33. Easements**

61. Draft model provisions 32 and 33 reflect the substance of legislative recommendation 45, which have been reformulated in two separate provisions for ease of reading.

**Model provision 34. Financial arrangements**

62. The draft model provision reflects the substance of legislative recommendations 46 and 47.

**Model provision 35. Security interests**

63. The draft model provision reflects the substance of legislative recommendation 49.

**Model provision 36. Assignment of the concession agreement**

64. The draft model provision reflects the substance of legislative recommendation 50.

**Model provision 37. Transfer of controlling interest in the concessionaire**

65. The draft model provision reflects the substance of legislative recommendation 51.

**Model provision 38. Operation of infrastructure**

66. Model provision 38, paragraph 1, reflects the substance of legislative recommendations 53 and 55.

67. The Working Group reconsidered the question of the desirability of including a model provision dealing with the concessionaire's right to issue and enforce rules concerning the use of the infrastructure facility, which the Working Group, at its fourth session, did not consider to be necessary (see A/CN.9/505, para. 144). It was noted that some countries with a well-established tradition of awarding concessions for the provision of public services recognized the concessionaire's power to establish rules designed to facilitate the provision of the service (such as instructions to users or safety rules), take reasonable measures to ensure compliance with those rules and suspend the provision of service for emergency or safety reasons. However, given the essential nature of certain public services, the exercise of that power by an entity other than a Government sometimes required legislative authority. The Working Group therefore agreed, at its fifth session, that it was useful to retain the provision contained in paragraph 2 (A/CN.9/521, para. 183).

**Model provision 39. Compensation for specific changes in legislation**

68. Draft model provision 39 reflects legislative recommendation 58 (c). A number of elements have been added, however, so as to reflect the depth of the discussion in paragraphs 122-125 of chapter IV of the *Legislative Guide*.

**Model provision 40. Revision of the concession agreement**

69. Draft model provision 40 reflects legislative recommendation 58 (c). A number of elements have been added, however, so as to reflect the depth of the discussion in paragraphs 126-130 of chapter IV of the *Legislative Guide*.

70. The draft model provision does not address the issue of the consequences of a disagreement between the contracting authority and the concessionaire on a revision of the concession contract. That issue is addressed in draft model provision 45, subparagraph (b).

**Model provision 41. Takeover of an infrastructure project by the contracting authority**

71. The draft model provision reflects legislative recommendation 59.

**Model provision 42. Substitution of the concessionaire**

72. The draft model provision reflects legislative recommendation 60.

73. At its fifth session, the Working Group rejected the suggestion that the provision should also refer to the concessionaire as a party to the agreement that set forth the terms and conditions of the concessionaire's substitution. The Working Group also rejected the suggestion that the circumstances triggering such a substitution should be limited to a serious breach of the concessionaire's obligations under the concession contract. The Working Group felt that the proposed amendments departed from the policy embodied in the *Legislative Guide* (see A/CN.9/521, paras. 201-204).

**D. Duration, extension and termination of the concession agreement****Model provision 43. Duration and extension of the concession agreement**

74. The draft model provision reflects the substance of legislative recommendation 62.

75. At the fifth session of the Working Group, it was observed that the substance of the draft model provision, in particular subparagraph (c), was too stringent, as it did not provide for the possibility for the contracting authority and the concessionaire to agree on the extension of the term of the concession in the concession contract. In response to that view, it was pointed out that the provision reflected the advice of the *Legislative Guide* according to which such an extension should only be permissible if that possibility was set forth in the law of the enacting State. For that reason, the Working Group agreed to preserve the body of the text of the provision. It was then suggested that a footnote should be added to the provision for the purpose of reminding enacting States that they might wish to consider the possibility for an extension of the concession contract by mutual agreement between the contracting authority and the concessionaire for compelling reasons of public interest. The Working Group agreed with that suggestion (A/CN.9/521, paras. 207 and 208).

**Model provision 44. Termination of the concession agreement by the contracting authority**

76. The draft model provision reflects the substance of legislative recommendation 63.

77. The word “compelling” has been added before the word “reasons” in subparagraph (b) so as to align the provision more closely with the *Legislative Guide* and ensure consistency with the footnote added to the preceding draft model provision 43. In order to provide guidance to enacting States as to the meaning of the notion of “compelling” public interest, the Working Group decided to add a footnote to subparagraph (b) referring to the relevant section of the *Legislative Guide* (A/CN.9/521, para. 212).

**Model provision 45. Termination of the concession agreement by the concessionaire**

78. The draft model provision reflects the substance of legislative recommendation 64. Subparagraph (b) has been added to so as to align the draft model provision with draft model provision 40.

79. The cross-reference to subparagraphs (h) and (i) of draft model provision 28 in subparagraph (c) is intended to provide an indication of the nature of the acts of other public authorities that might trigger the concessionaire’s right to terminate the concession contract. The expression “appropriate revision”, which is used in the legislative recommendation, has been replaced with “revision”, as the right to terminate resulted from the objective fact of the absence of agreement on a revision, rather than on a subjective assessment of what would constitute an “appropriate” revision (see A/CN.9/521, para. 218).

**Model provision 46. Termination of the concession agreement by either party**

80. The draft model provision reflects the substance of legislative recommendation 65.

**Model provision 47. Financial arrangements upon expiry or termination of the concession agreement**

81. The draft model provision reflects the substance of legislative recommendation 67.

**Model provision 48. Wind-up and transfer measures**

82. Subparagraph (a) of the draft model provision reflects the substance of legislative recommendation 66 and matters referred to in paragraphs 37-42 of chapter V of the *Legislative Guide*. Subparagraph (b) reflects the substance of legislative recommendation 68 and the matters referred to in paragraphs 50-62 of chapter V of the *Legislative Guide*.

**E. Settlement of disputes**

**Model provision 49. Disputes between the contracting authority and the concessionaire**

83. The draft model provision reflects legislative recommendation 69.

84. At the fifth session of the Working Group it was pointed out that the laws of some States already provided dispute settlement mechanisms that were regarded as well

suited to the needs of privately financed infrastructure projects. The parties to the concession contract should not be discouraged from choosing those mechanisms, where they existed. The footnote to the provision contemplates that possibility (see A/CN.9/521, para. 232-236).

**Model provision 50. Disputes involving customers or users of the infrastructure facility**

85. The draft model provision, which reflects legislative recommendation 71, has been included despite the fact that the Working Group, at its fourth session, had not requested that a model provision be drafted on the matter (see A/CN.9/505, para. 174). At its fifth session, the Working Group reversed that earlier decision, since it felt that the draft model provision underscored the need for appropriate measures to protect the rights of the users of public services and infrastructure facilities, an important concern in many legal systems (see A/CN.9/521, para. 242).

**Model provision 51. Other disputes**

86. The draft model provision reflects the substance of legislative recommendation 70.

**III. MATTERS NOT COVERED IN THE DRAFT MODEL LEGISLATIVE PROVISIONS**

**A. Matters dealt with in chapter I, “General legislative and institutional framework”, of the *UNCITRAL Legislative Guide***

**Scope and authority to award concessions (see *UNCITRAL Legislative Guide*, legislative recommendations 2-5, and chap. I, “General legislative and institutional framework”, paras. 15-22)**

87. No model provision was drafted to implement legislative recommendation 5, although the Working Group, at its fourth session, had found that a model provision on the matter would be useful (see A/CN.9/505, paras. 93-96). The secretariat pointed out that in the view of the experts that it had consulted, it was not feasible to transform the legislative recommendation into a model legislative provision (see A/CN.9/WG.I/WP.29, para. 69). As an alternative, the issue of the degree of exclusivity of the concession has been mentioned among the contents of the concession agreement under draft model provision 28, subparagraph (b).

88. The Working Group, at its fifth session, did not object to the above suggestions.

**Administrative coordination (see *UNCITRAL Legislative Guide*, legislative recommendation 6, and chap. I, “General legislative and institutional framework”, paras. 23-29)**

89. At its fourth session, the Working Group found that a model provision on the matter would be useful (see A/CN.9/505, paras. 98-100). However, given the complexity of the issues and the various policy options mentioned in the legislative recommendation, the experts consulted by

the secretariat suggested that it would be better to keep it as a footnote to the text of the model provision dealing with the authority to enter into concession agreements in a footnote to draft model provision 3.

90. The Working Group, at its fifth session, did not object to the above suggestions.

**Authority to regulate infrastructure services (see *UNCITRAL Legislative Guide*, legislative recommendations 7-11, and chap. I, “General legislative and institutional framework”, paras. 30-53)**

91. No model provision was requested by the Working Group (see A/CN.9/505, para. 102).

**B. Matters dealt with in chapter II, “Project risks and government support”, of the *UNCITRAL Legislative Guide***

**Project risks and risk allocation (see *UNCITRAL Legislative Guide*, legislative recommendation 12, and chap. II, “Project risks and government support”, paras. 8-29)**

92. No model provision was requested by the Working Group (see A/CN.9/505, para. 104).

**Government support (see *UNCITRAL Legislative Guide*, legislative recommendation 13, and chap. II, “Project risks and government support”, paras. 30-60)**

93. At its fourth session, the Working Group found that a model provision on the matter would be useful (see A/CN.9/505, paras. 106-108). However, in view of the complexity of the issues and the various policy options mentioned in the legislative recommendation, the experts consulted by the secretariat suggested that it would be better to refer to the matter in a footnote to the text of the model provision dealing with the authority to enter into concession agreements (see proposed footnote to draft model provision 3). The matter is, however, referred to in draft model provision 28, subparagraph (f).

94. The Working Group, at its fifth session, did not object to the above suggestions.

**C. Matters dealt with in chapter IV, “Construction and operation of infrastructure: legislative framework and project agreement”, of the *UNCITRAL Legislative Guide***

**Financial arrangements (see *UNCITRAL Legislative Guide*, legislative recommendations 46-48, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 33-51)**

95. No specific model provision was requested by the Working Group with respect to legislative recommendations 47 and 48 (see A/CN.9/505, para. 129). The matters dealt with in those recommendations are, however, referred to in draft model provision 28, subparagraph (f).

**Construction works (see *UNCITRAL Legislative Guide*, legislative recommendation 52, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 69-79)**

96. No specific provision was requested by the Working Group (see A/CN.9/505, para. 138). The matter is, however, referred to in draft model provision 28, subparagraph (g).

**Infrastructure operation (see *UNCITRAL Legislative Guide*, legislative recommendations 53-55, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 80-97)**

97. No specific provision was requested by the Working Group with respect to legislative recommendation 54 (see A/CN.9/505, para. 142). Those matters are, however, referred to in draft model provision 28, subparagraphs (i) and (j).

**General contractual arrangements (see *UNCITRAL Legislative Guide*, legislative recommendations 56-60, and chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 98-150)**

98. No specific provision was requested by the Working Group with respect to legislative recommendations 56 and 57 (see A/CN.9/505, para. 146). However, the subject referred to in legislative recommendation 56 is mentioned in draft model provision 28, subparagraph (l).

99. Furthermore, no specific provision was requested by the Working Group with respect to legislative recommendation 58 (a), (b), (d) and (e) (see A/CN.9/505, para. 148). Nevertheless, for the sake of ensuring the completeness of the list contained in draft model provision 28, the matters referred to in legislative recommendation 58 (a) and (b) are mentioned in subparagraph (m) of the draft model provision. Likewise, the matters referred to in legislative recommendation 58 (d) and (e) are mentioned in subparagraphs (n) and (o) of draft model provision 28.

**D. Matters dealt with in chapter V, “Duration, extension and termination of the project agreement”, of the *UNCITRAL Legislative Guide***

100. No specific provision was requested by the Working Group with respect to legislative recommendation 66 (see A/CN.9/505, para. 160). However, the matter is generally referred to in draft model provision 48, subparagraph (a).

**IV. RELATIONSHIP BETWEEN THE DRAFT MODEL LEGISLATIVE PROVISIONS AND THE LEGISLATIVE RECOMMENDATIONS**

101. At its fifth session, the Working Group considered at length the relationship between the draft model provisions and the *Legislative Guide* (A/CN.9/521, paras. 18-21). There was general agreement that the draft model

provisions were not a departure from, but rather a development of, the policies and principles upon which the *Legislative Guide* was based. Thus, the draft model provisions did not replace the *Legislative Guide* in its entirety and were to be understood and applied in the light and with the assistance of the explanatory notes contained in the *Guide*.

102. The Working Group proceeded to consider the particular relationship between the draft model provisions and the legislative recommendations contained in the *Legislative Guide*. The Working Group noted, in that connection, that the draft model provisions covered most of the subject matter addressed in the legislative recommendations. However, the Working Group also noted that there were matters dealt with in some legislative recommendations that were not addressed in any of the draft model provisions, as was the case, in particular, of recommendations 1 and 5-13. That circumstance alone excluded the possibility of replacing the entirety of the legislative recommendations with the draft model provisions.

103. The Working Group then considered whether the draft model provisions and the legislative recommendations should be retained as two related but independent texts or whether they should be combined in a single text that contained all draft legislative provisions and those of the legislative recommendations on which no draft model provision had been drafted.

104. Although there were expressions of support for keeping the legislative recommendations separate from the draft model provisions, so as to reflect more clearly the develop-

ment of the Commission's work on the matter, the general preference was that, for the user's ease of reference, it was desirable to explore combining them. The secretariat was requested to review both the draft model provisions and the legislative recommendations carefully so as to identify which legislative recommendations dealt with matters not covered in the draft model provisions. Those legislative recommendations should then be presented under a separate heading in the same text as the draft model provisions, in order for the Commission to make an informed decision on the matter. The Working Group recommended that the Commission consider whether, once adopted, the model legislative provisions should supersede those legislative recommendations, which dealt with the same subject matter. A consolidated text including both the remaining legislative recommendations and the draft model provisions is contained in an addendum to the present document (A/CN.9/522/Add.1). For the Commission's ease of reference, the secretariat has also prepared a concordance table (see A/CN.9/522/Add.2).

105. The Working Group agreed to recommend to the Commission that, subject to the availability of funds in its publications budget, the draft model provisions should be consolidated with the *Legislative Guide* into one single publication as soon as possible after their adoption by the Commission. In order not to delay their dissemination, however, and with a view to avoiding wasting the existing stocks of the *Legislative Guide*, it was suggested that the Commission could consider whether draft model provisions might, for an interim period, appear in a separate publication, which should contain appropriate indication of its relationship to the *Guide*.

#### A/CN.9/522/Add.1

### Consolidated final draft of model legislative provisions

#### ADDENDUM

1. The annex to this note contains the full text of the model legislative provisions on privately financed infrastructure projects, as they were approved by the Working Group on Privately Financed Infrastructure Projects at its fifth session (Vienna, 9-13 September 2002).

2. As noted in document A/CN.9/521, paragraphs 19-21, there are essentially three options available to the Commission as regards the relationship between the draft model provisions and the legislative recommendations contained in the *Legislative Guide*. The first option might be to retain both the legislative recommendations and the model provisions, upon their adoption, as two parallel texts. The second option might be to replace the legislative recommendations in their entirety with the model legislative provisions. The third option might be to replace only those legislative recommendations in respect of which the Commission adopted model legislative provisions. A concordance table presenting the legislative recommendations and the corresponding model legislative provisions is contained in document A/CN.9/522/Add.2.

3. In order to further assist the Commission's consideration of the matter, the annex to this note sets out the text of those legislative recommendations in respect of which no model legislative provision has been prepared, which are followed by the full text of the model legislative provisions. The legislative recommendations have been renumbered, so as to keep their sequence. The foreword reflects the assumption that at least some of the legislative recommendations will be retained with the model legislative provisions.

4. If the Commission decides to proceed in this manner, the first publication of the model legislative provisions, pending their incorporation in a future consolidated edition of the *UNCITRAL Legislative Guide*, will contain a footnote with a statement along the following lines:

*"The model legislative provisions (hereinafter referred to as "model provisions") were adopted by the United Nations Commission on International Trade Law (UNCITRAL) in 2003 as an addition to the UNCITRAL*

Legislative Guide on Privately Financed Infrastructure Projects (hereinafter referred to as “the Legislative Guide”), which was adopted in 2000. The model provisions reflect, in legislative language, the principles set forth in the legislative recommendations originally contained in the legislative guide, which are superseded, except for those in respect of which no model provisions have been formulated. While most model provisions relate to specific legislative recommendations, they do not cover the entire range of issues dealt with in the legislative recommendations. In particular, no specific model provisions have been formulated on administrative or institutional matters, such as those dealt with in legislative recommendations 1 and 5-13. The consolidated text of the remaining legislative recommendations and the model provisions replaces the entirety of the legislative recommendations set out in

pages xi to xxv of the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects.”

5. The text in the annex contains cross-references underneath the headings of the draft model provisions, and occasionally in their text, to the corresponding legislative recommendations. If the Commission decides that the model provisions, upon adoption, should replace in whole or in part the legislative recommendations, those cross-references would be removed from the final text.

6. Internal cross-references between the draft model provisions have been kept italicized and in square brackets, pending a decision by the Commission as to whether or not the draft model provisions should become a model law. If the form of a model law were chosen, the cross-references would be to “articles” rather than “model provisions”.

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## Foreword

The following pages contain a set of general recommended legislative principles entitled “legislative recommendations” and model legislative provisions (hereinafter referred to as “model provisions”) on privately financed infrastructure projects. The legislative recommendations and the model provisions are intended to assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects. They are followed by notes that offer an analytical explanation to the financial, regulatory, legal, policy and other issues raised in the subject area. The user is advised to read the legislative recommendations and the model provisions together with the notes which provide background information to enhance the understanding of the legislative recommendations and model provisions.

The legislative recommendations and the model provisions consist of a set of core provisions dealing with matters that deserve attention in legislation specifically concerned with privately financed infrastructure projects.

The model provisions are designed to be implemented and supplemented by the issuance of regulations providing further details. Areas suitable for being addressed by regulations rather than by statutes are identified accordingly. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical, legal and financial expertise, appropriate human and financial resources and economic stability.

It should be noted that the legislative recommendations and the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure projects but on which no specific legislative recommendations are made in the Legislative Guide. Those other areas of law include, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, general contract law, rules on government contracts and administrative law, tax law, and environmental protection and consumer protection laws.

## Part One. Legislative recommendations

### I. General legislative and institutional framework

#### **Constitutional, legislative and institutional framework (see chap. I, “General legislative and institutional framework”, paras. 2-14)**

Recommendation 1. *The constitutional, legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness, and the long-term sustainability of projects. Undesirable restrictions on private sector participation in infrastructure development and operation should be eliminated.*

#### **Scope of authority to award concessions (see chap. I, “General legislative and institutional framework”, paras. 15-22)**

Recommendation 2. *The law should identify the public authorities of the host country (including, as appropriate, national, provincial and local authorities) that are empowered to award concessions and enter into agreements for the implementation of privately financed infrastructure projects.*

Recommendation 3. *Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems.*

Recommendation 4. *The law should identify the sectors or types of infrastructure in respect of which concessions may be granted.*

Recommendation 5. *The law should specify the extent to which a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.*

#### **Administrative coordination (see chap. I, “General legislative and institutional framework”, paras. 23-29)**

Recommendation 6. *Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.*

#### **Authority to regulate infrastructure services (see chap. I, “General legislative and institutional framework”, paras. 30-53)**

Recommendation 7. *The authority to regulate infrastructure services should not be entrusted to entities that directly or indirectly provide infrastructure services.*

Recommendation 8. *Regulatory competence should be entrusted to functionally independent bodies with a level of autonomy sufficient to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.*

Recommendation 9. *The rules governing regulatory procedures should be made public. Regulatory decisions should state the reasons on which they are based and should be accessible to interested parties through publication or other means.*

Recommendation 10. *The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and*

impartial body, which may include court review, and should set forth the grounds on which such a review may be based.

Recommendation 11. *Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector.*

## II. Project risks and government support

### Project risks and risk allocation (see chap. II, "Project risks and government support", paras. 8-29)

Recommendation 12. *No unnecessary statutory or regulatory limitations should be placed upon the contracting authority's ability to agree on an allocation of risks that is suited to the needs of the project.*

### Government support (see chap. II, "Project risks and government support", paras. 30-60)

Recommendation 13. *The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.*

## Part Two. Draft model legislative provisions on privately financed infrastructure projects

### I. General provisions

#### Model provision 1. Preamble

[see recommendation 1 and chap. I, paras. 2-14]

WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a favourable legislative framework to promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;

WHEREAS the [Government] [Parliament] of ... considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;

[Other objectives that the enacting State might wish to state:];

Be it therefore enacted as follows:

#### Model provision 2. Definitions

[see introduction, paras. 9-20]

For the purposes of this law:

(a) "Infrastructure facility" means physical facilities and systems that directly or indirectly provide services to the general public;

(b) "Infrastructure project" means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

(c) "Contracting authority" means the public authority that has the power to enter into a concession contract for the implementation of an infrastructure project [under the provisions of this law];<sup>1</sup>

(d) "Concessionaire" means the person that carries out an infrastructure project under a concession contract entered into with a contracting authority;

(e) "Concession contract" means the mutually binding agreement or agreements between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;

(f) "Bidder" and "bidders" mean persons, including groups thereof, that participate in selection proceedings concerning an infrastructure project;<sup>2</sup>

(g) "Unsolicited proposal" means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;

(h) "Regulatory agency" means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>3</sup>

#### Model provision 3. Authority to enter into concession contracts

[see recommendation 2 and chap. I, paras. 15-18]

The following public authorities have the power to enter into concession contracts<sup>4</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [the enacting State lists the relevant public authorities of the host country that may enter into concession contracts by way of an exhaustive or indicative list of

<sup>1</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession contracts. Depending on the regulatory regime of the enacting State, a separate body, referred to as "regulatory agency" in subparagraph (h), may have the responsibility for issuing rules and regulations governing the provision of the relevant service.

<sup>2</sup>The term "bidder" or "bidders" encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings or persons that have submitted a proposal in response to a contracting authority's request for proposals.

<sup>3</sup>The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, "General legislative and institutional framework", paras. 30-53).

<sup>4</sup>It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, "General legislative and institutional framework", paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, "Project risks and government support").

public authorities, a list of types or categories of public authorities or a combination thereof].<sup>5</sup>

#### **Model provision 4. Eligible infrastructure sectors**

[see recommendation 4 and chap. I, paras. 19-22]

Concession contracts may be entered into by the relevant authorities in the following sectors: [the enacting State indicates the relevant sectors by way of an exhaustive or indicative list].<sup>6</sup>

### **II. Selection of the concessionaire**

#### **Model provision 5. Rules governing the selection proceedings**

[see recommendation 14 and chap. III, paras. 1-33]

The selection of the concessionaire shall be conducted in accordance with [model provisions 6-27] and, for matters not provided herein, in accordance with [the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts].<sup>7</sup>

<sup>5</sup>Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession contracts, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those contracts, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to “the Union, the States [or provinces] and the municipalities”. In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>6</sup>It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>7</sup>The user’s attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are based largely on the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (hereinafter referred to as the “Model Procurement Law”). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for the selection of the concessionaire. The model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following matters: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, mutatis mutandis, supplement the practical elements of the selection procedure described herein.

### **1. Pre-selection of bidders**

#### **Model provision 6. Purpose and procedure of pre-selection**

[see chap. III, paras. 34-50]

1. The contracting authority shall engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.

2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the pre-qualification of suppliers and contractors].

3. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the pre-qualification of suppliers and contractors],<sup>8</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:

(a) A description of the infrastructure facility to be built or renovated;

(b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire);

(c) Where already known, a summary of the main required terms of the concession contract to be entered into;

(d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications; and

(e) The manner and place for solicitation of the pre-selection documents.

4. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors in proceedings for the pre-qualification of suppliers and contractors],<sup>9</sup> the pre-selection documents shall include at least the following information:

(a) The pre-selection criteria in accordance with [model provision 7];

(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [model provision 8];

<sup>8</sup>A list of elements typically contained in an invitation to participate in pre-qualification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

<sup>9</sup>A list of elements typically contained in pre-qualification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

(c) Whether the contracting authority intends to request only a limited number<sup>10</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [model provision 9, para. 2], and, if applicable, the manner in which this selection will be carried out;

(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [this State] in accordance with [model provision 30].

5. For matters not provided in this [model provision], the pre-selection proceedings shall be conducted in accordance with [the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the pre-qualification of suppliers and contractors].<sup>11</sup>

### Model provision 7. Pre-selection criteria

[see recommendation 15 and chap. III, paras. 34-40, 43 and 44]

In order to qualify for the selection proceedings, interested bidders must meet objectively justifiable criteria<sup>12</sup> that the contracting authority considers appropriate in the particular proceedings, as stated in the pre-selection documents. These criteria shall include at least the following:

(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, including design, construction, operation and maintenance;

(b) Sufficient ability to manage the financial aspects of the project and capability to sustain its financing requirements;

(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating similar infrastructure facilities.

### Model provision 8. Participation of consortia

[see recommendation 16 and chap. III, paras. 41 and 42]

1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall

<sup>10</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 48 and 49). See also footnote 14.

<sup>11</sup>Procedural steps on pre-qualification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority's decision on the bidders' qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.

<sup>12</sup>The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. The various issues raised by domestic preferences are discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", paras. 43 and 44). The *Legislative Guide* suggests that countries that wish to provide some incentive to national suppliers may wish to apply such preferences in the form of special evaluation criteria, rather than by a blanket exclusion of foreign suppliers. In any event, where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.

2. Unless otherwise [authorized by ... [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>13</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.

3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

### Model provision 9. Decision on pre-selection

[see recommendations 17 (for para. 2) and chap. III, paras. 47-50]

1. The contracting authority shall make a decision with respect to the qualifications of each bidder that has submitted an application for pre-selection. In reaching that decision, the contracting authority shall apply only the criteria that are set forth in the pre-selection documents. All pre-selected bidders shall thereafter be invited by the contracting authority to submit proposals in accordance with [model provisions 10-17].

2. Notwithstanding paragraph 1, the contracting authority may, provided that it has made an appropriate statement in the pre-selection documents to that effect, reserve the right to request proposals upon completion of the pre-selection proceedings only from a limited number<sup>14</sup> of bidders that best meet the pre-selection criteria. For this purpose, the contracting authority shall rate the bidders that meet the pre-selection criteria on the basis of the criteria applied to assess their qualifications and draw up the list of bidders that will be invited to submit proposals upon completion of the pre-selection proceedings. In drawing up the list, the contracting authority shall apply only the manner of rating that is set forth in the pre-selection documents.

<sup>13</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.

<sup>14</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, "Selection of the concessionaire", para. 48). It should be noted that the rating system is used solely for the purpose of the pre-selection of bidders. The ratings of the pre-selected bidders should not be taken into account at the stage of evaluation of proposals (see model provision 15), at which all pre-selected bidders should start out on an equal standing.

## 2. Procedure for requesting proposals

### Model provision 10. Single-stage and two-stage procedures for requesting proposals

[see recommendations 18 (for para. 1) and 19 (for paras. 2 and 3) and chap. III, paras. 51-58]

1. The contracting authority shall provide a set of the request for proposals and related documents issued in accordance with [model provision 11] to each pre-selected bidder that pays the price, if any, charged for those documents.

2. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when the contracting authority does not deem it to be feasible to describe in the request for proposals the characteristics of the project such as project specifications, performance indicators, financial arrangements or contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

3. Where a two-stage procedure is used, the following provisions apply:

(a) The initial request for proposals shall call upon the bidders to submit, in the first stage of the procedure, initial proposals relating to project specifications, performance indicators, financing requirements or other characteristics of the project as well as to the main contractual terms proposed by the contracting authority;<sup>15</sup>

(b) The contracting authority may convene meetings and hold discussions with any of the bidders to clarify questions concerning the initial request for proposals or the initial proposals and accompanying documents submitted by the bidders. The contracting authority shall prepare minutes of any such meeting or discussion containing the questions raised and the clarifications provided by the contracting authority;

(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial request for proposals by deleting or modifying any aspect of the initial project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the initial request for proposals, as well as by adding characteristics or criteria to it. The contracting authority shall indicate in the record of the selection pro-

<sup>15</sup>In many cases, in particular for new types of project, the contracting authority may not be in a position, at this stage, to have formulated a detailed draft of the contractual terms envisaged by it. Also, the contracting authority may find it preferable to develop such terms only after an initial round of consultations with the pre-selected bidders. In any event, however, it is important for the contracting authority, at this stage, to provide some indication of the key contractual terms of the concession contract, in particular the way in which the project risks should be allocated between the parties under the concession contract. If this allocation of contractual rights and obligations is left entirely open until after the issuance of the final request for proposals, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project (see chap. III, "Selection of the concessionaire", paras. 67-70; see further chap. II, "Project risks and government support", paras. 8-29).

ceedings to be kept pursuant to [model provision 26] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated in the invitation to submit final proposals;

(d) In the second stage of the proceedings, the contracting authority shall invite the bidders to submit final proposals with respect to a single set of project specifications, performance indicators or contractual terms in accordance with [model provisions 11-17].

### Model provision 11. Content of the request for proposals

[see recommendation 20 and chap. III, paras. 59-70]

To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of requests for proposals],<sup>16</sup> the request for proposals shall include at least the following information:

(a) General information as may be required by the bidders in order to prepare and submit their proposals;<sup>17</sup>

(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;<sup>18</sup>

(c) The contractual terms proposed by the contracting authority, including an indication of which terms are deemed to be non-negotiable;

(d) The criteria for evaluating proposals and the thresholds, if any, set by the contracting authority for identifying non-responsive proposals; the relative weight to be accorded to each evaluation criterion; and the manner in which the criteria and thresholds are to be applied in the evaluation and rejection of proposals.

### Model provision 12. Bid securities

[see chap. III, para. 62]

1. The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required bid security.

2. A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>19</sup>

(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;

(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 17, para. 1];

<sup>16</sup>A list of elements typically contained in a request for proposals for services can be found in article 38 of the Model Procurement Law.

<sup>17</sup>A list of elements that should be provided can be found in chapter III, "Selection of the concessionaire", paragraphs 61 and 62, of the *Legislative Guide*.

<sup>18</sup>See chapter III, "Selection of the concessionaire", paragraphs 64-66.

<sup>19</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.

(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 17, para. 2];

(d) Failure to sign the concession contract, if required by the contracting authority to do so, after the proposal has been accepted;

(e) Failure to provide required security for the fulfilment of the concession contract after the proposal has been accepted or to comply with any other condition prior to signing the concession contract specified in the request for proposals.

### Model provision 13. Clarifications and modifications

[see recommendation 21 and chap. III, paras. 71 and 72]

The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise any element of the request for proposals as set forth in [model provision 11]. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 26] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the request for proposals at a reasonable time prior to the deadline for submission of proposals.

### Model provision 14. Evaluation criteria

[see recommendations 22 (for para. 1) and 23 (for para. 2) and chap. III, paras. 73-77]

1. The criteria for the evaluation and comparison of the technical proposals<sup>20</sup> shall include at least the following:

- (a) Technical soundness;
- (b) Compliance with environmental standards;
- (c) Operational feasibility;
- (d) Quality of services and measures to ensure their continuity.

2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>21</sup> shall include, as appropriate:

- (a) The present value of the proposed tolls, unit prices and other charges over the concession period;
- (b) The present value of the proposed direct payments by the contracting authority, if any;
- (c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;
- (d) The extent of financial support, if any, expected from a public authority of [this State];

(e) Soundness of the proposed financial arrangements;

(f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;

(g) The social and economic development potential offered by the proposals.

### Model provision 15. Comparison and evaluation of proposals

[see recommendation 24 and chap. III, paras. 78-82]

1. The contracting authority shall compare and evaluate each proposal in accordance with the evaluation criteria, the relative weight accorded to each such criterion and the evaluation process set forth in the request for proposals.

2. For the purposes of paragraph 1, the contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects. Proposals that fail to achieve the thresholds shall be regarded as non-responsive and rejected from the selection procedure.<sup>22</sup>

### Model provision 16. Further demonstration of fulfilment of qualification criteria

[see recommendation 25 and chap. III, paras. 78-82]

The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so.<sup>23</sup>

### Model provision 17. Final negotiations

[see recommendations 26 (for para. 1) and 27 (for para. 2) and chap. III, paras. 83 and 84]

1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession contract the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.

<sup>22</sup>This model provision offers an example of an evaluation process that a contracting authority may wish to apply to compare and evaluate proposals for privately financed infrastructure projects. Alternative evaluation processes are described in chapter III, "Selection of the concessionaire", paragraphs 79-82, of the *Legislative Guide*, such as a two-step evaluation process or the two-envelope system. In contrast to the process set forth in this model provision, the processes described in the *Legislative Guide* are designed to allow the contracting authority to compare and evaluate the non-financial criteria separately from the financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. In order to ensure the integrity, transparency and predictability of the evaluation stage of the selection proceedings, it is recommended that the enacting State set forth in its law the evaluation processes that contracting authorities may use to compare and evaluate proposals and the details of the application of this process.

<sup>23</sup>Where pre-qualification proceedings have been engaged in, the criteria shall be the same as those used in the pre-qualification proceedings.

<sup>20</sup>See chapter III, "Selection of the concessionaire", paragraph 74.

<sup>21</sup>Ibid., paragraphs 75-77.

2. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a concession contract, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the other bidders in the order of their ranking until it arrives at a concession contract or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with which negotiations have been terminated pursuant to this paragraph.

### 3. Negotiation of concession contracts without competitive procedures

#### Model provision 18. Circumstances authorizing award without competitive procedures

[see recommendation 28 and chap. III, para. 89]

Subject to approval by ... [the enacting State indicates the relevant authority],<sup>24</sup> the contracting authority is authorized to negotiate a concession contract without using the procedure set forth in [model provisions 6-17], in the following cases:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in the procedures set forth in [model provisions 6-17] would be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

(b) Where the project is of short duration and the anticipated initial investment value does not exceed the amount [of ...] [the enacting State specifies a monetary ceiling] [set forth in ...] [the enacting State indicates the provisions of its laws that specify the monetary threshold below which a privately financed infrastructure project may be awarded without competitive procedures];<sup>25</sup>

<sup>24</sup>The rationale for subjecting the award of the concession contract without competitive procedures to the approval of a higher authority is to ensure that the contracting authority engages in direct negotiations with bidders only in the appropriate circumstances (see chap. III, "Selection of the concessionaire", paras. 85-96). The model provision therefore suggests that the enacting State indicate a relevant authority that is competent to authorize negotiations in all cases set forth in the model provision. The enacting State may provide, however, for different approval requirements for each subparagraph of the model provision. In some cases, for instance, the enacting State may provide that the authority to engage in such negotiations derives directly from the law. In other cases, the enacting State may make the negotiations subject to the approval of different higher authorities, depending on the nature of the services to be provided or the infrastructure sector concerned. In those cases, the enacting State may need to adapt the model provision to these approval requirements by adding the particular approval requirement to the subparagraph concerned, or by adding a reference to provisions of its law where these approval requirements are set forth.

<sup>25</sup>As an alternative to the exclusion provided in subparagraph (b), the enacting State may consider devising a simplified procedure for request for proposals for projects falling thereunder, for instance by applying the procedures described in article 48 of the Model Procurement Law.

(c) Where the project involves national defence or national security;

(d) Where there is only one source capable of providing the required service, such as when the provision of the service requires the use of intellectual property, trade secrets or other exclusive rights owned or possessed by a certain person or persons;

(e) In cases of unsolicited proposals falling under [model provision 23];

(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals and if, in the judgement of the contracting authority, issuing a new invitation to the pre-selection proceedings and a new request for proposals would be unlikely to result in a project award within a required time frame;<sup>26</sup>

(g) In other cases where the [the enacting State indicates the relevant authority] authorizes such an exception for compelling reasons of public interest.<sup>27</sup>

#### Model provision 19. Procedures for negotiation of a concession contract

[see recommendation 29 and chap. III, para. 90]

Where a concession contract is negotiated without using the procedures set forth in [model provisions 6-17] the contracting authority shall:<sup>28</sup>

(a) Except for concession contracts negotiated pursuant to [model provision 18, subpara. (c)], cause a notice of its intention to commence negotiations in respect of a concession contract to be published in accordance with [the enacting State indicates the provisions of any relevant laws on procurement proceedings that govern the publication of notices];

(b) Engage in negotiations with as many persons as the contracting authority judges capable<sup>29</sup> of carrying out the project as circumstances permit;

(c) Establish evaluation criteria against which proposals shall be evaluated and ranked.

<sup>26</sup>The enacting State may wish to require that the contracting authority include in the record to be kept pursuant to [model provision 26] a summary of the results of the negotiations and indicate the extent to which those results differed from the project specifications and contractual terms of the original request for proposals, and that it state the reasons therefor.

<sup>27</sup>Enacting States that deem it desirable to authorize the use of negotiated procedures on an ad hoc basis may wish to retain subparagraph (g) when implementing the model provision. Enacting States wishing to limit exceptions to the competitive selection procedures may in turn prefer not to include the subparagraph. In any event, for purposes of transparency, the enacting State may wish to indicate here or elsewhere in the model provision other exceptions, if any, authorizing the use of negotiated procedures that may be provided under specific legislation.

<sup>28</sup>A number of elements to enhance transparency in negotiations under this model provision are discussed in chapter III, "Selection of the concessionaire", paragraphs 90-96, of the *Legislative Guide*.

<sup>29</sup>Enacting States wishing to enhance transparency in the use of negotiated procedures may establish, by specific regulations, qualification criteria to be met by persons invited to negotiations pursuant to [model provisions 18 and 19]. An indication of possible qualification criteria is contained in [model provision 7].

#### 4. Unsolicited proposals<sup>30</sup>

##### Model provision 20. Admissibility of unsolicited proposals

[see recommendation 30 and chap. III, paras. 97-109]

As an exception to [model provisions 6-17], the contracting authority<sup>31</sup> is authorized to consider unsolicited proposals pursuant to the procedures set forth in [model provisions 21-23], provided that such proposals do not relate to a project for which selection procedures have been initiated or announced.

##### Model provision 21. Procedures for determining the admissibility of unsolicited proposals

[see recommendations 31 (for paras. 1 and 2) and 32 (for para. 3) and chap. III, paras. 110-112]

1. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority shall promptly inform the proponent whether or not the project is considered to be potentially in the public interest.<sup>32</sup>

2. If the project is considered to be potentially in the public interest under paragraph 1, the contracting authority shall invite the proponent to submit as much information on the proposed project as is feasible at this stage to allow the contracting authority to make a proper evaluation of the proponent's qualifications<sup>33</sup> and the technical and economic feasibility of the project and to determine whether the project is likely to be successfully implemented in the manner proposed in terms acceptable to the contracting authority. For this purpose, the proponent shall submit a technical and economic feasibility study, an environmental impact study and satisfactory information regarding the concept or technology contemplated in the proposal.

3. In considering an unsolicited proposal, the contracting authority shall respect the intellectual property, trade secrets or other exclusive rights contained in, arising from or referred to in the proposal. Therefore, the contracting

<sup>30</sup>The policy considerations on the advantages and disadvantages of unsolicited proposals are discussed in chapter III, "Selection of the concessionaire", paragraphs 98-100, of the *Legislative Guide*. States that wish to allow contracting authorities to handle such proposals may wish to use the procedures set forth in model provisions 21-23.

<sup>31</sup>The model provision assumes that the power to entertain unsolicited proposals lies with the contracting authority. However, depending on the regulatory system of the enacting State, a body separate from the contracting authority may have the responsibility for entertaining unsolicited proposals or for considering, for instance, whether an unsolicited proposal is in the public interest. In such a case, the manner in which the functions of such a body may need to be coordinated with those of the contracting authority should be carefully considered by the enacting State (see footnotes 1, 3 and 24 and the references cited therein).

<sup>32</sup>The determination that a proposed project is in the public interest entails a considered judgement regarding the potential benefits to the public that are offered by the project, as well as its relationship to the Government's policy for the infrastructure sector concerned. In order to ensure the integrity, transparency and predictability of the procedures for determining the admissibility of unsolicited proposals, it may be advisable for the enacting State to provide guidance, in regulations or other documents, concerning the criteria that will be used to determine whether an unsolicited proposal is in the public interest, which may include criteria for assessing the appropriateness of the contractual arrangements and the reasonableness of the proposed allocation of project risks.

<sup>33</sup>The enacting State may wish to provide in regulations the qualification criteria that need to be met by the proponent. Elements to be taken into account for that purpose are indicated in [model provision 7].

authority shall not make use of information provided by or on behalf of the proponent in connection with its unsolicited proposal other than for the evaluation of that proposal, except with the consent of the proponent. Except as otherwise agreed by the parties, the contracting authority shall, if the proposal is rejected, return to the proponent the original and any copies of documents that the proponent submitted and prepared throughout the procedure.

##### Model provision 22. Unsolicited proposals that do not involve intellectual property, trade secrets or other exclusive rights

[see recommendation 33 and chap. III, paras. 113 and 114]

1. Except in the circumstances set forth in [model provision 18], the contracting authority shall, if it decides to implement the project, initiate a selection procedure in accordance with [model provisions 6-17] if the contracting authority considers that:

(a) The envisaged output of the project can be achieved without the use of intellectual property, trade secrets or other exclusive rights owned or possessed by the proponent; and

(b) The proposed concept or technology is not truly unique or new.

2. The proponent shall be invited to participate in the selection proceedings initiated by the contracting authority pursuant to paragraph 1 and may be given an incentive or a similar benefit in a manner described by the contracting authority in the request for proposals in consideration for the development and submission of the proposal.

##### Model provision 23. Unsolicited proposals involving intellectual property, trade secrets or other exclusive rights

[see recommendations 34 (for paras. 1 and 2) and 35 (for paras. 3 and 4) and chap. III, paras. 115-117]

1. If the contracting authority determines that the conditions of [model provision 22, para. 1 (a) and (b)] are not met, it shall not be required to carry out a selection procedure pursuant to [model provisions 6-17]. However, the contracting authority may still seek to obtain elements of comparison for the unsolicited proposal in accordance with the provisions set out in paragraphs 2-4.<sup>34</sup>

2. Where the contracting authority intends to obtain elements of comparison for the unsolicited proposal, the contracting authority shall publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals within [a reasonable period] [the enacting State indicates a certain amount of time].

3. If no proposals in response to an invitation issued pursuant to paragraph 2 are received within [a reasonable period] [the amount of time specified in paragraph 2 above], the contracting authority may engage in negotiations with the original proponent.

<sup>34</sup>The enacting State may wish to consider adopting a special procedure for handling unsolicited proposals falling under this model provision, which may be modelled, *mutatis mutandis*, on the request-for-proposals procedure set forth in article 48 of the Model Procurement Law.



4. If the contracting authority receives proposals in response to an invitation issued pursuant to paragraph 2, the contracting authority shall invite the proponents to negotiations in accordance with the provisions set forth in [model provision 19]. In the event that the contracting authority receives a sufficiently large number of proposals, which appear prima facie to meet its infrastructure needs, the contracting authority shall request the submission of proposals pursuant to [model provisions 10-17], subject to any incentive or other benefit that may be given to the person who submitted the unsolicited proposal in accordance with [model provision 22, para. 2].

## 5. Miscellaneous provisions

### Model provision 24. Confidentiality of negotiations

[see recommendation 36 and chap. III, para. 118]

The contracting authority shall treat proposals in such a manner as to avoid the disclosure of their content to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, paras. 3, 17, 18, 19 or 23, paras. 3 and 4] shall be confidential. Unless required by law or by a court order, no party to the negotiations shall disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.

### Model provision 25. Notice of contract award

[see recommendation 37 and chap. III, para. 119]

Except for concession contracts awarded pursuant to [model provision 18, subpara. (c)], the contracting authority shall cause a notice of the contract award to be published in accordance with [the enacting State indicates the provisions of its laws on procurement proceedings that govern the publication of contract award notices]. The notice shall identify the concessionaire and include a summary of the essential terms of the concession contract.

### Model provision 26. Record of selection and award proceedings

[see recommendation 38 and chap. III, paras. 120-126]

The contracting authority shall keep an appropriate record of information pertaining to the selection and award proceedings in accordance with [the enacting State indicates the provisions of its laws on public procurement that govern the record of procurement proceedings].<sup>35</sup>

<sup>35</sup>The content of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, are discussed in chapter III, "Selection of the concessionaire", paragraphs 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award is further set out in article 11 of the Model Procurement Law. If the laws of the enacting State do not adequately address these matters, the enacting State should adopt legislation or regulations to that effect.

### Model provision 27. Review procedures

[see recommendation 39 and chap. III, paras. 127-131]

A bidder that claims to have suffered, or that may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts or failures to act in accordance with [the enacting State indicates the provisions of its laws governing the review of decisions made in procurement proceedings].<sup>36</sup>

## III. Construction and operation of infrastructure

### Model provision 28. Contents of the concession contract

[see recommendation 40 and chap. IV, paras. 1-11]

The concession contract shall provide for such matters as the parties deem appropriate, such as:

(a) The nature and scope of works to be performed and services to be provided by the concessionaire [see chap. IV, para. 1];

(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire's rights under the concession contract [see recommendation 5];

(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project;

(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [model provision 30] [see recommendations 42 and 43 and model provision 30];

(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [model provisions 31-33] [see recommendations 44 and 45 and model provisions 31-33];

(f) The remuneration of the concessionaire, whether consisting of tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of any such tariffs or fees; and payments, if any, that may be made by the contracting authority or other public authority [see recommendations 46 and 48];

(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility [see recommendation 52];

(h) The extent of the concessionaire's obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users [see recommendation 53 and model provision 38];

<sup>36</sup>Elements for the establishment of an adequate review system are discussed in chapter III, "Selection of the concessionaire", paragraphs 127-131, of the *Legislative Guide*. They are also contained in chapter VI of the Model Procurement Law. If the laws of the enacting State do not provide such an adequate review system, the enacting State should consider adopting legislation to that effect.

(i) The contracting authority's or other public authority's right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements [see recommendations 52 and 54, subpara. (b)];

(j) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations [see recommendation 54, subpara. (a)];

(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled [see chap. IV, paras. 73-76];

(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the concessionaire, in particular with the concessionaire's own shareholders or other affiliated persons [see recommendation 56];

(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project [see recommendation 58, subparas. (a) and (b)];

(n) Remedies available in the event of default of either party [see recommendation 58, subpara. (e)];

(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession contract owing to circumstances beyond its reasonable control [see recommendation 58, subpara. (d)];

(p) The duration of the concession contract and the rights and obligations of the parties upon its expiry or termination [see recommendation 61];

(q) The manner for calculating compensation pursuant to [model provision 47] [see recommendation 67];

(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire [see recommendation 69 and model provision 49].

### Model provision 29. Governing law

[see recommendation 41 and chap. IV, paras. 5-8]

The concession contract is governed by the law of this State unless otherwise provided in the concession contract.<sup>37</sup>

<sup>37</sup>Legal systems provide varying answers to the question as to whether the parties to a concession contract may choose as the governing law of the contract a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 5-8), in some countries the concession contract may be subject to administrative law, while in others the concession contract may be governed by private law (see also *Legislative Guide*, chap. VII, "Other relevant areas of law", paras. 24-27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally *Legislative Guide*, chap. VII, "Other relevant areas of law", sect. B).

### Model provision 30. Organization of the concessionaire

[see recommendations 42 and 43 and chap. IV, paras. 12-18]

The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [*this State*], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession contract.

### Model provision 31. Ownership of assets<sup>38</sup>

[see recommendation 44 and chap. IV, paras. 20-26]

The concession contract shall specify, as appropriate, which assets are or shall be public property and which assets are or shall be the private property of the concessionaire. The concession contract shall in particular identify which assets belong to the following categories:

(a) Assets, if any, that the concessionaire is required to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the concession contract;

(b) Assets, if any, that the contracting authority, at its option, may purchase from the concessionaire; and

(c) Assets, if any, that the concessionaire may retain or dispose of upon expiry or termination of the concession contract.

### Model provision 32. Acquisition of rights related to the project site

[see recommendation 45 and chap. IV, paras. 27-29]

1. The contracting authority or other public authority under the terms of the law and the concession contract shall make available to the concessionaire or, as appropriate, shall assist the concessionaire in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.

2. Any compulsory acquisition of land that may be required for the execution of the project shall be carried

<sup>38</sup>Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see "Introduction and background information on privately financed infrastructure projects", paras. 47-53). Those general policy options typically determine the legislative approach for ownership of project-related assets (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 20-26). Irrespective of the host country's general or sectoral policy, the ownership regime of the various assets involved should be clearly defined and based on sufficient legislative authority. Clarity in this respect is important, as it will directly affect the concessionaire's ability to create security interests in project assets for the purpose of raising financing for the project (*ibid.*, paras. 52-61). Consistent with the flexible approach taken by various legal systems, the model provision does not contemplate an unqualified transfer of all assets to the contracting authority but allows a distinction between assets that must be transferred to the contracting authority, assets that may be purchased by the contracting authority, at its option, and assets that remain the private property of the concessionaire, upon expiry or termination of the concession contract or at any other time.

out in accordance with [the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest].

### Model provision 33. Easements<sup>39</sup>

[see recommendation 45 and chap. IV, para. 30]

The concessionaire shall [have] [be granted] the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project in accordance with [the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws].

### Model provision 34. Financial arrangements

[see recommendations 46 and 47 and chap. IV, paras. 33-51]

The concessionaire shall have the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession contract shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [in accordance with the rules established by the competent regulatory agency].<sup>40</sup>

### Model provision 35. Security interests

[see recommendation 49 and chap. IV, paras. 52-61]

1. Subject to any restriction that may be contained in the concession contract,<sup>41</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

<sup>39</sup>The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the concessionaire directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 30-32). The alternative wording offered within the first set of square brackets in the model provision is intended to reflect those options.

<sup>40</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as "tariffs", may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, "Project risks and government support", paras. 30-60). The cost at which public services are provided is typically an element of the Government's infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of "reasonableness", "fairness" or "equity" (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 36-46).

<sup>41</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.

(a) Security over movable or immovable property owned by the concessionaire or its interests in project assets;

(b) A pledge of the proceeds of, and receivables owed to the concessionaire for, the use of the facility or the services it provides.

2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire.

3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is prohibited by the law of [this State].

### Model provision 36. Assignment of the concession contract

[see recommendation 50 and chap. IV, paras. 62 and 63]

Except as otherwise provided in [model provision 35], the rights and obligations of the concessionaire under the concession contract may not be assigned to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which the contracting authority shall give its consent to an assignment of the rights and obligations of the concessionaire under the concession contract, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire's technical and financial capability as necessary for providing the service.

### Model provision 37. Transfer of controlling interest<sup>42</sup> in the concessionaire

[see recommendation 51 and chap. IV, paras. 64-68]

Except as otherwise provided in the concession contract, a controlling interest in the concessionaire may not be transferred to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which consent of the contracting authority shall be given.

### Model provision 38. Operation of infrastructure

[see recommendation 53 and chap. IV, paras. 80-93 (for para. 1) and recommendation 55 and chap. IV, paras. 96 and 97 (for para. 2)]

1. The concession contract shall set forth, as appropriate, the extent of the concessionaire's obligations to ensure:

<sup>42</sup>The notion of "controlling interest" generally refers to the power to appoint the management of a corporation and influence or determine its business. Different criteria may be used in various legal systems or even in different bodies of law within the same legal system, ranging from formal criteria attributing a controlling interest to the ownership of a certain amount (typically more than 50 per cent) of the total combined voting power of all classes of stock of a corporation to more complex criteria that take into account the actual management structure of a corporation. Enacting States that do not have a statutory definition of "controlling interest" may need to define the term in regulations issued to implement the model provision.

(a) The modification of the service so as to meet the demand for the service;

(b) The continuity of the service;

(c) The provision of the service under essentially the same conditions for all users;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

2. The concessionaire shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.

### **Model provision 39. Compensation for specific changes in legislation**

[see recommendation 58, subpara. (c) and chap. IV, paras. 122-125]

The concession contract shall set forth the extent to which the concessionaire is entitled to compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the services it provides.

### **Model provision 40. Revision of the concession contract**

[see recommendation 58, subpara. (c) and chap. IV, paras. 126-130]

1. Without prejudice to [model provision 39], the concession contract shall further set forth the extent to which the concessionaire is entitled to a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:

(a) Changes in economic or financial conditions; or

(b) Changes in legislation or regulations not specifically applicable to the infrastructure facility or the services it provides;

provided that the economic, financial, legislative or regulatory changes:

(a) Occur after the conclusion of the contract;

(b) Are beyond the control of the concessionaire; and

(c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the concession contract was negotiated or to have avoided or overcome their consequences.

2. The concession contract shall establish procedures for revising the terms of the concession contract following the occurrence of any such changes.

### **Model provision 41. Takeover of an infrastructure project by the contracting authority**

[see recommendation 59 and chap. IV, paras. 143-146]

Under the circumstances set forth in the concession contract, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.

### **Model provision 42. Substitution of the concessionaire**

[see recommendation 60 and chap. IV, paras. 147-150]

The contracting authority may agree with the entities extending financing for an infrastructure project on the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession contract upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession contract or other similar circumstances.<sup>43</sup>

## **IV. Duration, extension and termination of the concession contract**

### *1. Duration and extension of the concession contract*

### **Model provision 43. Duration and extension of the concession contract**

[see recommendation 62 and chap. V, paras. 2-8]

1. The term of the concession contract, as stipulated in accordance with [model provision 28, subpara. (p)] shall not be extended except as a result of the following circumstances:

(a) Completion delay or interruption of operation due to circumstances beyond either party's reasonable control;

(b) Project suspension brought about by acts of the contracting authority or other public authorities; or

(c) [Other circumstances, as specified by the enacting State.]<sup>44</sup>

2. The term of the concession contract may further be extended to allow the concessionaire to recover additional

<sup>43</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession contract (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority.

<sup>44</sup>The enacting State may wish to consider the possibility of authorizing a consensual extension of the concession contract pursuant to its terms, for compelling reasons of public interest.

costs arising from requirements of the contracting authority not originally foreseen in the concession contract, if the concessionaire would not be able to recover such costs during the original term.

## 2. Termination of the concession contract

### **Model provision 44. Termination of the concession contract by the contracting authority**

[see recommendation 63 and chap. V, paras. 14-27]

The contracting authority may terminate the concession contract:

(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

(b) For [compelling]<sup>45</sup> reasons of public interest, subject to payment of compensation to the concessionaire, the terms of the compensation to be as agreed in the concession contract;

(c) [Other circumstances that the enacting State might wish to add in the law.]

### **Model provision 45. Termination of the concession contract by the concessionaire**

[see recommendation 64 and chap. V, paras. 28-33]

The concessionaire may not terminate the concession contract except under the following circumstances:

(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession contract;

(b) If the conditions for a revision of the concession contract under [model provision 40, para. 1] are met, but the parties have failed to agree on a revision of the concession contract; or

(c) If the cost of the concessionaire's performance of the concession contract has substantially increased or the value that the concessionaire receives for such performance has substantially diminished as a result of acts or omissions of the contracting authority or other public authorities, such as those referred to in [model provision 28, subparagraphs (h) and (i)], and the parties have failed to agree on a revision of the concession contract.

### **Model provision 46. Termination of the concession contract by either party**

[see recommendation 65 and chap. V, paras. 34 and 35]

Either party shall have the right to terminate the concession contract in the event that the performance of its obligations is rendered impossible by circumstances beyond either party's reasonable control. The parties shall also have the right to terminate the concession contract by mutual consent.

## 3. Arrangements upon expiry or termination of the concession contract

### **Model provision 47. Financial arrangements upon expiry or termination of the concession contract**

[see recommendation 67 and chap. V, paras. 43-49]

The concession contract shall stipulate how compensation due to either party is calculated in the event of termination of the concession contract, providing, where appropriate, for compensation for the fair value of works performed under the concession contract, costs incurred or losses sustained by either party, including, as appropriate, lost profits.

### **Model provision 48. Wind-up and transfer measures**

[see recommendation 66 and chap. V, paras. 37-42 (for lit. a) and recommendation 68 and chap. V, paras. 50-62 (for lit. b-d)]

The concession contract shall set forth, as appropriate, the rights and obligations of the parties with respect to:

(a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;

(b) The transfer of technology required for the operation of the facility;

(c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

(d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.

## V. Settlement of disputes

### **Model provision 49. Disputes between the contracting authority and the concessionaire**

[see recommendation 69 and chap. VI, paras. 3-41]

Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession contract.<sup>46</sup>

### **Model provision 50. Disputes involving customers or users of the infrastructure facility**

[see recommendation 71 and chap. VI, paras. 43-45]

Where the concessionaire provides services to the public or operates infrastructure facilities accessible to the public, the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.

<sup>45</sup>[Possible situations of a compelling reason of public interest are discussed in chapter V, "Duration, extension and termination of the project agreement", paragraph 27, of the *Legislative Guide*.]

<sup>46</sup>The enacting State may provide in its legislation dispute settlement mechanisms that are best suited to the needs of privately financed infrastructure projects.

**Model provision 51. Other disputes**

*[see recommendation 70 and chap. VI, para. 42]*

1. The concessionaire and its shareholders shall be free to choose the appropriate mechanisms for settling disputes among themselves.

2. The concessionaire shall be free to agree on the appropriate mechanisms for settling disputes between itself and its lenders, contractors, suppliers and other business partners.

## Concordance table of draft model legislative provisions and legislative recommendations

## ADDENDUM

<i>Headings</i>	<i>No.</i>	<i>Model legislative provisions</i>	<i>No.</i>	<i>Legislative recommendations</i>
			3	Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems.
			6	Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.
			7	The authority to regulate infrastructure services should not be entrusted to entities that directly or indirectly provide infrastructure services.
			8	Regulatory competence should be entrusted to functionally independent bodies with a level of autonomy sufficient to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.
			9	The rules governing regulatory procedures should be made public. Regulatory decisions should state the reasons on which they are based and should be accessible to interested parties through publication or other means.
			10	The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body, which may include court review, and should set forth the grounds on which such a review may be based.
			11	Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector.
			12	No unnecessary statutory or regulatory limitations should be placed upon the contracting authority's ability to agree on an allocation of risks that is suited to the needs of the project.
			13	The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.
Preamble [see recommendation 1 and chap. I, paras. 2-14]	1	WHEREAS the [Government] [Parliament] of ... considers it desirable to establish a favourable legislative framework to promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;	1	The constitutional, legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness, and the long-term sustainability of projects. Undesirable restrictions on private sector participation in infrastructure development and operation should be eliminated.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
		<p>WHEREAS the [Government] [Parliament] of ... considers it desirable to further develop the general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects;</p> <p>[Other objectives that the enacting State might wish to state].</p> <p>Be it therefore enacted as follows:</p>		
<p>Definitions [see introduction, paras. 9-20]</p>	2	<p>For the purposes of this law:</p> <p>(a) “<i>Infrastructure facility</i>” means physical facilities and systems that directly or indirectly provide services to the general public;</p> <p>(b) “<i>Infrastructure project</i>” means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;</p> <p>(c) “<i>Contracting authority</i>” means the public authority that has the power to enter into a concession contract for the implementation of an infrastructure project [under the provisions of this law];<sup>1</sup></p> <p>(d) “<i>Concessionaire</i>” means the person that carries out an infrastructure project under a concession contract entered into with a contracting authority;</p> <p>(e) “<i>Concession contract</i>” means the mutually binding agreement or agreements between the contracting authority and the concessionaire that set forth the terms and conditions for the implementation of an infrastructure project;</p> <p>(f) “<i>Bidder</i>” and “<i>bidders</i>” mean persons, including groups thereof, that participate in selection proceedings concerning an infrastructure project;<sup>2</sup></p> <p>(g) “<i>Unsolicited proposal</i>” means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a request or solicitation issued by the contracting authority within the context of a selection procedure;</p> <p>(h) “<i>Regulatory agency</i>” means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.<sup>3</sup></p>		
<p>Authority to enter into concession contracts [see recommendation 2 and chap. I, paras. 15-18]</p>	3	<p>The following public authorities have the power to enter into concession contracts<sup>4</sup> for the implementation of infrastructure projects falling within their respective spheres of competence: [the enacting State lists the relevant public authorities of the host country that may enter into concession contracts by way of an exhaustive or indicative list of public authorities, a list of types or categories of public authorities or a combination thereof].<sup>5</sup></p>	2	<p>The law should identify the public authorities of the host country (including, as appropriate, national, provincial and local authorities) that are empowered to award concessions and enter into agreements for the implementation of privately financed infrastructure projects.</p>
<p>Eligible infrastructure sectors [see recommendation 4 and chap. I, paras. 19-22]</p>	4	<p>Concession contracts may be entered into by the relevant authorities in the following sectors: [the enacting State indicates the relevant sectors by way of an exhaustive or indicative list].<sup>6</sup></p>	4	<p>The law should identify the sectors or types of infrastructure in respect of which concessions may be granted.</p>
<p>Rules governing the selection proceedings [see recommendation 14 and chap. III, paras. 1-33]</p>	5	<p>The selection of the concessionaire shall be conducted in accordance with [model provisions 6-27] and, for matters not provided herein, in accordance with [the enacting State indicates the provisions of its laws that provide for transparent and efficient competitive procedures for the award of government contracts].<sup>7</sup></p>	14	<p>The law should provide for the selection of the concessionaire through transparent and efficient competitive procedures adapted to the particular needs of privately financed infrastructure projects.</p>



Purpose and procedure of pre-selection [see chap. III, paras. 34-50]

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1. The contracting authority shall engage in pre-selection proceedings with a view to identifying bidders that are suitably qualified to implement the envisaged infrastructure project.
  2. The invitation to participate in the pre-selection proceedings shall be published in accordance with [the enacting State indicates the provisions of its laws governing publication of invitation to participate in proceedings for the pre-qualification of suppliers and contractors].
  3. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of invitations to participate in proceedings for the pre-qualification of suppliers and contractors],<sup>8</sup> the invitation to participate in the pre-selection proceedings shall include at least the following:
    - (a) A description of the infrastructure facility to be built or renovated;
    - (b) An indication of other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tariffs or whether public funds such as direct payments, loans or guarantees may be provided to the concessionaire);
    - (c) Where already known, a summary of the main required terms of the concession contract to be entered into;
    - (d) The manner and place for the submission of applications for pre-selection and the deadline for the submission, expressed as a specific date and time, allowing sufficient time for bidders to prepare and submit their applications; and
    - (e) The manner and place for solicitation of the pre-selection documents.

<sup>1</sup>It should be noted that the authority referred to in this definition relates only to the power to enter into concession contracts. Depending on the regulatory regime of the enacting State, a separate body, referred to as “regulatory agency” in subparagraph (h), may have the responsibility for issuing rules and regulations governing the provision of the relevant service.

<sup>2</sup>The term “bidder” or “bidders” encompasses, according to the context, both persons that have sought an invitation to take part in pre-selection proceedings or persons that have submitted a proposal in response to a contracting authority’s request for proposals.

<sup>3</sup>The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see recommendations 7-11 and chap. I, “General legislative and institutional framework”, paras. 30-53).

<sup>4</sup>It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see legislative recommendation 6 and chap. I, “General legislative and institutional framework”, paras. 23-29). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or regulation governing the activities of entities authorized to offer government support, to clearly identify which entities have the power to provide such support and what kind of support may be provided (see chap. II, “Project risks and government support”).

<sup>5</sup>Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into concession contracts, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those contracts, without naming the relevant public authorities. In a federal State, for example, such an enabling clause might refer to “the Union, the States [or provinces] and the municipalities”. In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>6</sup>It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

<sup>7</sup>The user’s attention is drawn to the relationship between the procedures for the selection of the concessionaire and the general legislative framework for the award of government contracts in the enacting State. While some elements of structured competition that exist in traditional procurement methods may be usefully applied, a number of adaptations are needed to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase, flexibility in the formulation of requests for proposals, special evaluation criteria and some scope for negotiations with bidders. The selection procedures reflected in this chapter are based largely on the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was adopted by UNCITRAL at its twenty-seventh session, held in New York from 31 May to 17 June 1994 (hereinafter referred to as the “Model Procurement Law”). The model provisions on the selection of the concessionaire are not intended to replace or reproduce the entire rules of the enacting State on government procurement, but rather to assist domestic legislators to develop special rules suited for the selection of the concessionaire. The model provisions assume that there exists in the enacting State a general framework for the award of government contracts providing for transparent and efficient competitive procedures in a manner that meets the standards of the Model Procurement Law. Thus, the model provisions do not deal with a number of practical procedural steps that would typically be found in an adequate general procurement regime. Examples include the following matters: manner of publication of notices, procedures for issuance of requests for proposals, record-keeping of the procurement process, accessibility of information to the public, bid security and review procedures. Where appropriate, the notes to these model provisions refer the reader to provisions of the Model Procurement Law, which may, *mutatis mutandis*, supplement the practical elements of the selection procedure described herein.

<sup>8</sup>A list of elements typically contained in an invitation to participate in pre-qualification proceedings can be found in article 25, paragraph 2, of the Model Procurement Law.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
		<p>4. To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of the pre-selection documents to be provided to suppliers and contractors in proceedings for the pre-qualification of suppliers and contractors],<sup>9</sup> the pre-selection documents shall include at least the following information:</p> <p>(a) The pre-selection criteria in accordance with [model provision 7];</p> <p>(b) Whether the contracting authority intends to waive the limitations on the participation of consortia set forth in [model provision 8];</p> <p>(c) Whether the contracting authority intends to request only a limited number<sup>10</sup> of pre-selected bidders to submit proposals upon completion of the pre-selection proceedings in accordance with [model provision 9, para. 2], and, if applicable, the manner in which this selection will be carried out;</p> <p>(d) Whether the contracting authority intends to require the successful bidder to establish an independent legal entity established and incorporated under the laws of [this State] in accordance with [model provision 30].</p> <p>5. For matters not provided in this [model provision], the pre-selection proceedings shall be conducted in accordance with [the enacting State indicates the provisions of its laws on government procurement governing the conduct of proceedings for the pre-qualification of suppliers and contractors].<sup>11</sup></p>		
Pre-selection criteria [see recommendation 15 and chap. III, paras. 34-40, 43 and 44]	7	<p>In order to qualify for the selection proceedings, interested bidders must meet objectively justifiable criteria<sup>12</sup> that the contracting authority considers appropriate in the particular proceedings, as stated in the pre-selection documents. These criteria shall include at least the following:</p> <p>(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, including design, construction, operation and maintenance;</p> <p>(b) Sufficient ability to manage the financial aspects of the project and capability to sustain its financing requirements;</p> <p>(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating similar infrastructure facilities.</p>	15	<p>The bidders should demonstrate that they meet the pre-selection criteria that the contracting authority considers appropriate for the particular project, including:</p> <p>(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, namely, engineering, construction, operation and maintenance;</p> <p>(b) Sufficient ability to manage the financial aspects of the project and capability to sustain the financing requirements for the engineering, construction and operational phases of the project;</p> <p>(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating public infrastructure</p>
Participation of consortia [see recommendation 16 and chap. III, paras. 41 and 42]	8(1-2)	<p>1. The contracting authority, when first inviting the participation of bidders in the selection proceedings, shall allow them to form bidding consortia. The information required from members of bidding consortia to demonstrate their qualifications in accordance with [model provision 7] shall relate to the consortium as a whole as well as to its individual participants.</p> <p>2. Unless otherwise [authorized by ... [the enacting State indicates the relevant authority] and] stated in the pre-selection documents, each member of a consortium may participate, either directly or indirectly, in only one consortium.<sup>13</sup> A violation of this rule shall cause the disqualification of the consortium and of the individual members.</p>	16	<p>The bidders should be allowed to form consortia to submit proposals, provided that each member of a pre-selected consortium may participate, either directly or through subsidiary companies, in only one bidding consortium.</p>
	8(3)	<p>3. When considering the qualifications of bidding consortia, the contracting authority shall consider the individual capabilities of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.</p>		

Decision on pre-selection [see recommendation 17 (for para. 2) and chap. III, paras. 47-50]	9(1)	1. The contracting authority shall make a decision with respect to the qualifications of each bidder that has submitted an application for pre-selection. In reaching that decision, the contracting authority shall apply only the criteria that are set forth in the pre-selection documents. All pre-selected bidders shall thereafter be invited by the contracting authority to submit proposals in accordance with [model provisions 10-17].	18	
	9(2)	2. Notwithstanding paragraph 1, the contracting authority may, provided that it has made an appropriate statement in the pre-selection documents to completion that effect, reserve the right to request proposals upon completion of the pre-selection proceedings only from a limited number <sup>14</sup> of bidders that best meet the pre-selection criteria. For this purpose, the contracting authority shall rate the bidders that meet the pre-selection criteria on the basis of the criteria applied to assess their qualifications and draw up the list of bidders that will be invited to submit proposals upon completion of the pre-selection proceedings. In drawing up the list, the contracting authority shall apply only the manner of rating that is set forth in the pre-selection documents.	17	The contracting authority should draw up a short list of the pre-selected bidders that will subsequently be invited to submit proposals upon of the pre-selection phase.
Single-stage and two-stage procedures for requesting proposals [see recommendations 18 (for para. 1) and 19 (for paras. 2 and 3) and chap. III, paras. 51-58]	10(1)	1. The contracting authority shall provide a set of the request for proposals and related documents issued in accordance with [model provision 11] to each pre-selected bidder that pays the price, if any, charged for those documents.	18	Upon completion of the pre-selection proceedings, the contracting authority should request the pre-selected bidders to submit final proposals.

<sup>9</sup>A list of elements typically contained in pre-qualification documents can be found in article 7, paragraph 3, of the Model Procurement Law.

<sup>10</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, “Selection of the concessionaire”, paras. 48 and 49). See also footnote 14.

<sup>11</sup>Procedural steps on pre-qualification proceedings, including procedures for handling requests for clarifications and disclosure requirements for the contracting authority’s decision on the bidders’ qualifications, can be found in article 7 of the Model Procurement Law, paragraphs 2-7.

<sup>12</sup>The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. The various issues raised by domestic preferences are discussed in the *Legislative Guide* (see chap. III, “Selection of the concessionaire”, paras. 43 and 44). The *Legislative Guide* suggests that countries that wish to provide some incentive to national suppliers may wish to apply such preferences in the form of special evaluation criteria, rather than by a blanket exclusion of foreign suppliers. In any event, where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

<sup>13</sup>The rationale for prohibiting the participation of bidders in more than one consortium to submit proposals for the same project is to reduce the risk of leakage of information or collusion between competing consortia. Nevertheless, the model provision contemplates the possibility of ad hoc exceptions to this rule, for instance, in the event that only one company or only a limited number of companies could be expected to deliver a specific good or service essential for the implementation of the project.

<sup>14</sup>In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). The manner in which rating systems (in particular quantitative ones) may be used to arrive at such a range of bidders is discussed in the *Legislative Guide* (see chap. III, “Selection of the concessionaire”, para. 48). It should be noted that the rating system is used solely for the purpose of the pre-selection of bidders. The ratings of the pre-selected bidders should not be taken into account at the stage of evaluation of proposals (see model provision 15), at which all pre-selected bidders should start out on an equal standing.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
	10(2-3)	<p>2. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when the contracting authority does not deem it to be feasible to describe in the request for proposals the characteristics of the project such as project specifications, performance indicators, financial arrangements or contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.</p> <p>3. Where a two-stage procedure is used, the following provisions apply:</p> <p>(a) The initial request for proposals shall call upon the bidders to submit, in the first stage of the procedure, initial proposals relating to project specifications, performance indicators, financing requirements or other characteristics of the project as well as to the main contractual terms proposed by the contracting authority;<sup>15</sup></p> <p>(b) The contracting authority may convene meetings and hold discussions with any of the bidders to clarify questions concerning the initial request for proposals or the initial proposals and accompanying documents submitted by the bidders. The contracting authority shall prepare minutes of any such meeting or discussion containing the questions raised and the clarifications provided by the contracting authority;</p> <p>(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial request for proposals by deleting or modifying any aspect of the initial project specifications, performance indicators, financing requirements or other characteristics of the project, including the main contractual terms, and any criterion for evaluating and comparing proposals and for ascertaining the successful bidder, as set forth in the initial request for proposals, as well as by adding characteristics or criteria to it. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 26] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated in the invitation to submit final proposals;</p> <p>(d) In the second stage of the proceedings, the contracting authority shall invite the bidders to submit final proposals with respect to a single set of project specifications, performance indicators or contractual terms in accordance with [model provisions 11-17].</p>	19	<p>Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when it is not feasible for it to formulate project specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated. Where a two-stage procedure is used, the following provisions should apply:</p> <p>(a) The contracting authority should first call upon the pre-selected bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms;</p> <p>(b) The contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals;</p> <p>(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial project specifications and contractual terms prior to issuing a final request for proposals</p>
Content of the request for proposals [see recommendation 20 and chap. III, paras. 59-70]	11	<p>To the extent not already required by [the enacting State indicates the provisions of its laws on procurement proceedings that govern the content of requests for proposals],<sup>16</sup> the request for proposals shall include at least the following information:</p> <p>(a) General information as may be required by the bidders in order to prepare and submit their proposals;<sup>17</sup></p> <p>(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;<sup>18</sup></p> <p>(c) The contractual terms proposed by the contracting authority, including an indication of which terms are deemed to be non-negotiable;</p> <p>(d) The criteria for evaluating proposals and the thresholds, if any, set by the contracting authority for identifying non-responsive proposals; the relative weight to be accorded to each evaluation criterion; and the manner in which the criteria and thresholds are to be applied in the evaluation and rejection of proposals.</p>	20	<p>The final request for proposals should include at least the following:</p> <p>(a) General information as may be required by the bidders in order to prepare and submit their proposals;</p> <p>(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;</p> <p>(c) The contractual terms proposed by the contracting authority;</p> <p>(d) The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which the criteria are to be applied in the evaluation of proposals.</p>

Bid securities [see chap. III, para. 62]	12	<p>1. The request for proposals shall set forth the requirements with respect to the issuer and the nature, form, amount and other principal terms and conditions of the required bid security.</p> <p>2. A bidder shall not forfeit any bid security that it may have been required to provide, other than in cases of:<sup>19</sup></p> <p>(a) Withdrawal or modification of a proposal after the deadline for submission of proposals and, if so stipulated in the request for proposals, before that deadline;</p> <p>(b) Failure to enter into final negotiations with the contracting authority pursuant to [model provision 17, para. 1];</p> <p>(c) Failure to formulate a best and final offer within the time limit prescribed by the contracting authority pursuant to [model provision 17, para. 2];</p> <p>(d) Failure to sign the concession contract, if required by the contracting authority to do so, after the proposal has been accepted;</p> <p>(e) Failure to provide required security for the fulfilment of the concession contract after the proposal has been accepted or to comply with any other condition prior to signing the concession contract specified in the request for proposals.</p>		
Clarifications and modifications [see recommendation 21 and chap. III, paras. 71 and 72]	13	The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, review and, as appropriate, revise any element of the request for proposals as set forth in [model provision 11]. The contracting authority shall indicate in the record of the selection proceedings to be kept pursuant to [model provision 26] the justification for any revision to the request for proposals. Any such deletion, modification or addition shall be communicated to the bidders in the same manner as the request for proposals at a reasonable time prior to the deadline for submission of proposals.	21	The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the final request for proposals by issuing addenda at a reasonable time prior to the deadline for submission of proposals.
Evaluation criteria [see recommendation 22 (for para. 1) and 23 (for para. 2) and chap. III, paras. 73-77]	14(1)	<p>1. The criteria for the evaluation and comparison of the technical proposals<sup>20</sup> shall include at least the following:</p> <p>(a) Technical soundness;</p> <p>(b) Compliance with environmental standards;</p> <p>(c) Operational feasibility;</p> <p>(d) Quality of services and measures to ensure their continuity.</p>	22	<p>The criteria for the evaluation and comparison of the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:</p> <p>(a) Technical soundness;</p> <p>(b) Operational feasibility;</p> <p>(c) Quality of services and measures to ensure their continuity;</p> <p>(d) Social and economic development potential offered by the proposals.</p>

<sup>15</sup>In many cases, in particular for new types of project, the contracting authority may not be in a position, at this stage, to have formulated a detailed draft of the contractual terms envisaged by it. Also, the contracting authority may find it preferable to develop such terms only after an initial round of consultations with the pre-selected bidders. In any event, however, it is important for the contracting authority, at this stage, to provide some indication of the key contractual terms of the concession contract, in particular the way in which the project risks should be allocated between the parties under the concession contract. If this allocation of contractual rights and obligations is left entirely open until after the issuance of the final request for proposals, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project (see chap. III, “Selection of the concessionaire”, paras. 67-70; see further chap. II, “Project risks and government support”, paras. 8-29).

<sup>16</sup>A list of elements typically contained in a request for proposals for services can be found in article 38 of the Model Procurement Law.

<sup>17</sup>A list of elements that should be provided can be found in chapter III, “Selection of the concessionaire”, paragraphs 61 and 62, of the *Legislative Guide*.

<sup>18</sup>See chapter III, “Selection of the concessionaire”, paragraphs 64-66.

<sup>19</sup>General provisions on bid securities can be found in article 32 of the Model Procurement Law.

<sup>20</sup>See chapter III, “Selection of the concessionaire”, paragraph 74.

<sup>21</sup>See chapter III, “Selection of the concessionaire”, paragraphs 75-77.

<i>Headings</i>	<i>No.</i>	<i>Model legislative provisions</i>	<i>No.</i>	<i>Legislative recommendations</i>
	14(2)	<p>2. The criteria for the evaluation and comparison of the financial and commercial proposals<sup>21</sup> shall include, as appropriate:</p> <p>(a) The present value of the proposed tolls, unit prices and other charges over the concession period;</p> <p>(b) The present value of the proposed direct payments by the contracting authority, if any;</p> <p>(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;</p> <p>(d) The extent of financial support, if any, expected from a public authority of [<i>this State</i>];</p> <p>(e) Soundness of the proposed financial arrangements;</p> <p>(f) The extent of acceptance of the negotiable contractual terms proposed by the contracting authority in the request for proposals;</p> <p>(g) The social and economic development potential offered by the proposals.</p>		<p>The criteria for the evaluation and comparison of the financial and commercial proposals may include, as appropriate:</p> <p>(a) The present value of the proposed tolls, fees, unit prices and other charges over the concession period;</p> <p>(b) The present value of the proposed direct payments by the contracting authority, if any;</p> <p>(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;</p> <p>(d) The extent of financial support, if any, expected from the Government;</p> <p>(e) Soundness of the proposed financial arrangements;</p> <p>(f) The extent of acceptance of the proposed contractual terms.</p>
Comparison and evaluation of proposals [see recommendation 24 and chap. III, paras. 78-82]	15	<p>1. The contracting authority shall compare and evaluate each proposal in accordance with the evaluation criteria, the relative weight accorded to each such criterion and the evaluation process set forth in the request for proposals.</p> <p>2. For the purposes of paragraph 1, the contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects. Proposals that fail to achieve the thresholds shall be regarded as non-responsive and rejected from the selection procedure.<sup>22</sup></p>	24	The contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects to be reflected in the proposals in accordance with the criteria set out in the request for proposals. Proposals that fail to achieve the thresholds should be regarded as non-responsive.
Further demonstration of fulfilment of qualification criteria [see recommendation 25 and chap. III, paras. 78-82]	16	The contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications in accordance with the same criteria used for pre-selection. The contracting authority shall disqualify any bidder that fails to demonstrate again its qualifications if requested to do so. <sup>23</sup>	25	Whether or not it has followed a pre-selection process, the contracting authority may retain the right to require the bidders to demonstrate their qualifications again in accordance with criteria and procedures set forth in the request for proposals or the pre-selection documents, as appropriate. Where a pre-selection process has been followed, the criteria should be the same as those used in the pre-selection proceedings.
Final negotiations [see recommendation 26 (for para. 1) and 27 (for para. 2) and chap. III, paras. 83 and 84]	17(1)	1. The contracting authority shall rank all responsive proposals and invite for final negotiation of the concession contract the bidder that has attained the best rating. Final negotiations shall not concern those contractual terms, if any, that were stated as non-negotiable in the final request for proposals.	26	The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating. Final negotiations may not concern those terms of the contract which were stated as non-negotiable in the final request for proposals.
	17(2)	2. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a concession contract, the contracting authority shall inform the bidder of its intention to terminate the negotiations and give the bidder reasonable time to formulate its best and final offer. If the bidder fails to formulate an offer acceptable to the contracting authority within the prescribed time limit, the contracting authority shall terminate the negotiations with the bidder concerned. The contracting authority shall then invite for negotiations the other bidders in the order of their ranking until it arrives at a concession contract or rejects all remaining proposals. The contracting authority shall not resume negotiations with a bidder with which negotiations have been terminated pursuant to this paragraph.	27	If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the other bidders on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals.

Circumstances authorizing award without competitive procedures [see recommendation 28 and chap. III, para. 89]

18 Subject to approval by ... [the enacting State indicates the relevant authority],<sup>24</sup> the contracting authority is authorized to negotiate a concession contract without using the procedure set forth in [model provisions 6-17], in the following cases:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in the procedures set forth in [model provisions 6-17] would be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

(b) Where the project is of short duration and the anticipated initial investment value does not exceed the amount [of ...] [the enacting State specifies a monetary ceiling] [set forth in ...] [the enacting State indicates the provisions of its laws that specify the monetary threshold below which a privately financed infrastructure project may be awarded without competitive procedures];<sup>25</sup>

(c) Where the project involves national defence or national security;

(d) Where there is only one source capable of providing the required service, such as when the provision of the service requires the use of intellectual property, trade secrets or other exclusive rights owned or possessed by a certain person or persons;

(e) In cases of unsolicited proposals falling under [model provision 23];

(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals and if, in the judgement of the contracting authority, issuing a new invitation to the pre-selection proceedings and a new request for proposals would be unlikely to result in a project award within a required time frame;<sup>26</sup>

(g) In other cases where the [the enacting State indicates the relevant authority] authorizes such an exception for compelling reasons of public interest.<sup>27</sup>

28 The law should set forth the exceptional circumstances under which the contracting authority may be authorized to award a concession without using competitive procedures, such as:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in a competitive selection procedure would therefore be impractical;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence or national security;

(d) Cases where there is only one source capable of providing the required service (for example, because it requires the use of patented technology or unique know-how);

(e) In case of unsolicited proposals of the type referred to in legislative recommendations 34 and 35;

(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals, and if, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award;

(g) Other cases where the higher authority authorizes such an exception for compelling reasons of public interest.

<sup>22</sup>This model provision offers an example of an evaluation process that a contracting authority may wish to apply to compare and evaluate proposals for privately financed infrastructure projects. Alternative evaluation processes are described in chapter III, "Selection of the concessionaire", paragraphs 79-82, of the *Legislative Guide*, such as a two-step evaluation process or the two-envelope system. In contrast to the process set forth in this model provision, the processes described in the *Legislative Guide* are designed to allow the contracting authority to compare and evaluate the non-financial criteria separately from the financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. In order to ensure the integrity, transparency and predictability of the evaluation stage of the selection proceedings, it is recommended that the enacting State set forth in its law the evaluation processes that contracting authorities may use to compare and evaluate proposals and the details of the application of this process.

<sup>23</sup>Where pre-qualification proceedings have been engaged in, the criteria shall be the same as those used in the pre-qualification proceedings.

<sup>24</sup>The rationale for subjecting the award of the concession contract without competitive procedures to the approval of a higher authority is to ensure that the contracting authority engages in direct negotiations with bidders only in the appropriate circumstances (see chap. III, "Selection of the concessionaire", paras. 85-96). The model provision therefore suggests that the enacting State indicates a relevant authority that is competent to authorize negotiations in all cases set forth in the model provision. The enacting State may provide, however, for different approval requirements for each subparagraph of the model provision. In some cases, for instance, the enacting State may provide that the authority to engage in such negotiations derives directly from the law. In other cases, the enacting State may make the negotiations subject to the approval of different higher authorities, depending on the nature of the services to be provided or the infrastructure sector concerned. In those cases, the enacting State may need to adapt the model provision to these approval requirements by adding the particular approval requirement to the subparagraph concerned, or by adding a reference to provisions of its law where these approval requirements are set forth.

<sup>25</sup>As an alternative to the exclusion provided in subparagraph (b), the enacting State may consider devising a simplified procedure for request for proposals for projects falling thereunder, for instance by applying the procedures described in article 48 of the Model Procurement Law.

<sup>26</sup>The enacting State may wish to require that the contracting authority include in the record to be kept pursuant to [model provision 26] a summary of the results of the negotiations and indicate the extent to which those results differed from the project specifications and contractual terms of the original request for proposals, and that it state the reasons therefor.

<sup>27</sup>Enacting States that deem it desirable to authorize the use of negotiated procedures on an ad hoc basis may wish to retain subparagraph (g) when implementing the model provision. Enacting States wishing to limit exceptions to the competitive selection procedures may in turn prefer not to include the subparagraph. In any event, for purposes of transparency, the enacting State may wish to indicate here or elsewhere in the model provision other exceptions, if any, authorizing the use of negotiated procedures that may be provided under specific legislation.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
Procedures for negotiation of a concession contract [see recommendation 29 and chap. III, para. 90]	19	Where a concession contract is negotiated without using the procedures set forth in [model provisions 6-17] the contracting authority shall: <sup>28</sup> (a) Except for concession contracts negotiated pursuant to [model provision 18, subpara. (c)], cause a notice of its intention to commence negotiations in respect of a concession contract to be published in accordance with [the enacting State indicates the provisions of any relevant laws on procurement proceedings that govern the publication of notices]; (b) Engage in negotiations with as many persons as the contracting authority judges capable <sup>29</sup> of carrying out the project as circumstances permit; (c) Establish evaluation criteria against which proposals shall be evaluated and ranked.	29	The law may require that the following procedures be observed for the award of a concession without competitive procedures: (a) The contracting authority should publish a notice of its intention to award a concession for the implementation of the proposed project and should engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit; (b) Offers should be evaluated and ranked according to the evaluation criteria established by the contracting authority; (c) Except for the situation referred to in recommendation 28 (c), the contracting authority should cause a notice of the concession award to be published, disclosing the specific circumstances and reasons for the award of the concession without competitive procedures.
Admissibility of unsolicited proposals [see recommendation 30 and chap. III, paras. 97-109]	20	As an exception to [model provisions 6-17], the contracting authority <sup>30</sup> is authorized to consider unsolicited proposals pursuant to the procedures set forth in [model provisions 21-23], provided that such proposals do not relate to a project for which selection procedures have been initiated or announced.	30	By way of exception to the selection procedures described in legislative recommendations 14-27, the contracting authority may be authorized to handle unsolicited proposals pursuant to specific procedures established by the law for handling unsolicited proposals, provided that such proposals do not relate to a project for which selection procedures have been initiated or announced by the contracting authority.
Procedures for determining the admissibility of unsolicited proposals [see recommendations 31 (for paras. 1 and 2) and 32 (for para. 3) and chap. III, paras. 110-112]	21(1-2)	1. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority shall promptly inform the proponent whether or not the project is considered to be potentially in the public interest. <sup>31</sup>  2. If the project is considered to be potentially in the public interest under paragraph 1, the contracting authority shall invite the proponent to submit as much information on the proposed project as is feasible at this stage to allow the contracting authority to make a proper evaluation of the proponent's qualifications <sup>32</sup> and the technical and economic feasibility of the project and to determine whether the project is likely to be successfully implemented in the manner proposed in terms acceptable to the contracting authority. For this purpose, the proponent shall submit a technical and economic feasibility study, an environmental impact study and satisfactory information regarding the concept or technology contemplated in the proposal.	31	Following receipt and preliminary examination of an unsolicited proposal, the contracting authority should inform the proponent, within a reasonably short period, whether or not there is a potential public interest in the project. If the project is found to be in the public interest, the contracting authority should invite the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to make a proper evaluation of the concept or technology and determine whether the proposal meets the conditions set forth in the law and is likely to be successfully implemented at the scale of the proposed project.
	21(3)	3. In considering an unsolicited proposal, the contracting authority shall respect the intellectual property, trade secrets or other exclusive rights contained in, arising from or referred to in the proposal. Therefore, the contracting authority shall not make use of information provided by or on behalf of the proponent in connection with its unsolicited proposal other than for the evaluation of that proposal, except with the consent of the proponent. Except as otherwise agreed by the parties, the contracting authority shall, if the proposal is rejected, return to the proponent the original and any copies of documents that the proponent submitted and prepared throughout the procedure.	32	The proponent should retain title to all documents submitted throughout the procedure and those documents should be returned to it in the event that the proposal is rejected.
Unsolicited proposals that do not involve intellectual property, trade secrets or other exclusive rights [see recommendation 33 and chap. III, paras. 113 and 114]	22	1. Except in the circumstances set forth in [model provision 18], the contracting authority shall, if it decides to implement the project, initiate a selection procedure in accordance with [model provisions 6-17] if the contracting authority considers that: (a) The envisaged output of the project can be achieved without the use of intellectual property, trade secrets or other exclusive rights owned or possessed by the proponent; and (b) The proposed concept or technology is not truly unique or new.	33	The contracting authority should initiate competitive selection procedures under recommendations 14-27 above if it is found that the envisaged output of the project can be achieved without the use of a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights or if the proposed concept or technology is not truly unique or new. The author of the unsolicited proposal should be invited to participate in such proceedings and may be given a premium for submitting the proposal.



		2. The proponent shall be invited to participate in the selection proceedings initiated by the contracting authority pursuant to paragraph 1 and may be given an incentive or a similar benefit in a manner described by the contracting authority in the request for proposals in consideration for the development and submission of the proposal.		
Unsolicited proposals involving intellectual property, trade secrets or other exclusive rights [see recommendations 34 (for paras. 1 and 2) and 35 (for paras. 3 and 4) and chap. III, paras. 115-117]	23(1-2)	1. If the contracting authority determines that the conditions of [model provision 22, para. 1 (a) and (b)] are not met, it shall not be required to carry out a selection procedure pursuant to [model provisions 6-17]. However, the contracting authority may still seek to obtain elements of comparison for the unsolicited proposal in accordance with the provisions set out in paragraphs 2-4. <sup>33</sup> 2. Where the contracting authority intends to obtain elements of comparison for the unsolicited proposal, the contracting authority shall publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals within [a reasonable period] [the enacting State indicates a certain amount of time].	34	If it appears that the envisaged output of the project cannot be achieved without using a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights, the contracting authority should seek to obtain elements of comparison for the unsolicited proposal. For that purpose, the contracting authority should publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period.
	23(3-4)	3. If no proposals in response to an invitation issued pursuant to paragraph 2 are received within [a reasonable period] [the amount of time specified in paragraph 2 above], the contracting authority may engage in negotiations with the original proponent. 4. If the contracting authority receives proposals in response to an invitation issued pursuant to paragraph 2, the contracting authority shall invite the proponents to negotiations in accordance with the provisions set forth in [model provision 19]. In the event that the contracting authority receives a sufficiently large number of proposals, which appear prima facie to meet its infrastructure needs, the contracting authority shall request the submission of proposals pursuant to [model provisions 10-17], subject to any incentive or other benefit that may be given to the person who submitted the unsolicited proposal in accordance with [model provision 22, para. 2].	35	The contracting authority may engage in negotiations with the author of the unsolicited proposal if no alternative proposals are received, subject to approval by a higher authority. If alternative proposals are submitted, the contracting authority should invite all the proponents to negotiations in accordance with the provisions of legislative recommendation 29 (a)-(c).
Confidentiality of negotiations [see recommendation 36 and chap. III, para. 118]	24	The contracting authority shall treat proposals in such a manner as to avoid the disclosure of their content to competing bidders. Any discussions, communications and negotiations between the contracting authority and a bidder pursuant to [model provisions 10, paras. 3, 17, 18, 19 or 23, paras. 3 and 4] shall be confidential. Unless required by law or by a court order, no party to the negotiations shall disclose to any other person, apart from its agents, subcontractors, lenders, advisers or consultants, any technical, price or other information that it has received in relation to discussions, communications and negotiations pursuant to the aforementioned provisions without the consent of the other party.	36	Negotiations between the contracting authority and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other commercial information relating to the negotiations without the consent of the other party.

<sup>28</sup>A number of elements to enhance transparency in negotiations under this model provision are discussed in chapter III, “Selection of the concessionaire”, paragraphs 90-96, of the *Legislative Guide*.

<sup>29</sup>Enacting States wishing to enhance transparency in the use of negotiated procedures may establish, by specific regulations, qualification criteria to be met by persons invited to negotiations pursuant to [model provisions 18 and 19]. An indication of possible qualification criteria is contained in [model provision 7].

<sup>30</sup>The model provision assumes that the power to entertain unsolicited proposals lies with the contracting authority. However, depending on the regulatory system of the enacting State, a body separate from the contracting authority may have the responsibility for entertaining unsolicited proposals or for considering, for instance, whether an unsolicited proposal is in the public interest. In such a case, the manner in which the functions of such a body may need to be coordinated with those of the contracting authority should be carefully considered by the enacting State (see footnotes 1, 3 and 24 and the references cited therein).

<sup>31</sup>The determination that a proposed project is in the public interest entails a considered judgement regarding the potential benefits to the public that are offered by the project, as well as its relationship to the Government’s policy for the infrastructure sector concerned. In order to ensure the integrity, transparency and predictability of the procedures for determining the admissibility of unsolicited proposals, it may be advisable for the enacting State to provide guidance, in regulations or other documents, concerning the criteria that will be used to determine whether an unsolicited proposal is in the public interest, which may include criteria for assessing the appropriateness of the contractual arrangements and the reasonableness of the proposed allocation of project risks.

<sup>32</sup>The enacting State may wish to provide in regulations the qualification criteria that need to be met by the proponent. Elements to be taken into account for that purpose are indicated in [model provision 7].

<sup>33</sup>The enacting State may wish to consider adopting a special procedure for handling unsolicited proposals falling under this model provision, which may be modelled, mutatis mutandis, on the request-for-proposals procedure set forth in article 48 of the Model Procurement Law.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
Notice of contract award [see recommendation 37 and chap. III, para. 119]	25	Except for concession contracts awarded pursuant to [model provision 18, subpara. (c)], the contracting authority shall cause a notice of the contract award to be published in accordance with [the enacting State indicates the provisions of its laws on procurement proceedings that govern the publication of contract award notices]. The notice shall identify the concessionaire and include a summary of the essential terms of the concession contract.	37	The contracting authority should cause a notice of the award of the project to be published. The notice should identify the concessionaire and include a summary of the essential terms of the project agreement.
Record of selection and award proceedings [see recommendation 38 and chap. III, paras. 120-126]	26	The contracting authority shall keep an appropriate record of information pertaining to the selection and award proceedings in accordance with [the enacting State indicates the provisions of its laws on public procurement that govern record of procurement proceedings]. <sup>34</sup>	38	The contracting authority should keep an appropriate record of key information pertaining to the selection and award proceedings. The law should set forth the requirements for public access.
Review procedures [see recommendation 39 and chap. III, paras. 127-131]	27	A bidder that claims to have suffered, or that may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts or failures to act in accordance with [the enacting State indicates the provisions of its laws governing the review of decisions made in procurement proceedings]. <sup>35</sup>	39	Bidders who claim to have suffered, or who may suffer, loss or injury owing to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts in accordance with the laws of the host country.
Contents of the concession contract [see recommendation 40 and chap. IV, paras. 1-11]	28	The concession contract shall provide for such matters as the parties deem appropriate, such as:	40	The law might identify the core terms to be provided in the project agreement, which may include those terms referred to in recommendations 41-68 below.
[see chap. IV, para. 1]	28(a)	(a) The nature and scope of works to be performed and services to be provided by the concessionaire;		
[see recommendation 5]	28(b)	(b) The conditions for provision of those services and the extent of exclusivity, if any, of the concessionaire's rights under the concession contract;	5	The law should specify the extent to which a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.
	28(c)	(c) The assistance that the contracting authority may provide to the concessionaire in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project;		
[see recommendations 42 and 43 and model provision 30]	28(d)	(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with [model provision 30];	42	The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country.
			43	The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval by the contracting authority of the statutes and by-laws of the project company and fundamental changes therein.
[see recommendations 44 and 45 and model provisions 31-33]	28(e)	(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with [model provisions 31-33];	44	The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.

			45	The contracting authority should assist the concessionaire in obtaining such rights related to the project site as necessary for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction, operation and maintenance of the facility.
[see recommendations 46 and 48]	28(f)	(f) The remuneration of the concessionaire, whether consisting of tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of any such tariffs or fees; and payments, if any, that may be made by the contracting authority or other public authority;	46	The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees.
			48	The contracting authority should have the power, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users or to enter into commitments for the purchase of fixed quantities of goods or services.
[see recommendation 52]	28(g)	(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility;	52	The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority's right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances.
[see recommendation 53 and model provision 38]	28(h)	(h) The extent of the concessionaire's obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users;	53	The project agreement should set forth, as appropriate, the extent of the concessionaire's obligations to ensure: <ul style="list-style-type: none"> <li>(a) The adaptation of the service so as to meet the actual demand for the service;</li> <li>(b) The continuity of the service;</li> <li>(c) The availability of the service under essentially the same conditions to all users;</li> <li>(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.</li> </ul>
[see recommendations 52 and 54, subpara. (b)]	28(i)	(i) The contracting authority's or other public authority's right to monitor the works to be performed and services to be provided by the concessionaire and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements;	52	The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority's right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances.
			54(b)	(b) The procedures for monitoring the concessionaire's performance and for taking such reasonable actions as the contracting authority or a regulatory body may find appropriate, to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements.

<sup>34</sup>The content of such a record for the various types of project award contemplated in the model provisions, as well as the extent to which the information contained therein may be accessible to the public, are discussed in chapter III, "Selection of the concessionaire", paragraphs 120-126, of the *Legislative Guide*. The content of such a record for the various types of project award is further set out in article 11 of the Model Procurement Law. If the laws of the enacting State do not adequately address these matters, the enacting State should adopt legislation or regulations to that effect.

<sup>35</sup>Elements for the establishment of an adequate review system are discussed in chapter III, "Selection of the concessionaire", paragraphs 127-131, of the *Legislative Guide*. They are also contained in chapter VI of the Model Procurement Law. If the laws of the enacting State do not provide such an adequate review system, the enacting State should consider adopting legislation to that effect.

<i>Headings</i>	<i>No.</i>	<i>Model legislative provisions</i>	<i>No.</i>	<i>Legislative recommendations</i>
[ <i>see recommendation 54, subpara. (a)</i> ]	28(j)	(j) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations;	54(a)	(a) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory body, as appropriate, with reports and other information on its operations;
[ <i>see chap. IV, paras. 73-76</i> ]	28(k)	(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the concessionaire might be entitled;	...	...
[ <i>see recommendation 56</i> ]	28(l)	(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the concessionaire, in particular with the concessionaire's own shareholders or other affiliated persons;	56	The contracting authority may reserve the right to review and approve major contracts to be entered into by the concessionaire, in particular contracts with the concessionaire's own shareholders or related persons. The contracting authority's approval should not normally be withheld except where the contracts contain provisions inconsistent with the project agreement or manifestly contrary to the public interest or to mandatory rules of a public law nature.
[ <i>see recommendation 58, subparas. (a) and (b)</i> ]	28(m)	(m) Guarantees of performance to be provided and insurance policies to be maintained by the concessionaire in connection with the implementation of the infrastructure project;	58(a)	(a) The forms, duration and amounts of the guarantees of performance that the concessionaire may be required to provide in connection with the construction and the operation of the facility;
			58(b)	(b) The insurance policies that the concessionaire may be required to maintain;
[ <i>see recommendation 58, in subpara. (e)</i> ]	28(n)	(n) Remedies available in the event of default of either party;	58(e)	(e) Remedies available to the contracting authority and the concessionaire the event of default by the other party.
[ <i>see recommendation 58, subpara. (d)</i> ]	28(o)	(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the concession contract owing to circumstances beyond its reasonable control;	58(d)	(d) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement owing to circumstances beyond their reasonable control;
[ <i>see recommendation 61</i> ]	28(p)	(p) The duration of the concession contract and the rights and obligations of the parties upon its expiry or termination;	61	The duration of the concession should be specified in the project agreement.
[ <i>see recommendation 67</i> ]	28(q)	(q) The manner for calculating compensation pursuant to [ <i>model provision 47</i> ];	67	The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement, and for losses, including lost profits.
[ <i>see recommendation 69 and model provision 49</i> ].	28(r)	(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the concessionaire;	69	The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as best suited to the needs of the project.
Governing law [ <i>see recommendation 41 and chap. IV, paras. 5-8</i> ]	29	The concession contract is governed by the law of this State unless otherwise provided in the concession contract. <sup>36</sup>	41	Unless otherwise provided, the project agreement should be governed by the law of the host country.
Organization of the concessionaire [ <i>see recommendations 42 and 43 and chap. IV, paras. 12-18</i> ]	30	The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [ <i>this State</i> ], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws and significant changes therein shall be set forth in the concession contract.	42	The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country.
			43	The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval by the contracting authority of the statutes and by-laws of the project company and fundamental changes therein.

Ownership of assets [see recommendation 44 and chap. IV, paras. 20-26]	31	The concession contract shall specify, as appropriate, which assets are or shall be public property and which assets are or shall be the private property of the concessionaire. The concession contract shall in particular identify which assets belong to the following categories:  (a) Assets, if any, that the concessionaire is required to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the concession contract;  (b) Assets, if any, that the contracting authority, at its option, may purchase from the concessionaire; and  (c) Assets, if any, that the concessionaire may retain or dispose of upon expiry or termination of the concession contract.	44	The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.
Acquisition of rights related to the project site [see recommendation 45 and chap. IV, paras. 27-29]	32	1. The contracting authority or other public authority under the terms of the law and the concession contract shall make available to the concessionaire or, as appropriate, shall assist the concessionaire in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.  2. Any compulsory acquisition of land that may be required for the execution of the project shall be carried out in accordance with [the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest].	45	The contracting authority should assist the concessionaire in obtaining such rights related to the project site as necessary for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction, operation and maintenance of the facility.
Easements [see recommendation 45 and chap. IV, para. 30]	33	The concessionaire shall [have] [be granted] the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project in accordance with [the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws].	45	The contracting authority should assist the concessionaire in obtaining such rights related to the project site as necessary for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction, operation and maintenance of the facility.
Financial arrangements [see recommendation 46 and 47 and chap. IV, paras. 33-51]	34	The concessionaire shall have the right to charge, receive or collect tariffs or fees for the use of the facility or the services it provides. The concession contract shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [in accordance with the rules established by the competent regulatory agency]. <sup>37</sup>	46	The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees.
			47	Where the tariffs or fees charged by the concessionaire are subject to external control by a regulatory body, the law should set forth the mechanisms for periodic and extraordinary revisions of the tariff adjustment formulas.

<sup>36</sup>Legal systems provide varying answers to the question as to whether the parties to a concession contract may choose as the governing law of the contract a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 5-8), in some countries the concession contract may be subject to administrative law, while in others the concession contract may be governed by private law (see also *Legislative Guide*, chap. VII, “Other relevant areas of law”, paras. 24-27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally *Legislative Guide*, chap. VII, “Other relevant areas of law”, sect. B).

<sup>37</sup>Tolls, fees, prices or other charges accruing to the concessionaire, which are referred to in the *Legislative Guide* as “tariffs”, may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, “Project risks and government support”, paras. 30-60). The cost at which public services are provided is typically an element of the Government’s infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of “reasonableness”, “fairness” or “equity” (see chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, paras. 36-46).

<i>Headings</i>	<i>No.</i>	<i>Model legislative provisions</i>	<i>No.</i>	<i>Legislative recommendations</i>
Security interests [see recommendation 49 and chap. IV, paras. 52-61]	35	1. Subject to any restriction that may be contained in the concession contract, <sup>38</sup> the concessionaire has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following: (a) Security over movable or immovable property owned by the concessionaire or its interests in project assets; (b) A pledge of the proceeds of, and receivables owed to the concessionaire for, the use of the facility or the services it provides. 2. The shareholders of the concessionaire shall have the right to pledge or create any other security interest in their shares in the concessionaire. 3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is prohibited by the law of [this State].	49	The concessionaire should be responsible for raising the funds required to construct and operate the infrastructure facility and, for that purpose, should have the right to secure any financing required for the project with a security interest in any of its property, with a pledge of shares of the project company, with a pledge of the proceeds and receivables arising out of the concession, or with other suitable security, without prejudice to any rule of law that might prohibit the creation of security interests in public property.
Assignment of the concession contract [see recommendation 50 and chap. IV, paras. 62 and 63]	36	Except as otherwise provided in [model provision 35], the rights and obligations of the concessionaire under the concession contract may not be assigned to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which the contracting authority shall give its consent to an assignment of the rights and obligations of the concessionaire under the concession contract, including the acceptance by the new concessionaire of all obligations thereunder and evidence of the new concessionaire's technical and financial capability as necessary for providing the service.	50	The concession should not be assigned to third parties without the consent of the contracting authority. The project agreement should set forth the conditions under which the contracting authority might give its consent to an assignment of the concession, including the acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability as necessary for providing the service.
Transfer of controlling interest in the concessionaire [see recommendation 51 and chap. IV, paras. 64-68]	37	Except as otherwise provided in the concession contract, a controlling interest in the concessionaire may not be transferred to third parties without the consent of the contracting authority. The concession contract shall set forth the conditions under which consent of the contracting authority shall be given.	51	The transfer of a controlling interest in a concessionaire company may require the consent of the contracting authority, unless otherwise provided.
Operation of infrastructure [see recommendation 53 and chap. IV, paras. 80-93 (for para. 1) and recommendation 55 and chap. IV, paras. 96 and 97 (for para. 2)]	38(1)	1. The concession contract shall set forth, as appropriate, the extent of the concessionaire's obligations to ensure: (a) The modification of the service so as to meet the demand for the service; (b) The continuity of the service; (c) The provision of the service under essentially the same conditions for all users; (d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.	53	The project agreement should set forth, as appropriate, the extent of the concessionaire's obligations to ensure: (a) The adaptation of the service so as to meet the actual demand for the service; (b) The continuity of the service; (c) The availability of the service under essentially the same conditions to users; (d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.
	38(2)	2. The concessionaire shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.	55	The concessionaire should have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.
Compensation for specific changes in legislation [see recommendation 58, subpara. (c) and chap. IV, paras. 122-125]	39	The concession contract shall set forth the extent to which the concessionaire is entitled to compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the services it provides.	58(c)	(c) The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;

Revision of the concession contract [see recommendation 58, subpara. (c) and chap. IV, paras. 126-130]	40	<p>1. Without prejudice to [model provision 39], the concession contract shall further set forth the extent to which the concessionaire is entitled to a revision of the concession contract with a view to providing compensation in the event that the cost of the concessionaire's performance of the concession contract has substantially increased or that the value that the concessionaire receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:</p> <p>(a) Changes in economic or financial conditions; or</p> <p>(b) Changes in legislation or regulations not specifically applicable to the infrastructure facility or the services it provides;</p> <p>Provided that the economic, financial, legislative or regulatory changes:</p> <p>(a) Occur after the conclusion of the contract;</p> <p>(b) Are beyond the control of the concessionaire; and</p> <p>(c) Are of such a nature that the concessionaire could not reasonably be expected to have taken them into account at the time the concession contract was negotiated or to have avoided or overcome their consequences.</p> <p>2. The concession contract shall establish procedures for revising the terms of the concession contract following the occurrence of any such changes.</p>	58(c)	(c) The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;
Takeover of an infrastructure project by the contracting authority [see recommendation 59 and chap. IV, paras. 143-146]	41	Under the circumstances set forth in the concession contract, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.	59	The project agreement should set forth the circumstances under which the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations.
Substitution of the concessionaire [see recommendation 60 and chap. IV, paras. 147-150]	42	The contracting authority may agree with the entities extending financing for an infrastructure project on the substitution of the concessionaire by a new entity or person appointed to perform under the existing concession contract upon serious breach by the concessionaire or other events that could otherwise justify the termination of the concession contract or other similar circumstances. <sup>39</sup>	60	The contracting authority should be authorized to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required or if other specified events occur that could justify the termination of the project agreement.

<sup>38</sup>These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.

<sup>39</sup>The substitution of the concessionaire by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the concession contract (see chap. IV, "Construction and operation of infrastructure: legislative framework and project agreement", paras. 147-150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the concessionaire company by selling those shares to a third party acceptable to the contracting authority.

Headings	No.	Model legislative provisions	No.	Legislative recommendations
Duration and extension of the concession contract [see recommendation 62 and chap. V, paras. 2-8]	43	<p>1. The term of the concession contract, as stipulated in accordance with [model provision 28, subpara. (p)] shall not be extended except as a result of the following circumstances:</p> <p>(a) Completion delay or interruption of operation due to circumstances beyond either party's reasonable control;</p> <p>(b) Project suspension brought about by acts of the contracting authority or other public authorities; or</p> <p>(c) [Other circumstances, as specified by the enacting State.]<sup>40</sup></p> <p>2. The term of the concession contract may further be extended to allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the concession contract, if the concessionaire would not be able to recover such costs during the original term.</p>	62	<p>The term of the concession should not be extended, except for those circumstances specified in the law, such as:</p> <p>(a) Completion delay or interruption of operation due to the occurrence of circumstances beyond either party's reasonable control;</p> <p>(b) Project suspension brought about by acts of the contracting authority or other public authorities;</p> <p>(c) To allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the agreement that the concessionaire would not be able to recover during the normal term of the project agreement.</p>
Termination of the concession contract by the contracting authority [see recommendation 63 and chap. V, paras. 14-27]	44	<p>The contracting authority may terminate the concession contract:</p> <p>(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;</p> <p>(b) For [compelling]<sup>41</sup> reasons of public interest, subject to payment of compensation to the concessionaire, the terms of the compensation to be as agreed in the concession contract;</p> <p>(c) [Other circumstances that the enacting State might wish to add in the law.]</p>	63	<p>The contracting authority should have the right to terminate the project agreement:</p> <p>(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;</p> <p>(b) For reasons of public interest, subject to payment of compensation to the concessionaire.</p>
Termination of the concession contract by the concessionaire [see recommendation 64 and chap. V, paras. 28-33]	45	<p>The concessionaire may not terminate the concession contract except under the following circumstances:</p> <p>(a) In the event of serious breach by the contracting authority or other public authority of their obligations in connection with the concession contract;</p> <p>(b) If the conditions for a revision of the concession contract under [model provision 40, para. 1] are met, but the parties have failed to agree public on a revision of the concession contract; or</p> <p>(c) If the cost of the concessionaire's performance of the concession contract has substantially increased or the value that the concessionaire receives for such performance has substantially diminished as a result of acts or omissions of the contracting authority or other public authorities, such as those referred to in [model provision 28, subparas. (h) and (i)], and the parties have failed to agree on a revision of the concession contract.</p>	64	<p>The concessionaire should have the right to terminate the project agreement under exceptional circumstances specified in the law, such as:</p> <p>(a) In the event of serious breach by the contracting authority or other public authority of their obligations under the project agreement;</p> <p>(b) In the event that the concessionaire's performance is rendered substantially more onerous as a result of variation orders or other acts of the contracting authority, unforeseen changes in conditions or acts of other authorities and that the parties have failed to agree on an appropriate revision of the project agreement.</p>
Termination of the concession contract by either party [see recommendation 65 and chap. V, paras. 34 and 35]	46	<p>Either party shall have the right to terminate the concession contract in the event that the performance of its obligations is rendered impossible by circumstances beyond either party's reasonable control. The parties shall also have the right to terminate the concession contract by mutual consent.</p>	65	<p>Either party should have the right to terminate the project agreement in the event that the performance of its obligations is rendered impossible by the occurrence of circumstances beyond either party's reasonable control. The parties should also have the right to terminate the project agreement by mutual consent.</p>



Financial arrangements upon expiry or termination of the concession contract [see recommendation 67 and chap. V, paras. 43-49]	47	The concession contract shall stipulate how compensation due to either party is calculated in the event of termination of the concession contract, providing, where appropriate, for compensation for the fair value of works performed under the concession contract, costs incurred or losses sustained by either party, including, as appropriate, lost profits.	67	The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement, and for losses, including lost profits.
Wind-up and transfer measures [see recommendation 66 and chap. V, paras. 37-42 (for lit. a) and recommendation 68 and chap. V, paras. 50-62 (for lit. b-d)]	48(a)	The concession contract shall set forth, as appropriate, the rights and obligations of the parties with respect to: (a) Mechanisms and procedures for the transfer of assets to the contracting authority, where appropriate;	66	The project agreement should lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement.
	48(b-d)	(b) The transfer of technology required for the operation of the facility; (c) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility; (d) The provision, by the concessionaire, of continuing support services and resources, including the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.	68	The project agreement should set out, as appropriate, the rights and obligations of the parties with respect to: (a) The transfer of technology required for the operation of the facility; (b) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility; (c) The provision, by the concessionaire, of operation and maintenance services and the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.
Disputes between the contracting authority and the concessionaire [see recommendation 69 and chap. VI, paras. 3-41]	49	Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession contract. <sup>42</sup>	69	The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as best suited to the needs of the project.
Disputes involving customers or efficient users of the infrastructure facility [see recommendation 71 and chap. VI, paras. 43-45]	50	Where the concessionaire provides services to the public or operates infrastructure facilities accessible to the public, the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.	71	The concessionaire may be required to make available simplified and mechanisms for handling claims submitted by its customers or users of the infrastructure facility.
Other disputes [see recommendation 70 and chap. VI, para. 42] contractors,	51	1. The concessionaire and its shareholders shall be free to choose the appropriate mechanisms for settling disputes among themselves. 2. The concessionaire shall be free to agree on the appropriate mechanisms for settling disputes between itself and its lenders, contractors, suppliers and other business partners.	70	The concessionaire and the project promoters should be free to choose the appropriate mechanisms for settling commercial disputes among the project promoters, or disputes between the concessionaire and its lenders, suppliers and other business partners.

<sup>40</sup>The enacting State may wish to consider the possibility of authorizing a consensual extension of the concession contract pursuant to its terms, for compelling reasons of public interest.

<sup>41</sup>[Possible situations of a compelling reason of public interest are discussed in chapter V, "Duration, extension and termination of the project agreement", paragraph 27, of the *Legislative Guide*.]

<sup>42</sup>The enacting State may provide in its legislation dispute settlement mechanisms that are best suited to the needs of privately financed infrastructure projects.

A/CN.9/533

**D. Draft addendum to the UNCITRAL *Legislative Guide on Privately Financed Infrastructure Projects*: note by the secretariat**

(A/CN.9/533 and Add.1-7) [Original: English]

**Compilation of comments by Governments and international organizations**

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**I. INTRODUCTION**

1. The Working Group on Privately Financed Infrastructure Projects was established by the United Nations Commission on International Trade Law at its thirty-fourth session and entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects.

2. At its fifth session, held in Vienna from 9 to 13 September 2002, the Working Group reviewed the draft model provisions that had been prepared by the secretariat with the assistance of outside experts and approved their text, as set out in the annex to its report on that session (A/CN.9/521). The Working Group requested the secretariat to circulate the draft model provisions for comments and to submit the draft model provisions, together with the comments received, to the Commission, for its review and adoption, at its thirty-sixth session.

3. The present note reproduces comments received from an international organization. Further comments will be issued as addenda to the present note in the order they are received.

**II. COMPILATION OF COMMENTS**

**International organizations**

***International Lawyers' Union***

*[Original: English]*

*Model provision 2. Definitions*

We understand that the Working Group on Privately Financed Infrastructure Projects has faced difficulty in

agreeing on a definition of the word "concession" that would be appropriate for all legal systems.

However, it is essential for a concession law to have its scope of application determined clearly. This is especially true when a law on public procurement exists. In such a case, it is necessary to make clear which law shall apply to a particular contractual relationship irrespective of the name given to the contract regulating the relationship (concession, licence, lease, usufruct rights, head of agreement, etc.).

In many countries where a build-operate-transfer or concession law exists, it can be seen that contractors try to escape its application (in particular the strict provisions on selection of concessionaires), by using different contract titles or by negating the fact that there is a concession.

The difficulty of defining the term concession has been addressed by the European Union in the European Commission interpretative communication on concessions under Community law, dated 12 April 2000, which defines concessions as follows:

"This communication therefore concerns acts attributable to the State whereby a public authority entrusts to a third party—by means of a contractual act or a unilateral act with the prior consent of the third party—the total or partial management of services for which that authority would normally be responsible and for which the third party assumes the risk. Such services are covered by this communication only if they constitute economic activities ... These acts of State will henceforth be referred to as 'concessions', regardless of their legal name under national law."

Obviously this definition, which is a compromise between common law and civil law systems, might be im-

proved. However, it could be given as an example for guidance to the legislator.

It would be counterproductive to simply elude this most important question of defining what the law is about.

*Model provision 3. Authority to enter into concession contracts*

It is always difficult to fix precisely in a concession law what assets or services may be subject to a concession and by which entitled organ. Names and competences of organs may change. For the concession law to be acceptable, in particular in countries with economies in transition, it should not affect any previously agreed distribution of power (in particular of local self-government). It is therefore recommended to adopt a neutral provision referring to the proper authority having jurisdiction over assets and services to be conceded.

*Model provision 4. Eligible infrastructure sectors*

The remark for model provision 3 also applies to model provision 4.

In most legal systems, a concession law cannot grant more rights than those granted by sectorial or specific laws. Rather than an indicative or exhaustive list of matters that may be conceded, it is preferable to refer generally to services and assets that can be conceded pursuant to any applicable law and, if necessary, to amend specific or sectorial laws to allow concessions, if not already provided for.

Conversely, a list of assets or services that cannot be conceded as being part of national sovereignty or national wealth, is often established.

*Model provision 18. Circumstances authorizing award without competitive procedures*

Exception (b) should be based not only on a maximum amount of investment, but also on a maximum yearly turnover and a maximum contract duration (three to five years).

*Model provision 26. Record of selection and award proceedings*

It should be recommended that each concession agreement be registered in a separate national concession registry, kept within a specific agency or ministry (Ministry of Finance) and accessible to all interested persons or entities. This would facilitate recourse and give to other contracting authorities the possibility to benefit from past contractual experience.

*Model provision 27. Review procedures*

Where a regulator exists, it might be advisable to provide for a first instance recourse to the regulator during the tender/direct negotiation process or soon afterwards, prior to the effective date of the concession.

*Model provision 40. Revision of the concession contract*

In order to reduce contractual uncertainty, a fourth condition should be added in paragraph 1:

“(d) Exceed a threshold amount [to be determined] of investment cost or of operational expenses, over a certain period of time [to be determined], or upset the overall financial or economic balance of the contract (*bouleversement de l'économie du contrat*).”

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**Compilation of comments by Governments and intergovernmental organizations**

ADDENDUM

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## II. COMPILATION OF COMMENTS

### A. States

#### *Italy*

1. The Government of Italy confirms its appreciation for the work accomplished on the task of drafting model legislative provisions on privately financed infrastructure projects to be submitted to the United Nations Commission on International Trade Law (UNCITRAL) at its next session. Indeed, the model provisions reproduce most of the suggestions and views expressed by the Italian delegation, which, however, wishes to make some comments on individual provisions always with the aim of increasing transparency and fairness in the competitive procedures.

2. As regards the relationship between the draft model provisions and the legislative recommendations contained in the *Legislative Guide*, the Italian delegation suggests the adoption of the third option mentioned in paragraph 2 of the note by the Secretariat of 19 December 2002 (A/CN.9/522/Add.1). Since it is not actually possible to replace the legislative recommendations in their entirety with the model legislative provisions (second option), it might be desirable to replace only those legislative recommendations in respect of which the Commission adopts model legislative provisions.

#### *Model provision 5. Rules governing the selection proceedings*

3. Obviously, the model provisions do not deal with a number of practical procedures or steps that would normally be found in an adequate general procurement regime (such as, for example, bid security and review of procedures, right of information of the public, manner of publication of notices, etc.). However, if some of these practical, yet fundamental, procedural provisions are not contained in the general framework of the enacting State, it would be preferable for the model provisions to contain a reference to supplementary provisions (for instance, to provisions of the UNCITRAL Model Procurement Law) providing for transparent and efficient competitive procedures.

#### *Model provision 6. Purpose and procedure of pre-selection*

4. The invitation to participate in the selection proceedings should contain sufficient information for bidders to be able to ascertain whether the works and services entailed in the project could be provided by the interested bidder (for instance, with reference to possible pre-selection criteria, such as the use of national goods or employing local labour).

5. Thus it could be envisaged to add a closing phrase to the provision, such as, for example, "any other information concerning essential elements of the project".

#### *Model provision 15. Comparison and evaluation of proposals*

6. This model provision could make a reference to alternative evaluation processes such as a two-step evaluation process or the two-envelope system (described in chap. III, "Selection of the concessionaire", paras. 79-82, of the *UNCITRAL Legislative Guide*).

#### *Model provision 17. Final negotiations*

7. Such negotiations may have a number of disadvantages since they both require highly skilled personnel with sufficient experience and bring with them a higher risk of abusive or corrupt practices. Therefore, it would be preferable to specify in the model provision that the use of competitive selection procedures is a rule for the award of privately financed infrastructure projects and to reserve concession awards without competitive procedures only for exceptional cases.

#### *Model provision 19. Procedures for negotiation of a concession contract*

8. For the purpose of enhancing transparency, the provision could establish a minimum number of bidders with whom the contracting authority, where possible, should negotiate or from whom the contracting authority could solicit proposals (subpara. b)).

#### *Model provision 26. Record of selection and award proceedings*

9. The record of selection and award proceedings is necessary with the aim of ensuring transparency and accountability and to make it easier to exercise the right of bidders to ask for review of decisions made by the contracting authority.

10. Thus, it would be advisable to assert this right also if the laws of the enacting State do not adequately address these matters, for instance, by adding the words "if they exist" or similar wording with reference to the pertaining provisions of the enacting State.

#### *Model provision 30. Organization of the concessionaire*

11. As discussed in the *Legislative Guide*, it would be advisable for the model provision to refer to the legislative provisions or to require the consistency of regulatory requirements with international obligations assumed by the host country.

#### *Model provision 33. Easements*

12. Easements are usually not expeditiously or easily obtained by the concessionaire directly from the owners of the properties concerned; for that reason it is more frequent for the necessary easements to be compulsorily acquired by the contracting authority at the same time as the project site. It would be advisable therefore to use the words "the concessionaire shall be granted".

*Model provision 34. Financial arrangements*

13. This provision sets forth the concessionaire's right to charge and collect tariffs or fees, which are the main, if not the sole source of income for the concessionaire.

14. The concession contract shall provide for methods and formulas for the establishment and adjustment of those tariffs and fees; it is assumed that in drafting the concession contract the contracting authority takes into account parameters for pricing goods or services on the basis of principles of standards of fairness and equity. For these reasons, it would be advisable to eliminate the words contained in square brackets.

*Model provision 43. Duration and extension of the concession contract*

15. The Working Group has already examined the possibility for the contracting authority and the concessionaire to agree on the extension of the term of the concession in the concession contract. In that regard, the Working Group agreed to preserve the body of the text of the provision, suggesting the addition of a footnote. Notwithstanding the above, since in general terms it is not advisable to exclude entirely the option to negotiate the extension of the concession period, the footnote could be modified by replacing the words "compelling reasons of public interest" with the words "under certain specific circumstances (such as specified in the concession contract)".

*Model provision 44. Termination of the concession contract by the contracting authority*

16. In consideration of the serious consequences of its application, termination should be regarded as an extreme measure. The conditions for the exercise of this right by either party should therefore be limited, for instance, by maintaining the word "compelling" when reasons of public interest are invoked.

17. Also, it could be desirable for the model provision to imply the possibility of termination in the public interest only on condition that it has been already expressly mentioned in the draft concession contract circulated with the request for proposals.

18. Furthermore, since it is not appropriate to use the right of termination for reasons of public interest as a substitute for other contractual remedies in case of dissatisfaction with the concessionaire's performance, the model provisions could contain wording such as "if not otherwise specified in the concession contract".

19. With the aim of reducing the discretionary power of the contracting authority to terminate the contract unilaterally, the model provision could establish the need for a decision by a judicial or other dispute settlement body.

*Malaysia*

1. Malaysia notes that the objectives of the *UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects* is to provide model provisions with a view to:

(a) Establishing a favourable legislative framework to promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions on private sector participation in infrastructure development and operation;

(b) Developing general principles of transparency, economy and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects.

2. Based on these objectives, the model provisions include, among others:

(a) Provisions on authority to enter into concession contracts and rules governing the selection of the concessionaire;

(b) Procedure for pre-selection of bidders;

(c) Circumstances authorizing award of concession contracts without competitive procedures;

(d) Procedures for negotiation of a concession contract and content of the concession contract.

3. At the moment, Malaysia does not have any specific legislation that covers this process. An agency in the Prime Minister's Department is entrusted with the powers to oversee and implement matters relating to the privatization process and procedures. As regards regulatory regimes, specific laws have been enacted to regulate and enforce rules against concessionaires and privatized activities. For the purpose of the present comments, reference is made to the model provisions and the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*.

*Provisions on authority to enter into concession contracts*

4. The draft model legislative provisions propose that the enacting State list the relevant public authorities that may enter into concession contracts. It is also recommended that the law identify the public authority that is empowered to award concessions and enter into agreements for the implementation of privately financed infrastructure projects.

5. Malaysia finds that this proposal is highly regulatory and may be too restrictive. A public authority need not be a party in all concession contracts, but there can be instances where a public authority may need to be a party for purposes of ensuring effective implementation of a concession contract. In cases where domestic law has been enacted to legislate the specific functions of the public authority, such law will be sufficient to confer on the public authority the necessary powers to regulate and control the privatized entity and its activities. It is therefore not necessary to list the relevant public authorities that may enter into a concession contract.

*Rules governing the selection of the concessionaire*

6. The draft model legislative provisions propose that the selection of the concessionaire be conducted through transparent and efficient procedures. This proposal augurs well and can be considered subject to the State's policies and practices. Malaysia notes that in some countries the authorities encourage a limit on the number of prospective bids to ensure meaningful competition (for example, three or four). Also, some countries practise a rating system on prospective bidders in order to maintain quality. Such practices can promote transparency and efficiency.

*Circumstances authorizing award of concession contracts without competitive procedures*

7. Where the project involves national defence or national interests and where there is only one source capable of providing the required service, the model provisions recommend that approval from a higher authority be obtained. Malaysia finds that this recommendation is useful in the practical sense and can be given due consideration.

8. Malaysia is also of the view that when such a contract is offered to a foreign bidder, special provisions on secrecy and confidentiality must be formulated. To some extent a degree of flexibility should be offered in order to meet the changed conditions, including expansion of the service to meet additional demand.

*Procedures for negotiation of a concession contract*

9. The draft model legislative provisions propose that a notice of intention to commence negotiation of a concession contract be made, that the authority identify as many capable persons as it can and that evaluation criteria be established. That proposal can only be effective if an independent and efficient committee is established to oversee all these criteria. Proposals should be presented before this committee, whereby the formulation of the criteria and the evaluation of the proposal can be carefully studied.

10. Malaysia observes that even though the recommendations are commendable, in practice they may hinder the expeditiousness of the process. Codifying the procedures for negotiation would entail the whole process becoming rigid and cumbersome. This may not be conducive to a good business environment.

*Content of the concession contract*

11. The draft model legislative provisions set forth recommendations on the content of the concession contract that include, inter alia, the nature and scope of work, the extent of exclusivity, the concessionaire's obligations, remedies available and termination.

12. Malaysia notes that all the recommendations are useful and have been put into practice.

13. However, Malaysia observes that model provision 40 stipulates that concessionaires are entitled to a revision of

the concession contract in the event of changes in economic or financial conditions or changes in legislation. Malaysia is of the view that this provision would burden the contracting State. No compensation should be given to concessionaires in the event of a change in economic or financial conditions, as these circumstances are part of the commercial risks that the concessionaires have to take. Similarly, no compensation should be given to concessionaires in the event of changes in legislation, as this would restrict the Government's decision-making process.

14. Malaysia also observes that model provision 44, subparagraph (a), dealing with termination of the concession contract, stipulates that the contract may be terminated if it is reasonably expected that the concessionaire is no longer able or willing to fulfil its obligations. Although the test for reasonableness appears to be an objective test, it is very much a question of facts and can be disputed. Insolvency, serious breach or otherwise are given as instances when a party is unable or unwilling to perform its obligations. The word "serious" breach is often the bone of contention and for the purpose of avoidance of doubt it is suggested that the contract should identify and specify which provisions are material in the breach and would lead to termination. Likewise the words "or otherwise" are vague and open-ended.

15. Model provision 49, dealing with dispute settlement, would be clearer if it included options for the settlement of disputes so that the enacting State could then consider which mode to adopt in its legislation.

*Whether the model provisions and the Guide are two related but independent texts or whether they both should be combined as a single text*

16. Although the *Guide* was a useful reference for States wishing to establish a legal framework favourable to private investment in public infrastructure, it was thought that a more concrete guide in the form of model legislative provisions or a model law dealing with specific issues would be desirable. To that end, the model provisions were drafted. Malaysia further notes that the *Guide* complements the model provisions well. The model provisions are not exhaustive and only provide for the core provisions. Perhaps this is intended to be so, as it would give parties flexibility and more room to manoeuvre. Malaysia is of the view that the model provisions and the *Guide* should be read together as a single text.

17. Both documents would provide a more complete and comprehensive text. However, this issue is only secondary, as the primary issue is still whether it is necessary to have these provisions enacted as legislation. Transparency, fairness and accountability can still be achieved by having a guideline or manual.

## Turkey

Turkey is of the view that in order to ensure best use of the draft UNCITRAL model legislative provisions on privately financed infrastructure projects for those States willing to make use of them, the letter and spirit of the provisions should be duly interpreted taking into account the legislative recommendations contained in the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. Furthermore, Turkey believes that the draft model provisions and the legislative recommendations should be combined in a single text containing all model legislative provisions and those legislative recommendations on which no model provision has been drafted, in order to produce a comprehensive compilation of all the relevant texts for ease of use.

### B. Intergovernmental organizations

#### *Asian Development Bank*

1. The draft model provisions are the outgrowth of UNCITRAL's earlier work in this area on the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, which was published in 2001. Though UNCITRAL has worked through a large panel of experts on the draft model provisions, representing very significant amounts of work, this is the first time the draft model provisions have been made available for comment. The cover letter from the secretariat requests "specific comments ... on the individual provisions so as to facilitate the preparation of the analytical commentary that will be submitted to the Commission". Given the short time available to the Asian Development Bank to comment on such a significant piece of legislative architecture, the Bank is not in a position to make an exhaustive review, but would like to make the following observations.

#### *Concessions*

2. As the introduction to the draft model provisions makes clear, the UNCITRAL Working Group began by working on a specific phase of infrastructure projects, namely, the selection of the concessionaire. However, it expanded its mandate to other important areas, namely, construction and operation, termination and dispute resolution.

#### *Comments on specific provisions*

*Model provision 18. Circumstances authorizing award without competitive procedures*

##### *Subparagraph (a)*

3. This provision would be highly desirable to facilitate the rapid installation of urgently needed infrastructure that has been long neglected. For example, a country that ignores power generation for many years might need to rapidly install a large number of small power plants for peaking purposes by means of the abbreviated procedure described here, while it requires larger plants to be awarded by means of the competitive bidding described earlier in the draft model provisions.

#### *Unsolicited proposals*

4. These provisions generally provide much-needed guidance to legislatures that want to establish some basic rules for this controversial area.

*Model provision 23. Unsolicited proposals involving intellectual property, trade secrets or other exclusive rights*

5. This provision specifies that the contracting authority may publish a description of the essential elements of an unsolicited proposal in order to solicit other proposals for the project. Paragraph 4 concludes that, in the event many proposals are then made, the contracting authority shall then request the proposals to undergo the full competitive bidding process of draft model provisions 10-17.

6. A proponent would be unlikely to go through the effort and cost implied by draft model provision 21, paragraph 2, if it might lose the project to other proponents precisely because of its hard work in preparing a feasibility study. This will be contrary to the most often cited reason for setting up a process for accepting unsolicited proposals in the first place, namely, that speed might be needed for a particular type of project (for example, small water-treatment or sewerage projects). The Asian Development Bank recommends that the Working Group consider specifying that only unsolicited proposals of below a certain size may be considered, perhaps measured by a total project cost figure. The contracting authority or another agency would periodically set that figure. The contracting authority would then conduct abbreviated cost and value comparisons to verify the merit of the proposal, followed by appropriate public hearings as required by law.

*Model provision 45. Termination of the concession contract by the concessionaire*

7. A number of concessionaires have recently pulled out of projects as a result of their own difficulties or change in business orientation. Model provision 45 would prohibit the concessionaire from terminating the contract in such circumstances, which is highly desirable. In some cases, the contracting authorities have been left with no readily available alternate concessionaire and, despite reasonable planning, face a very desperate situation with respect to the infrastructure that the project was intended to supply. The Asian Development Bank recommends that the Working Group consider an additional subparagraph (d) along these lines:

"(d) The concession contract shall specify damages payable by a concessionaire to the contracting authority in the event the concessionaire terminates the concession under other circumstances, including but not limited to the concessionaire's own financial difficulty, change in business orientation or the uneconomical nature of the project."

8. Please note the typographical error in footnote 14.

### *European Bank for Reconstruction and Development*

1. The European Bank for Reconstruction and Development would like to congratulate the Working Group for developing model legislative provisions that address in a constructive way many of the issues fundamental to facilitating the financing of infrastructure concessions. In particular, the Bank is especially pleased to see the clarity and transparency of the process developed for selecting concessionaires. In addition and consistent with its approach of encouraging flexibility with respect to the terms of concession agreements, the Bank is pleased to see an approach that is not over-prescriptive in defining what must be contained in a concession agreement and that further permits, as the parties may agree, the application of foreign law and arbitration.

2. The European Bank for Reconstruction and Development further commends the Working Group for explicitly including a section regarding the grant of security to lenders and a mechanism that would permit, subject to the consent of the contracting authority, the substitution of a concessionaire.

3. However, in this regard, there are three areas of the draft model legislative provisions where greater clarity might be offered.

4. Firstly, as noted above, model provision 42 indicates that a contracting authority may agree with lenders to the concessionaire on the substitution of a new entity upon breach by a concessionaire. It is not entirely clear from this wording whether such agreement may be put in place in advance, such as through a direct agreement. Further, it may not seem entirely clear from the model legislative provisions whether a contracting authority may enter into a more general direct agreement with lenders to, for example, acknowledge the grant of security or provide for other provisions that may be important to secure financing for such concession.

5. Secondly, and related to the previous point, it is noted that model provision 36 generally suggests that the assignment or pledge of the concession agreement is not permissible without the consent of the contracting authority. While many of the concerns of lenders in having security over the concession agreement might be adequately addressed through the proposed possibility of substitution rights mentioned above, there may be rights of the concessionaire under a concession agreement with respect to which lenders will want a first ranking security interest, such as, for example, termination of payments, if any. It also generally facilitates financing for lenders to be able to confirm that they have security over the main asset in concession financing, that is, the concession agreement, even if such security is subject to the rights of the contracting authority under such concession agreement. Accordingly, it is suggested that concessionaires should be permitted to assign their rights in a concession agreement as security for loans from financiers, but also to terminate the concession agreement if, by virtue of any such foreclosure, a substitute entity did not meet the criteria agreed with the contracting authority.

6. Thirdly, it is noted that the shareholders of the concessionaire are permitted under model provision 35 to pledge their interests in the shares of the concessionaire. However, it is not entirely clear how the permission of such security interplays with model provision 37, which prohibits changes in control.

7. Finally, it is gratifying to note that the Office of the General Counsel of the European Bank for Reconstruction and Development now formally refers to the *UNCITRAL Legislative Guide* as a benchmark of best internationally accepted standards. This will be the case for assessments of concession laws throughout 27 countries of the Bank's operations and also in developing a concession-related page on the Bank's web site.

### *International Finance Corporation*

1. The proposed draft addendum to the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* is an important piece of work for member countries of the International Finance Corporation. The Corporation is pleased to have been given an opportunity to comment upon it. Given the time constraints, a brief review has been made of the legislative recommendations only and the following comments are based on the experience of the Corporation.

#### *Foreword*

#### *Other laws affecting private infrastructure projects and judicial systems*

2. The last paragraph should also refer to tax, banking, foreign exchange and bankruptcy laws and regulations as being areas that are not addressed by the *Guide* but have an impact on privately financed infrastructure projects. The accompanying commentary should encourage Governments to authorize regulators to implement practical and straightforward regulations and procedures to implement the law. For example, the system for converting and repatriating foreign exchange must be simple and fast. The last paragraph of the *Guide* should also state that the experience, transparency and predictability of court systems are also essential. Finally, the paragraph should encourage Governments to reconcile inconsistencies with other conflicting laws and regulations. For example, does the concession law of a country supersede the tax laws or laws relating to government contracts?

#### *Specific provisions*

#### *Foreign bidders*

3. The *Guide*, model provision 7, provides that there may be instances in which domestic bidders are preferred and that is acceptable as long as the requests for proposals clearly so provide. The International Finance Corporation supports the accompanying commentary, which describes the issues surrounding these types of preferences and how to provide alternatives to foreign bidding.

#### *Parliamentary approval*

4. Although the *Guide* does not appear to address parliamentary approvals, perhaps the provisions relating to the



authority of the contracting authority should specify the scope (ideally limited) of the issues that would require parliamentary approval.

*Governing law and dispute resolution/immunities/language*

5. Model provision 29 provides that the concession contract is governed by the law of the State unless otherwise provided in the concession contract. Although this leaves some flexibility to provide for foreign governing law, many countries have laws that prohibit or restrict foreign governing law or, as a practical matter, object to foreign governing law. This can have an impact on the mobilization of foreign investors and lenders, in particular coupled with the comments on dispute resolution in the next sentence. The commentary should encourage Governments to ensure that their law permits foreign governing law, even in contracts involving a governmental entity.

6. Model provision 49 provides that the parties may specify the dispute settlement mechanisms in the concession contract. This would presumably mean that they can specify international arbitration rules or foreign courts. However, many countries are neither party to treaties with multiple other countries for the enforcement of foreign judgements, nor are they party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The commentary should urge Governments to consent to international arbitration and to adopt or become parties to the relevant treaties.

7. It is also important for the Government to have laws permitting it to waive its immunities with respect to these dispute resolution procedures and the relevant awards or judgements. Some countries' laws prohibit or restrict such waivers of immunity. This might be covered in the commentary.

8. The *Guide* should expressly provide that the language of the concession contract may be English.

*Ownership and assignment of assets and security*

9. Model provisions 31 and 35 address ownership of assets and the security that may be taken over such assets, and state that security over public assets may not be taken where the creation of security is prohibited by law. Governments should re-examine the rationale of and reconsider broad prohibitions of this type, and try to narrow such prohibitions or provide flexibility to the contracting authority to deviate from those prohibitions.

*Compensation for specific changes in legislation and changes in economic circumstances*

10. Model provisions 39 and 40 provide that the concessionaire may be entitled to compensation in the event the cost of performance "has substantially increased" or the value it receives is "substantially diminished" as a result of a change in law or broader economic situations. This language is broad and vague and could lead to disputes in the future.

*Temporary takeover of project*

11. Model provision 41 provides that there may be circumstances in which the contracting authority may temporarily take over the operation of the project. The International Finance Corporation has found that there are sometimes provisions in concession contracts permitting the contracting authority (usually governmental) to take over the assets permanently and to step into the shoes of the concessionaire with respect to the financing documents. This can be a problem for institutions like the Corporation. Ideally, the recommendations would encourage only temporary takeovers and flexibility in insisting on being entitled to take over the financing agreements, perhaps subject to lenders' consent.

*Equilibrium clause*

12. Model provision 45 states that the concessionaire may not terminate the concession contract except under narrow circumstances, as opposed to saying that the concessionaire may terminate in certain circumstances. This is unusually restrictive and the opposite of the spirit of a concessionaire entering into the project. In any event, the concession contract should ideally also permit the concessionaire to terminate for extended force majeure or at least governmental force majeure and for a change in law that invalidates the contract.

*General comments*

*Concessions only*

13. The *Guide* could usefully cover structures other than concession-based infrastructure contracts. For example, many of the provisions and principles apply to the awarding of independent power projects to private companies, but without a concession.

*Negotiating teams*

14. Perhaps as important as addressing the recommended legislative provisions, countries should address the practical impediments to doing business in their countries. As an example, although the authority of contracting authorities is addressed, countries should be urged to have teams within their ministries authorized and empowered to negotiate and agree to provisions in the concession contracts. It often happens that ministers themselves insist on being involved in negotiations and decisions, which can significantly delay implementation of projects. Although this is not something that can be added per se to the law or regulations, it is important.

*International transaction counsel*

15. Governments are urged to seek advice from experienced international transaction counsel to represent their interests in these transactions. Technical assistance funding may be available from various multilateral institutions to finance such advice.

## A/CN.9/533/Add.2

## Compilation of comments by Governments and international organizations

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## II. COMPILATION OF COMMENTS

## A. States

## 1. Spain

*[Original: Spanish]*

1. The Secretary-General invited the Government of Spain to comment on the model legislative provisions on privately financed infrastructure projects. The delegation of Spain would like to make the following comments.

(a) *Model provision 18.* In paragraph (d), the words “secretos comerciales”, the equivalent of which appears in the English version as “trade secrets”, are omitted. Moreover, the words “u otro derecho exclusivo” should be in plural as in the English version (“or other exclusive rights”);

(b) *Model provision 36.* The title of the provision contains the word “traspaso”. On 13 September 2002, however, the delegation of Colombia made the unopposed suggestion that “traspaso” be replaced by “cesión”;

(c) *Model provision 42.* The word “inicial” should be deleted as its equivalent does not appear in the English version;

(d) *Chapter IV, section 2, of the model provisions.* The title of section 2 is currently “Rescisión del proyecto de acuerdo” but should be “Rescisión del contrato de concesión”.

2. The Secretary-General also invited the Government of Spain to comment on the various alternatives for coordinating and presenting the recommendations and text of the model legislative provisions.

3. According to paragraph 2 of document A/CN.9/522/Add.1, three options are available to the Commission. The delegation of Spain is in favour of the first option mentioned in the document, namely to retain both the recommendations and the model provisions as separate but connected texts. The delegation of Spain considers that the connection between the two could be made by including a preamble or preface explaining the legislative procedure adopted and the relationship between the model provisions and the recommendations. A connection could also be made by retaining the references to the recommendations and corresponding paragraphs in the *Guide* as they currently exist in brackets in each of the model provisions, or by including a concordance table of model legislative provisions and legislative recommendations, as in document A/CN.9/522/Add.2.

4. In the opinion of the delegation of Spain, a different solution should be found if it is decided to transform the model provisions into a model law, in which case the second and third options mentioned in paragraph 2 of document A/CN.9/522/Add.1 might, we feel, be preferable. If the second option of replacing the legislative recommendations in their entirety with the model legislative provisions is chosen, we believe that the content and terminology used in the *Legislative Guide* should be brought into line with the Model Law.

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## I. INTRODUCTION

The present note reproduces comments on the draft addendum to the *United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Privately Financed Infrastructure Projects*<sup>1</sup> received subsequently to the comments reproduced in documents A/CN.9/533 and Add.1 and 2.

## II. COMPILATION OF COMMENTS

### International organizations

#### *European Lawyers' Union*

[Original: English]

It was suggested at the fifth session of the Working Group on Privately Financed Infrastructure Projects that the then draft model provision 41 (now renumbered 42) should be amended in order to provide that the concessionaire should be a party to the agreement that set forth the terms and conditions of the concessionaire's substitution (see A/CN.9/521, para. 202).

The Working Group did not agree with that suggestion, as it felt that it departed from the policy embodied in the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*.

It is, however, pointed out that the suggestion to make the concessionaire a party to the agreement effecting substitution, either through a tripartite agreement between the contracting authority, the lenders and the concessionaire, or through two sets of agreements, one between the authority and the concessionaire and the other between the authority and the lenders, does not depart from the policy set out in the *UNCITRAL Legislative Guide*, which provides at chapter IV, paragraph 148, that "Clauses allowing the lenders to select ... a new concessionaire ... have been included in a number of recent agreements for large infrastructure projects. Such clauses are typically supplemented by a direct agreement between the contracting authority and the lenders ..."

Being included in the concession/project agreement, such clauses providing for the substitution have therefore been agreed by the concessionaires. This is precisely the essence of the suggestion made by the European Lawyers' Union. Indeed it would be misleading to suggest to Member States and national authorities a model legislative provision, whereby a substitution mechanism can be put in place solely by agreement between the contracting authority and the lenders, while the underlying notes and recommendations do not lead to such a conclusion.

In this respect, a distinction must be made between, on the one hand, agreeing the principle of the right of substitution, and on the other hand, setting out the mechanics of effecting the substitution. It would perhaps also assist in understanding the suggestion of the European Lawyers'

Union, if background information were provided about one of the large infrastructure projects referred to in the notes, which, to our knowledge, was the first to implement a substitution mechanism for the benefit of its lenders. This is the project for the construction and operation of a fixed link across the English Channel between the United Kingdom of Great Britain and Northern Ireland and France, which was the subject of a concession agreement, dated 14 March 1986, entered into between the two States and Eurotunnel, a partnership between a French company, France Manche S.A., and an English company, the Channel Tunnel Group Ltd.

#### *The principle of substitution*

Under article 32 of this concession agreement (to which the lenders are not a party), upon the occurrence of specified events, new concessionaires shall at the option of the lenders be substituted for the initial concessionaires. The Governments then have two months to ascertain the candidates' financial and technical capability required in order to complete the project and at the end of such period the approval of the Governments is presumed to be granted.

As will be explained, the adoption of such a mechanism was totally circumstantial, that is, the result of the specific characteristics of that project; a project between the territories of two independent States, therefore subject to two different legal systems, with the need to devise a security package—without which no financing could be raised—which reconciled as far as possible the differences between those two systems.

In the French legal system, where there is a long established and commonly used body of administrative law governing the type of contract chosen for the Channel Tunnel project, known as a public service concession, it is not possible for the concessionaire to create security over the concession agreement (including the land and fixed assets thereon), whereas under English law a concession agreement and the rights arising therefrom can be the subject of formal security. In particular, through the concept of a floating charge, under which all assets present and future can be the subject of security, together with the possibility of appointing a receiver, it is possible upon the occurrence of an event of default, to manage the business and complete the project.

Because of the obvious limited value of enforcing security over only half of the infrastructure (the part subject to English law) it was essential to devise a system whereby the benefit of the concession agreement, as well as the land, fixed assets, moveable property, intellectual property rights, etc., could be transferred to the lenders in order to ensure completion and continuity of the project. The solution was found in setting up this mechanism by contract.

A provision was therefore made in the concession agreement for this transfer to occur in certain circumstances. The concessionaire therefore agreed for this mechanism to take place, in certain circumstances, but this agreement had to be embodied in the law, in France be-

<sup>1</sup>United Nations publication, Sales No. E.01.V.4.

cause it was contrary to the existing bankruptcy law, and obviously a contract would not supersede the law, and in England, because it was necessary to empower the contracting authority to effect the substitution.

#### *The mechanics of effecting substitution*

The position again varies according to English law or French law. In England the substitution is effected by agreement between the Governments and the lenders, rather than by agreement between the concessionaires and the lenders, as well as pursuant to powers specifically granted to the contracting authority to that effect. The lenders are not a party to the concession agreement and are therefore not entitled, as a matter of English law, to enforce any provision contained in that agreement, such as the one granting them an option to request for substitution. The right of the lenders arises under an agreement entered into directly with the Governments, which entitles them to seek the exercise of their right of substitution directly against the Governments without the need to proceed through the concessionaires.

In France, the substitution is effected by operation of the law rather than by agreement. It is akin to the exercise by the State of a right not known in private contracts, namely, the exercise of prerogatives derived from the contracting authority of the State. In this context, it is essential that no agreement takes place between the lenders and the concessionaires concerning the exercise of the right of substitution, in order to maintain substitution as a mechanism derived from public law. Indeed, entering into such an agreement would undermine the very foundations of the legal analysis under which it is maintained that substitution remains legally valid despite the occurrence of an event of default by the concessionaire. Further it would also attract heavy tax consequences applicable to the vesting of assets to the lenders.

#### *Conclusion*

The substitution mechanism put in place for the Channel Tunnel project was very much the result of specific circumstances and, particularly, the need to alleviate some rigidity of the French law on security. It would not have been legally necessary, had the project been carried out solely in England, although (had this been the case) it did provide more flexibility than the existing English law. This is the reason why it has become a standard feature in Private Finance Initiative and Public Private Partnership investments in the last 10 years in the United Kingdom. In the standard Private Finance Initiative contract guidelines, the substitution mechanism is implemented through a tripartite agreement between the contracting authority, the lenders and the concessionaire or project company.

To suggest that a right of substitution could be established without the agreement of the project company would be a mistake. If the implementation of such a right remains at the option of the lenders, under a direct agreement with the contracting authority, the very existence of this right must be agreed by the concessionaire.

To suggest that it does not, but, as the current text of draft model provision 42 indicates, can be agreed solely between the contracting authority and the lenders, which means that one's rights under a contract can be taken away without one's consent, would hurt a fundamental principle of contract law in most jurisdictions, which would trigger far-reaching consequences in the legislation of the said jurisdictions.

Finally and more importantly, it would defeat the whole purpose of the Commission's objective, namely the promotion of private investment in public infrastructure, as it would inevitably dissuade any investor from committing funding into a project if they can be deprived of their rights without their consent.

**A/CN.9/533/Add.4**

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## II. COMPILATION OF COMMENTS

### A. States

#### 1. Mexico

[Original: Spanish]

##### *General comments*

1. With reference to the model provisions and the legislative recommendations contained in the *Legislative Guide*, we would like to comment on whether (a) to retain the model provisions and legislative recommendations as two parallel texts; (b) to replace the legislative recommendations in their entirety with the model legislative provisions; or (c) to replace only those legislative recommendations in respect of which the Commission adopted model legislative provisions.

2. We think that the first option would create confusion and unnecessary repetitions, while the second option would exclude legislative recommendations in respect of which no model provision has been drafted. Therefore, the third option is the most acceptable.

3. It should be remembered that the success of any UNCITRAL document depends to a large extent on the “users” of the document. The *Legislative Guide* adopted in 2000 would be enriched by the model legislative provisions, which are easier to implement than the legislative recommendations that the *Legislative Guide* originally contained.

##### *Specific comments*

4. Model provision 13 should specify that there is no need for the contracting authority to inform the partici-

pants who the other bidders are. (This is not stated in model provision 24 either.) In cases where the identities of the bidders are known, it is easier to prepare a technical and commercial bid. It is also not specified whether clarifications and modifications necessarily go together or whether they must be made in writing with a reference to the person who made the request. There is no provision stating whether bidders must refrain from contacting the authority orally or in writing during the evaluation process.

5. Model provision 16 states that “the contracting authority may require any bidder that has been pre-selected to demonstrate again its qualifications ...”. We think it is necessary to clarify whether this also applies to consortia, or whether it is sufficient for one member of a consortium to have the required qualifications.

6. With regard to model provision 17, when a contractual term has been “clarified”, it may have been modified; this should be noted in the final contract, without the need to use the “format” that the authority usually uses for other transactions. Sometimes the authority may argue that the “authorized format” does not allow it to take the clarification into account in the selection procedure; however, the clarification should be reflected somewhere so that it is binding on both parties.

7. In model provision 17, paragraph 2, there is a risk that any term “imposed” by the authority could lead to termination of the negotiations, which would allow the authority to conduct negotiations in “bad faith”. For example, agreement may not be reached on a term which is regarded as “fundamental” for the concessionaire but which is of little relevance to the authority. This raises the question of what would happen if the authority did not obtain the required authorizations in time and this caused the start of the work to be delayed; and who, in that case, would have to absorb the financial cost.

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## II. COMPILATION OF COMMENTS

### A. States

#### 1. Belarus

[Original: Russian]

1. On the basis of their consideration of the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, the relevant State authorities have formulated the following comments.

2. The characteristics of investment activity carried out on the basis of concessions in the Republic of Belarus are governed by the Investment Code of the Republic of Belarus (hereinafter referred to as “the Code”). Article 49 of the Code establishes that investment activity relating to the subsoil, bodies of water, forests, land and assets that are wholly owned by the State and activities over which the State enjoys exclusive rights may be carried out on the basis of concessions.

3. In the law of the Republic of Belarus, a concession is deemed, under article 50 of the Code, to constitute a contract concluded by Belarus with an investor on the transfer, for a consideration and for a specified period of time, of the right to engage, within the territory of Belarus, in a particular activity over which the State enjoys exclusive rights, or of the right to use property owned by the Republic of Belarus.

4. The recommendations put forward by UNCITRAL are to a large extent reflected in the legislation in force in Belarus.

5. For example, recommendation 2 is reflected in article 52 of the Code, which establishes that one of the parties to a concession contract shall be the Government of the Republic of Belarus or a national State administrative authority authorized by it (the concession authority).

6. Recommendations 4 and 5 are reflected in article 51 of the Code. Recommendations 10 and 11 are covered by existing economic procedural law, under which national economic courts resolve disputes of an economic nature, including those involving foreign persons. In such cases, the rights and obligations of foreign persons are equal to those of national persons.

7. Recommendation 13 is covered by articles 14 and 15 of the Code, which deals with State support for investment activity in the form of tax and customs duty exemptions, Government guarantees, centralized investment resources and supplementary guarantees for investors.

8. Article 52, subparagraph 2, of the Code corresponds to section II of the draft model legislative provisions for privately financed infrastructure projects (model provision 3, “Authority to enter into concession contracts”).

9. Model provision 4, “Eligible infrastructure sectors” is covered by article 53 of the Code.

10. Section II (Selection of the concessionaire), model provision 5, “Rules governing the selection proceedings”, and part 1 (Pre-selection of bidders), model provision 6, “Purpose and procedure of pre-selection”, correspond to chapter 12 of the Code.

11. Model provision 7, “Pre-selection criteria” is covered by article 63 of the Code, which relates to applications to participate in tenders or auctions. Model provision 8, “Participation of consortia” corresponds to paragraph 3 of the same article.

12. Model provision 9, “Decision on pre-selection” and the section on the procedure for requesting proposals are not adequately covered by existing Belarusian law.

13. Article 59, paragraph 4, of the Code, provides that the negotiation of concession contracts without competitive procedures is possible in only two sets of circumstances: in the event that only one application is received, or by a decision of the President of Belarus when, for the purposes of State security or defence, the concession contract has to be concluded through direct negotiations with a particular investor. Therefore, model provision 18 does not correspond to Belarusian law.

14. Belarusian law does not provide for unsolicited proposals; there is no need for such a provision, since a concession contract may be concluded only on the basis of a tender or auction, with the exception of those cases provided for in article 59, fourth paragraph, of the Code.

15. Model provision 24, “Confidentiality of negotiations” corresponds to article 63, fourth paragraph, of the Code, which establishes that information received about the participants in a tender or auction shall constitute a commercial secret.

16. Model provision 25, “Notice of contract award” corresponds to article 64, second paragraph, of the Code. Model provision 27, “Review procedures” corresponds to article 65.

17. With regard to model provision 28, “Contents of the concession contract”, we would like to point out that articles 67-70 of the Code set out terms for inclusion in a concession contract that are not fully consistent with the model provisions.

18. We agree with the content of model provision 29, “Governing law”, which establishes that the concession contract is governed by the law of the host State unless otherwise provided in the concession contract. It should be borne in mind that, under economic procedural law, disputes about immovable property or about violations of the rights of the owner or other lawful proprietor that do not involve dispossession fall within the sole jurisdiction of the place where the property is located. Article 130 of the Civil Code of the Republic of Belarus states that immovable property covers land, subsoil, isolated bodies of water and everything that is closely connected with land, including forests, buildings and installations.

19. The requirements set out in model provision 30 do not exist in Belarusian law. It seems appropriate to use the recommendations reflected in that model provision when we complete work on our legislation.

20. The content of model provision 31, "Ownership of assets" corresponds to the special terms for inclusion in a concession contract. Model provision 34, "Financial arrangements" is also reflected in the special terms.

21. With regard to model provision 32, "Acquisition of rights related to the project site", article 12 of the Land Code of the Republic of Belarus states that ownership of land may be transferred to legal persons in the Republic of Belarus, including businesses with foreign investment, when property owned by the State is privatized. Ownership of land may also be transferred to legal persons in the Republic of Belarus when investment projects are implemented. In such cases, the concession contract has a time limit; it is therefore envisaged that, when land is made available for use, land leases may be drawn up with the time limits of a concession contract.

22. With regard to model provision 33, article 3 of the Land Code of the Republic of Belarus establishes that a landowner is entitled to require the owner of neighbouring land or, where necessary, the owner of other land to grant him or her the right to restricted use of the neighbouring land (easement). Easement is established for the purpose of transit through neighbouring or, where necessary, other land, for the construction and use of electricity transmission lines, communication lines and pipelines, for ensuring water supplies and carrying out land improvement, and to meet other needs. The owner of land that is subject to an easement is entitled, unless otherwise provided by law, to require proportionate payment for use of the land from persons to whom an easement is granted.

23. The assignment of a concession contract, covered by model provisions 36 and 37, is not provided for in Belarusian law.

24. The content of model provision 39, "Compensation for specific changes in legislation" is reflected in article 76 of the Investment Code, which establishes that the terms of a concession contract shall remain in force for the entire duration of the contract.

25. With regard to section IV, "Duration, extension and termination of the concession contract", we would like to point out that article 72 of the Investment Code establishes that a concession contract may be concluded for a period of up to 99 years. Upon expiration of the contract, a concessionaire who has fulfilled the principal terms of the contract in good faith shall enjoy a priority right to renew the contract. Moreover, the President of Belarus or, on the President's instructions, the Government of Belarus may, at the request of the concessionaire, decide to extend the contract for the same period without holding a tender or auction. A concessionaire shall submit a written application for the extension of a contract to the concession authority not later than one year prior to the expiration of the concession contract. Belarusian law does not govern these legal relationships in greater detail.

26. It is envisaged that the model provisions in this section could be used to improve national legislation.

27. Section V, "Settlement of disputes" does not contradict Belarusian law. However, with regard to model provision 50, which states that the contracting authority may require the concessionaire to establish simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility, it should be noted that Belarusian law does not establish such powers for a party to a concession contract. The rights and legal interests of the user are protected in accordance with the procedure established in Belarusian law.

**A/CN.9/533/Add.6**

## **Compilation of comments by Governments and international organizations**

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## II. COMPILATION OF COMMENTS

### A. States

#### 1. *United States of America*

[Original: English]

1. Set forth below are the comments of the Committee on Project Finance of the Bar Association of the City of New York on the Draft Addendum to the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. This report has been approved by the Bar Association of the City of New York.

#### *Introductory comment*

2. The stated purpose of the *Legislative Guide* is “to assist in the establishment of a legal framework favourable to private investment in public infrastructure” (Introduction, paragraph 4). We have purposely highlighted the word favourable to emphasize that as originally envisioned the *Legislative Guide* was to recommend, in a balanced manner, legal frameworks which would attract foreign private capital to developing countries.

3. In general, the desired balance is maintained in the Draft Addendum but in some places it seems to us that the specific language has moved away from the goal of making affirmative recommendations for the attraction of foreign private capital toward a recitation of options, or of measures that the host government may or may not wish to adopt, as if it were a matter of free choice. In some respects discussed below, the affirmative recommendations contained in the *Legislative Guide* which we believe are favourable to the attraction of foreign capital have been softened, and certain other provisions have been added which we believe are unfavourable to that goal.

4. Our comments in Part I of this memorandum will be directed to those provisions of the Draft Addendum to the *Legislative Guide* which concern “Construction and Operation of Infrastructure”, which is Part III of the Draft Addendum. These are where the principal provisions of the *Legislative Guide* concerning financing are located. However, we note that Model Provision 1, Preamble, mentions the attraction of foreign private capital only in the context of transparency, fairness, sustainability and the elimination of “undesirable” restrictions on foreign private investment. We believe that Model Provision 1 would be improved if the first “WHEREAS” clause were more in line with the second sentence of the “Foreword” and paragraph 4 of the Introduction to the *Legislative Guide*, and accordingly recommend that the first “WHEREAS” clause be expanded to read as follows:

“WHEREAS, the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to establish a legislative framework favourable to private investment in public infrastructure; and

WHEREAS, the [Government] [Parliament] of \_\_\_\_\_ considers it desirable to promote and facilitate the implementation of privately financed infra-

structure projects by enhancing transparency, fairness and long-term sustainability and removing undesirable restrictions in private sector participation in infrastructure investment, development and operation;”

5. Our comments in Part II of this memorandum are directed to those provisions of the Draft Addendum to the *Legislative Guide* which concern “Selection of the concessionaire”, which is Part II of the Draft Addendum.

6. In response to the inquiry of the secretariat in its cover note, we would favour retaining the text of the Addendum as a separate document, because of our concern that a combination of the two may result in a less coherent and expansive survey of the field for host governments and their advisors than is contained in the initial *Legislative Guide*. Much substance could be lost in combining the two documents. In any event, the proposed combined document may take some time to prepare and adequate time for review and comment should be allowed.

#### *Comments on Draft Model Legislative Provisions*

*References are to the Model Provision numbers contained in the Draft Addendum.*

#### *Part I*

7. Model Provision 28, Contents of the concession contract. This provision would benefit by including some reference to each of the model provisions which concern the contents of the concession contract. Otherwise some model provisions of significance may appear to be subordinated.

8. Model Provision 34, Financial arrangements, omits some useful portions of Legislative Recommendations 47 and 48 which, in our view, should be restored. Legislative Recommendations 46, 47 and 48 called for the concessionaire to be able to collect tariff or user fees (46), for the law to set forth mechanisms for periodic and extraordinary adjustments to such tariffs or fees (47) and for the contracting authority to be empowered to make direct payments to the concessionaire as a substitute for, or addition to, service charges paid by end users (48). Of these three only 46 is preserved. But 47 and 48 are of considerable commercial importance and should be retained.

9. Related footnote 40 drifts off into a discussion of how some countries handle issues relating to tariff-controls. However, the text fails to suggest what would be best for the attraction of private foreign capital. We recommend dropping this footnote.

10. Model Provision 35, Security interests, appears to dilute the affirmative recommendations contained in Legislative Recommendation 49 in important respects, including whether or not the concessionaire should have the right to create security over the project assets which it owns, project company shares, and receivables, notwithstanding any law to the contrary, by stating that restrictions may appropriately be included in the project agreement (see footnote 41). This problem could be cured by dropping the “subject to” clause and footnote 41.



11. Model Provisions 39 and 40, Compensation for specific changes in legislation and revisions of the concession contract, appear to be softened from Legislative Recommendation 58, in that Model Provision 39 limits the circumstances under which the concessionaire is entitled to compensation for changes in law to laws of specific application to the infrastructure facility and no longer refers to the possibility of a change in compensation due to changes in economic or financial conditions. We favour the language of Legislative Recommendation 58 in this area because it leaves more flexibility for negotiations between the parties.

12. Model Provision 42, Substitution of concessionaire, is less helpful than Legislative Recommendation 50 in that in this draft the contracting authority “may”, rather than “should”, agree with financing parties on standards for substitution of the concessionaire. This is an important issue for lenders to these projects. We favour the restoration of the prior language.

13. Model Provision 45, Termination of the concession contract by concessionaire, appears to reduce the rights of the concessionaire to terminate due to acts or omissions of the contracting authority such as those referred to in Model Provision 28 (*h*) and (*i*) generally. By contrast, Legislative Recommendation 64, paragraph (*b*), helpfully allowed termination by the concessionaire for orders or acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities. This language should be restored.

14. Model Provision 48, Wind-up and transfer measures, reduces the force of Legislative Recommendation 66, which required criteria for establishing compensation to the concessionaire for assets transferred upon expiry or termination of the project agreement, by dropping out the provision for compensation. In our view, this Model Provision would be improved if this provision were restored.

## Part II

15. Model Provision 6, Purpose and procedure of pre-selection, would be improved if in 3 (*b*) the words “or operated” were added after “... to be built or renovated”.

16. Model Provision 8, Participation of consortia, would be improved if it did not presumptively bar a member of a losing bidding group from joining another bidder group, so long as such joining was disclosed to all parties and otherwise acceptable and so long as no bidder could, at any one time, be a member of more than one bidding group. For example, a bidder may have signed on with a group that cannot get required financing—but now desires instead to join another bidding group. This may be beneficial to all parties concerned. We believe this recommendation is not inconsistent with Legislative Recommendation 16, but rather expands upon it in a useful way.

17. Model Provision 12.2 (*a*), (*b*) and (*c*), Bid securities, appears to us to have increased the recommended remedies of the contracting authority with regard to forfeiture of bid security as compared to Chapter III, paragraph 62 of the *Legislative Guide*. Paragraph 62 merely states that it

is advisable for the request for proposals to indicate any bid security terms. The expanded provisions of this Model Provision with regard to bid security forfeiture are not, in our view, well considered. For example, there is now a provision authorizing forfeiture of a bidder’s security if the bidder fails to enter into final negotiations (subparagraph 2 (*b*)) or fails to formulate a best and final offer (subparagraph 2 (*c*)). We think it is entirely appropriate to ask a bidder to forfeit its bond if it backs out of an accepted deal (which (*d*) and (*e*) address), but if a bidder does not wish to formulate a “best and final offer”, it should not be compelled to do so at risk of losing its bid security, nor should it be compelled to enter into “final negotiations”. In our view, such standards lack a sufficient level of objectivity in the context of the often prolonged and complicated negotiations of these projects and may have the effect of chilling the willingness of bidders to bid.

18. Model Provision 17, Final negotiations, in the last sentence goes beyond Legislative Recommendation 27 (but a similar provision is contained in paragraph 84 of the *Legislative Guide*) and is not, in our view, advisable. We see little reason why the contracting authority should bar itself from restarting discussions with a bidder who was earlier rejected. It may be that such a bidder was putting forth proposals which the contracting authority thought (at first) “out of market”. But, for various reasons, it may transpire that the contracting authority cannot complete negotiations with another bidder, and may wish to try again with those very same bidders previously rejected. Once again the complexity and prolonged nature of negotiations in these projects makes a more flexible provision desirable, in our view.

19. Model Provision 24, Confidentiality of negotiations, goes beyond Legislative Recommendation 36 in stating that all “communications” with bidders will be confidential. This problem could be adequately addressed by adding the phrase “with appropriate exceptions” at the end of the second sentence.

20. Model Provision 28, Contents of the concession contract, should also, in our view, address: (*a*) the available enforcement mechanisms if any public user of the infrastructure facility does not pay for the goods/services rendered; (*b*) allocation of risk for undisclosed defects in facilities to be rehabilitated; and (*c*) allocation of risk for undisclosed environmental conditions for facilities to be operated or renovated by the concessionaire. Practitioners have observed the importance of these subjects.

## Conclusion

21. The *Legislative Guide* and the Addendum will serve as useful tools to local governments and their advisors in attracting foreign private capital in infrastructure projects. If it were possible to have another stage of this effort, we think it would be most helpful to focus on sector or type of infrastructure so that the recommendations can be made more substantive, and less procedural and formalistic, in nature.

A/CN.9/533/Add.7

**Compilation of comments by Governments and international organizations**

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II. COMPILATION OF COMMENTS

**A. States**

**1. Ecuador**

*[Original: Spanish]*

1. Ecuador proposes the following text for paragraph (a) of model provision 2, "Definitions":

    "For the purposes of this law:

    “(a) ‘Infrastructure facility’ means genuine investments giving rise to assets for public use that, through their use, determine and form the basis for the functioning and development of productive and social activities and for the provision of general services by the State”.

2. Genuine investments are productive investments as distinct from financial investments and investments for profit.

3. The following are considered assets for public use: highway administration in its different forms; land, maritime, river and air transport; energy and electricity; soil treatment; environmental sanitation; and ecology or the environment.

4. Ecuador proposes the following paragraph for model provision 6, "Purpose and procedure of pre-selection":

    “The Higher Technical Supervisory Agency shall decide autonomously and independently on the conclusion of all contracts entered into by public institutions to the extent determined by the national legislation of each country and shall verify the legality of the processes by which public institutions delegate or grant powers to the private sector, likewise in accordance with the national legislation of each country.”

5. Finally, the Government proposes that the model instrument should include a provision defining private financing as financing that comes from persons under private law and originating in the market, i.e., the convergence point of tradable economic goods and services.

## II. INSOLVENCY LAW

### A. Report of the Working Group on Insolvency Law on the work of its twenty-seventh session (Vienna, 9-13 December 2002)

(A/CN.9/529) [Original: English]

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#### I. INTRODUCTION: SUMMARY OF THE PREVIOUS DELIBERATIONS OF THE WORKING GROUP

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a “front-line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a

final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session in 2000 the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.<sup>1</sup>

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the secretariat, in cooperation with INSOL and the IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December 2000.

6. At its thirty-fourth session in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished so far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the Guide, should be included as far as possible.<sup>2</sup>

<sup>1</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 400-409.

<sup>2</sup>Ibid., Fifty-sixth Session, Supplement No. 17 (A/56/17), paras. 296-308.

8. The twenty-fourth session of Working Group V (Insolvency Law) (New York, 23 July to 3 August 2001) commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504. Work continued at the twenty-fifth (Vienna, 3-14 December 2001) and twenty-sixth (New York, 13-17 May 2002) sessions of the Working Group. The reports of those meetings are contained in documents A/CN.9/507 and A/CN.9/511 respectively.

9. At its thirty-fifth session in 2002, the Commission had before it the reports of the twenty-fourth, twenty-fifth and twenty-sixth sessions of the Working Group. The Commission noted that, at its twenty-sixth session, the Working Group had discussed the likely timing for the completion of its work and had considered that it would be in a better position to make a recommendation to the Commission after its twenty-seventh session (Vienna, 9-13 December 2002) when it would have the opportunity to review a further draft of the legislative guide. The Commission requested the Working Group to continue the preparation of the legislative guide and to consider its position with respect to completion of its work at its twenty-seventh session.<sup>3</sup>

## II. ORGANIZATION OF THE SESSION

10. Working Group V (Insolvency Law), which was composed of all States members of the Commission, held its twenty-seventh session in Vienna, from 9-13 December 2002. The session was attended by representatives of the following States members of the Working Group: Argentina, Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Romania, Russian Federation, Rwanda, Singapore, Spain, Sudan, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

11. The session was attended by observers from the following States: Algeria, Australia, Bulgaria, Indonesia, Ireland, Jordan, Lebanon, Nigeria, Philippines, Poland, Republic of Korea, Slovakia, Switzerland, Syrian Arab Republic, Turkey, Ukraine and Venezuela.

12. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: International Monetary Fund (IMF), the World Bank; (b) intergovernmental organizations: Asian-African Legal Consultative Organization (AALCO), Common Market for Eastern and Southern Africa (COMESA), Hague Conference on Private International Law; (c) non-governmental organizations invited by the Commission: American Bar Association (ABA), American Bar Foundation (ABF), Center of Legal Competence (CLC), Groupe de Réflexion sur L'Insolvabilité et sa Prévention (GRIP 21), International Federation of Insolvency Professionals (INSOL), International Bar Association, Committee J (IBA) and International Insolvency Institute (III).

<sup>3</sup>Ibid., Fifty-seventh Session, Supplement No. 17 (A/57/17), para. 194.

13. The Working Group elected the following officers:

- Chairman:* Mr. Wisit WISITSORA-AT  
(Thailand)
- Rapporteur:* Mr. Luis Humberto USTARIZ  
GONZÁLEZ (Colombia)

14. The Working Group had before it a Note by the secretariat: Draft legislative guide on insolvency law (A/CN.9/WG.V/WP.63 and Add.3-15). Those documents, which set forth the text of the commentary of the Guide together with recommendations, had been revised in the light of the discussion of the Working Group at its twenty-fifth and twenty-sixth sessions.

15. The following background materials were also made available: Possible future work on insolvency law: Note by the secretariat A/CN.9/WG.V/WP.50; Reports of the Secretary-General A/CN.9/WG.V/WP.54, A/CN.9/WG.V/WP.54/Add.1-2; A/CN.9/WG.V/WP.55; A/CN.9/WG.V/WP.57; A/CN.9/WG.V/WP.58; A/CN.9/WG.V/WP.59; A/CN.9/WG.V/WP.61, A/CN.9/WG.V/WP.61/Add.1-2; Report on the UNCITRAL/INSOL/IBA Global Insolvency Colloquium (2000) A/CN.9/495; Report of UNCITRAL on the work of its thirty-fourth session (2001) A/56/17 and thirty-fifth session (2002) A/57/17; Report of Working Group V (Insolvency Law) on the work of its twenty-second session (1999) A/CN.9/469; twenty-fourth session (July/August 2001) A/CN.9/504; twenty-fifth session (December 2001) A/CN.9/507 and twenty-sixth session (May 2002) A/CN.9/511.

16. The Working Group adopted the following agenda:

1. Scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of a legislative guide on insolvency law.
5. Other business.
6. Adoption of the report.

### III. SUMMARY OF DELIBERATIONS AND DECISIONS

17. The Working Group reviewed the draft legislative guide on insolvency law commencing with document A/CN.9/WG.V/WP.63/Add.3 and continuing through to A/CN.9/WG.V/WP.63/Add.9, recommendation (76). The deliberations and decisions of the Working Group with respect to the various addenda are set forth below. The Working Group noted that there might be insufficient time to prepare revisions of the material considered at the current session for further consideration by the Working Group at its twenty-eighth session in New York (24-28 February 2003). In response to the Commission's request to consider its position with respect to completion of the legislative guide, the Working Group stressed the need to finalize the Guide as soon as possible and recommended that while the draft Guide may not be ready for final adoption by the Commission in 2003, nevertheless a draft

should be presented to the Commission in 2003 for preliminary consideration and assessment of the policies on which the legislative guide is based. Such an approach would facilitate the use of the legislative guide as a reference tool before final adoption in 2004 and would allow those countries that have not participated in the Working Group an opportunity to consider the development of the guide. It was noted that the Working Group might require further sessions in the second half of 2003 and possibly even the first half of 2004 to refine the text for final adoption.

## IV. PREPARATION OF A DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

### 1. Part two.

#### Chapter II. Application and commencement

##### A. Eligibility and jurisdiction (A/CN.9/WG.V/WP.63/Add.3)

*Paragraphs 1 and 2—eligibility: debtors to be covered by an insolvency law*

18. There was general support for retaining the substance of paragraphs 1 and 2 as drafted.

*Paragraphs 3 and 4—debtors: individuals engaged in commercial activities*

19. It was suggested that because the insolvency of natural persons required different social and policy considerations to those of commercial entities, the discussion in the commentary should either be deleted, or else moved to a separate section and the different considerations discussed more fully. After discussion, general support, however, was expressed in favour of retaining the material on individuals involved in commercial activity and of the applicability of the insolvency law to those individuals as drafted. It was observed that in many countries commerce was conducted by individuals and to omit them would significantly affect the operation, and effectiveness, of the insolvency law.

*Paragraphs 5 and 6—State-owned enterprises*

20. Some concern was expressed about government organizations, municipalities and other similar entities and whether they were, or should be, covered by the Guide. There was general agreement that the Guide should apply to only commercial enterprises, which would not include government or similar entities except to the extent that they fell within the definition of a State-owned enterprise and conducted commercial activities. To clarify the current text, the secretariat was requested to add words to the effect that it was not intended that the Guide should apply to states, sub-national governments, municipalities and other similar types of entities.

21. The substance of paragraph 6 was found to be acceptable.

*Paragraphs 7 to 9—jurisdiction: centre of main interests*

22. Support was expressed in favour of a suggestion that the paragraphs should be amended to conform with the UNCITRAL Model Law on Cross-Border Insolvency, in particular with article 28 and the commencement of non-main insolvency proceedings on the basis of presence of assets.

23. A proposal was made that the Guide should focus only on a debtor's registered office and not establish a presumption as to centre of main interests. After discussion, however, there was general agreement that the presumption should be maintained, in particular to address situations where the debtor's centre of main interests did not coincide with its registered office, a situation commonly encountered in practice.

24. With regard to footnote 1 to paragraph 9 of the Guide, there was general agreement in the Working Group that the Model Law and Guide to Enactment should be included as an additional chapter of the Guide. It was acknowledged that addressing cross-border issues was an essential part of a modern insolvency regime and inclusion of that material would assist readers of the Guide. The need to ensure conformity between the Guide and the Model Law was noted, and that some minor changes to the Guide might be required to update certain references.

*Paragraphs 10 to 13—establishment and presence of assets*

25. The Working Group found the substance of the paragraphs to be acceptable.

*Recommendations*

26. It was suggested that the bracketed word "general" in clauses (a) and (b) of the purpose clause might be deleted as unnecessary. However, there was broad support for retaining the term to prevent ambiguity, especially where States had special insolvency regimes (distinct from the general insolvency law) for certain types of enterprises. It was noted that if the term was to be retained, it should be used consistently throughout the Guide.

27. A suggestion was made that it might assist interpretation if the term "courts" was qualified in clause (d) of the purposes section. It was also suggested that clause (d) be deleted on the basis that the issue of judicial delegation should be determined by the law of each country. In response, it was suggested that there was a need to specify where insolvency proceedings could be conducted to facilitate application for commencement. After discussion, retention of clause (d) was widely supported. It was suggested that the Guide might go further and indicate the types of court that could open a proceeding, in terms of both locality and subject matter. That suggestion received some support.

28. A question was raised as to whether not-for-profit organizations which conducted commercial activities, such as hospitals, would be included within the meaning of "commercial". To clarify that issue, it was suggested that

the words "whether or not for profit" could be added to modify the word "commercial" in recommendation (11). It was agreed that the substance of recommendation (12) was acceptable as drafted.

29. It was suggested that the "presence of assets" test should be included in recommendation (13). It was pointed out, however, that the recommendation adopted a flexible approach, suggesting only minimum and non-exclusive grounds, as agreed by the Working Group at its twenty-sixth session. It was noted that an express reference to the Model Law and the Guide to Enactment could be included to pick up the material on presence of assets as a basis for commencement of insolvency proceedings.

30. It was suggested that the words, "of operations", might be deleted from recommendation (15) to ensure clarity. However, it was noted that the language was based on the Model Law on Cross Border Insolvency and therefore should be retained as drafted.

31. It was also suggested that recommendation (16) might be amended to read, "The insolvency law should clearly state which type of court has jurisdiction over insolvency proceedings and which particular court over matters arising in the conduct of an insolvency proceeding". That suggestion received some support. A further suggestion was that the reference in the recommendation to the "insolvency law" might be omitted, as the jurisdictional rules need not necessarily be contained in the insolvency law.

***B. Application and commencement criteria  
(A/CN.9/WG.V/WP.63/Add.4)****Paragraphs 14 to 16—introduction*

32. The Working Group agreed that the substance of the paragraphs was acceptable.

*Paragraphs 17 to 22—application criteria*

33. Some concern was expressed with regard to the treatment of the liquidity test and the balance sheet test as alternatives (an approach reflected in a number of paragraphs) which could be chosen by a legislator. It was suggested that the Guide should make it clear that both tests could be included in an insolvency law and insolvency proceedings could be commenced where the debtor could satisfy either one of those tests. With regard to the balance sheet test, it was observed that that standard might be misleading as it focused upon what was essentially an accounting question of how the assets would be valued and may raise issues of whether the balance sheet was reliable. It was proposed that the Guide should focus instead on whether the debtor's assets (however valued) were sufficient to satisfy its liabilities, which might be more appropriately called an assets test. It was observed that the ideas reflected in paragraphs 17 to 21 were acceptable, but that some reordering and redrafting might be needed to make the commentary clearer and to reflect the Working Group's discussion on the balance sheet test. It was also suggested that the Guide could usefully include some indicators of general cessation of payments such as failure to pay rent, salaries, employee benefits and other essential business costs.

*Paragraph 23—liquidation: parties who may apply*

34. It was observed that some insolvency laws provided for commencement of insolvency proceedings by a court on its own motion, and that that possibility should be included in the Guide. In response, it was pointed out that a clear distinction should be made between a court applying for commencement of proceedings and making a decision to commence on the application of another party. To allow the court to undertake both actions would create a potential conflict or bias and be contrary to the clear, predictable and transparent insolvency regime that the Guide was recommending. The Working Group agreed that the court should not be able to commence proceedings on its own motion, only on the application of another party.

*Paragraphs 24 to 26—liquidation: debtor application*

35. A concern was expressed that the second part of the first sentence of paragraph 24 suggested that the court could commence proceedings even where the debtor did not satisfy any test of insolvency. In response it was observed that while in practice a debtor application might be treated more flexibly in terms of strict requirements, it was not to be suggested that proceedings could be commenced on a debtor application where creditors objected to such commencement or where to do so would amount to an abuse of the process. It was suggested that a distinction had to be drawn between accepting what the debtor said about its financial condition where no objections were raised, for example, by creditors and not questioning a debtor as to its financial circumstances where there was some doubt about its financial situation or where creditors raised objections to the commencement of proceedings. It was observed that some insolvency laws did provide that a declaration of insolvency by the debtor amounted to a presumption of insolvency or was treated as sufficient evidence of insolvency to commence proceedings without further verification. It was questioned whether the latter approach was desirable and whether or not some further proof should be required or could be demanded by creditors. It was noted that that approach was currently under consideration in one country that was reforming its insolvency law. As a matter of drafting it was suggested that the second sentence of paragraph 24 should end after the words “unable to pay its debts” to remove any uncertainty. The Working Group agreed that those issues required some further clarification and discussion in the Guide.

*Paragraphs 27 to 31—liquidation: creditor application*

36. With respect to the requirement for debts to be undisputed in paragraph 27, the suggestion was made that a debt did not need to be totally undisputed, but rather that a significant portion should be undisputed or free of offset. It was agreed that that issue should be further addressed.

37. Whilst noting that creditors holding unmaturing debt may have a legitimate interest in insolvency proceedings, it was pointed out that under some insolvency laws debt could not be claimed unless and until it matured. Under other insolvency laws, the failure to pay an instalment on long-term debt might form the basis of a creditor application. It was suggested that those examples should be included in the discussion.

38. The Working Group discussed the question of whether a single creditor could apply for commencement of proceedings and the manner in which the number of creditors required related to the value of their claims. A view was expressed that problems might arise, for example, where a debtor had a number of small creditors which it could pay and a single large creditor which it could not; in that case only the single large creditor should be able to apply for commencement. A suggestion was made that a distinction could be drawn between the number of creditors required to bring an application and what was required to be proved—whether the debtor’s inability to pay its debts related to some, all or the majority of its debts. A further view expressed was that a single creditor could apply for commencement where it had followed the procedure in paragraph 27 and served a demand for payment that was not met. After discussion, it was agreed that the Guide adequately addressed the various options with respect to creditor applications and that they were acceptable as drafted.

39. As a matter of drafting, it was suggested that the word “inexpensive” in paragraph 28 should be replaced with “cost-effective”. That change was supported.

40. The Working Group agreed that the substance of paragraphs 29 to 31 was acceptable.

*Paragraphs 32 and 33—applications by governmental authority*

41. It was questioned whether paragraph 32 addressed the situation of a government authority as a creditor, and paragraph 33 other situations where the government authority was not a creditor and where the purpose of insolvency proceedings was not to address insolvency but issues such as fraud or other criminal offences. The Working Group agreed with that interpretation and that that distinction needed to be stated more clearly in the text.

*Paragraphs 34 and 35—reorganization: debtor application*

42. An additional factor suggested in support of relaxing commencement criteria for reorganization and proposed for inclusion in paragraph 35 was the need to encourage debtors to apply at an early stage of their financial difficulties, for example, where the payment of mature debts caused financial hardship but not necessarily insolvency. It was noted that that situation might fall within the meaning of future inability to pay in recommendation 18(a).

*Paragraphs 36 to 40—creditor application*

43. It was suggested the section might be improved by redrafting to separate two key ideas: the adoption of a flexible approach to fixing commencement criteria for creditors so as to enable practical difficulties encountered to be overcome, such as the need for creditors to apply for commencement where the debtor would or could not (e.g. because management had left) and the likely discouraging of creditor applications if a creditor proposing reorganization was required to show that sufficient means were available to achieve a successful reorganization.

44. It was also suggested that a clear distinction needed to be made between debtor and creditor applications, which the Guide might better facilitate by introducing the common rules for both and then discussing the two procedures separately.

45. Another suggestion was that the reference to enhancement of the value of creditors' claims in the second sentence of paragraph 36 be amended to refer to enhancement of the value of assets and the increased return to creditors on their claims.

46. It was noted that the opening words of paragraph 40, "for these reasons", did not necessarily have a connection to the preceding paragraph and should be clarified.

*Paragraphs 41 to 43—procedural issues*

47. It was suggested that the title of paragraph 41 should be amended to "Application for commencement" to more accurately reflect the content. A further suggestion was that the paragraph should simply note that the process might be initiated by application to a competent court, without any further discussion of detail. In response, it was noted that since some jurisdictions provided for initiation without court involvement the current draft should be retained, or a new first sentence added to the effect that "The insolvency law should specify how the insolvency process is commenced". It was also observed that other applicable law might affect the manner in which the procedure was initiated.

48. It was generally agreed that the section may need some minor amendment to acknowledge that court involvement may not be necessary for initiation of the process, as discussed in relation to paragraph 41. A suggestion for an addition to the Guide to explain the reasons for requiring a court determination was that it helped to protect against abuse of the procedure by creditors.

49. An observation, applying generally to paragraphs 42 and 43, was that a clearer distinction should be made between voluntary and involuntary proceedings. Further, it was suggested that since the section currently focused on involuntary proceedings that focus should be expressly stated in the Guide.

50. A suggestion which was supported was that the Guide note the transition in several insolvency laws towards granting the debtor a fundamental right to be heard by the court or body that would determine an application for commencement.

51. It was suggested that the words, "to evade its creditors" be removed from the second sentence of paragraph 43, as other forms of abuse existed which did not need to be detailed in the Guide. It was suggested that the text of the last sentence of paragraph 43 should be amended to stress the need for clear rules on the application of the stay to this interregnum period and include a cross reference to chapter III.

52. Another cross reference suggested was to the discussion in the Guide of the responsibilities of the directors or

management of the debtor to apply for insolvency proceedings (paras. 229-230, chapter IV, A/CN.9/WG.V/WP.63/Add.10).

53. Several drafting suggestions were made: to remove the word "composite" from the first sentence of paragraph 38; and to replace the phrase "application for insolvency" in paragraph 41 with a more appropriate reference to relief or commencement.

*Paragraphs 44 and 45—procedural issues: establishing a time limit for making the commencement decision*

54. The substance of the paragraphs was found to be acceptable.

*Paragraph 46—procedural issues: denial of the application to commence*

55. Support was given to the suggestion that the section be redrafted to apply to both voluntary and involuntary proceedings and the title amended to, "Denial of the application to commence or dismissal of proceedings". It was recalled that that issue had been discussed at the Working Group's twenty-sixth session (see document A/CN.9/511, para. 37). The secretariat was requested to add commentary and recommendations (see also para. 80 below) to the Guide on the dismissal of proceedings. It was suggested that any revision should cover all possible arrangements under current laws, including those that allowed automatic commencement.

56. A further suggestion was that, while the grounds for denial of the debtor's application should be kept to a minimum and the debtor be given a limited time to remedy any defects in an application, the requirements placed on creditors should be more strictly applied.

57. A number of suggestions were made regarding amendment of the grounds for denial of the application for commencement contained in paragraph 46. The observation was made that, in reviewing the current list, the Working Group should not confuse grounds for denial with incidents of abuse of the subsequent procedure which could be dealt with under dismissal. Support was expressed for retaining in the list, in some form, the ground of obtaining preferential payments by the debtor, as it was noted that it was not uncommon in the case of an involuntary application for pressure to be applied to the debtor for such payment and any form of coercion of payment could be an inappropriate use of insolvency proceedings. An opposing view was that it would be inappropriate for a court to make such a decision because the investigation of such payments was a key function of insolvency proceedings.

58. A suggestion was made that use of the insolvency proceedings as a substitute debt enforcement mechanism should be removed from the list on the basis that although perhaps an inappropriate use of insolvency it should not, in itself, represent a ground for denial of an application. Suggested additions to the grounds for denial were insufficiency of assets (which should be cross-referenced to the discussion of assetless estates in paragraphs 52 and 53 and



a note made in paragraph 46 that that ground for denial was not recognized in all States) and involvement in fraud or other criminal activity.

59. A number of drafting suggestions were also made: in the third sentence of paragraph 46 the word “unjustifiably” be added; the phrase, “to obtain” be altered to “obtaining”; and the phrase, “of debts in full” be deleted (the example would read, “where the debtor uses insolvency as a means of prevaricating and *unjustifiably* depriving creditors of prompt payment or *obtaining* relief from onerous obligations, such as labour contracts”); and that the word, “inappropriate” should qualify “substitute” in the fourth example.

*Paragraphs 47-51—procedural issues: notice of commencement*

60. It was suggested that a clear distinction needed to be made in the Guide between notification of application and notification of commencement, as different consequences would result. Paragraph 47 should expressly address notification of commencement.

61. Strong support was expressed in favour of emphasizing in paragraph 49 that the debtor had a fundamental right to be notified (which should be cross-referenced to the discussion of the rights of the debtor in paras. 218-220, chapter 1V, A/CN.9/WG.V/WP.63/Add.10), and it should only be in very exceptional circumstances that notice to the debtor could be dispensed with, such as where the debtor was likely to act to the detriment of the creditors or where the debtor had disappeared. In response it was pointed out that if the debtor was not notified it could continue to act to the detriment of the estate. It was also observed that the issue of the debtor acting to the detriment of creditors might be better addressed by application of provisional measures. Strong support was expressed for retaining the notice requirement even where the debtor had disappeared. Where the debtor sought to avoid receiving personal notice, requirements for public notification might suffice, or notice could be served at the last known address of the debtor.

62. In voluntary application situations where there was a delay between application and commencement, it was suggested that creditors needed to be notified of the application so as to be able to make an informed decision as whether to continue to provide services to the debtor, with the possibility of incurring further debt during the interim period.

63. A number of options for achieving effective notification were suggested (see para. 74).

64. It was noted that the terms “involuntary” or “creditor” application in the first sentence of paragraph 49 may be confusing since involuntary applications were not necessarily limited to creditor applications and the terminology should be clarified.

65. It was suggested that trade unions and employee representatives might also be added to the list of parties in paragraph 50 to receive notice of commencement.

*Paragraphs 52-54—procedural issues: assetless estates*

66. Support was expressed for adding the desirability of rehabilitating entrepreneurs and other individuals engaging in commercial activities, and encouraging economic risk-taking by those same parties as further reasons for addressing the administration of assetless debtors. It was also suggested that a reference to revenue should be added to address those debtors that had no assets but did have a regular source of revenue and should not be treated in the context of “assetless” estates.

*Paragraphs 55-56—costs of the insolvency proceeding*

67. The comment was made that the paragraph, as drafted, reflected an awareness of the importance of cost-effectiveness in the design of an insolvency regime without drawing any effective conclusion. It was suggested that a stronger statement to the effect that a high cost regime would discourage commencement and use of insolvency proceedings should be included.

68. The substance of paragraph 56 was found to be acceptable.

*Recommendations*

69. Support was expressed in favour of deleting paragraph (b) of the purpose clause as those words were already included in the purpose clause in chapter II.A. A suggestion was made that paragraph (f) should appear before (e) as a more logical sequence.

70. Some concern was expressed with respect to the commencement criteria in recommendation (18) and a number of additions and amendments suggested. To reflect the Working Group’s agreement with respect to the application criteria (see para. 33), the word “alternatively” should be deleted; the conclusions of the Working Group’s discussion on the requirement that the debt be undisputed should be reflected, together with the additional word “whole” added to clarify that a part but not all of the debt could be disputed (the same change was to be made to recommendation (19); the word “general” should be added to the reference to cessation of payments to align recommendation (18)(a) and (b) with paragraphs 17 and 18 of the commentary; and recommendation (18)(b) should include the words “or will be” before “unable to pay its debts” to cover prospective insolvency. In response to that last suggestion, the view was expressed that prospective insolvency should only apply to debtor applications and not to creditor applications. The view was also expressed that recommendation (18)(a) should adopt a more flexible approach to encourage debtors to file at an early stage and to encourage reorganization, with a necessary distinction being drawn between the commencement criteria for liquidation and reorganization.

71. While some support was expressed for version 2 of recommendation (19), after discussion the prevailing view was that version 1 should be retained and incorporate footnotes 5 and 6.

72. A suggestion with respect to recommendation (20) was that the choice between paragraphs (a) and (b) should be expressed more clearly.

73. To address commencement by a government authority, which was discussed in the commentary, the words “or a government authority” should be added to recommendation (21) after the word “creditor”, with any necessary changes to take account of commencement by a public authority on a public interest rather than insolvency basis. To reflect the Working Group’s discussion on the exceptions to provision of notice to the debtor, it was suggested the word “generally” be added to the chapeau after “the insolvency law”.

74. Some concern was expressed with regard to recommendations (22) to (24) on notification of commencement of proceedings. One view was that a clear distinction should be made between notification of specific parties and general publication of the fact of commencement. With respect to publication, the view was expressed that publication in a government gazette was generally only a formality and should not be relied upon to provide effective notice, and that the reference to national newspapers should be deleted and replaced with a reference to local newspapers in the location of the debtor’s business. As an alternative to specifying the types of publications in which notice might be given, it was suggested that a formulation along the lines of “a publication that was generally likely to come to the notice of interested parties” should be adopted. The possibility of using electronic communications to effect notice to individuals was also suggested for inclusion. To clarify the procedural nature of recommendation (22), it was suggested that the opening words could include a reference to the need to establish a uniform procedure for notification. With respect to the party to provide the notice, it was proposed that the last sentence of recommendation (22) should be changed from “may” to “should”. The secretariat was requested to take those suggestions into account in revising the recommendations.

75. With regard to recommendation (23) it was suggested that the party responsible for preparing the list of creditors to be notified should be specified. The words “[who may be identified from the books and records of the debtor]” were felt to be unnecessary and possibly limiting, as there could be other known creditors who could not be so identified.

76. Suggestions made to add further requirements to recommendation (24) including providing information relating to verification of claims and any time frame within which that might occur, and to the application of a stay and its effect.

77. Some concerns were expressed with respect to the drafting and content of recommendation (25). It was pointed out that recommendation (25)(b) was too limited as it did not address the situation where the application was made by multiple creditors. Where the debt of one of those creditors was subject to dispute, that should not result in the application being denied. The view was expressed that the criteria mentioned in the recommendation were too narrow and should include, for example, failure to

meet time limits, issues related to competency of the parties, and non-payment of procedural expenses. In addition, the words “inter alia” should be added to the chapeau. A further suggestion was that since paragraph (c) should apply to both liquidation and reorganization, the opening words could be deleted. As a matter of drafting, it was suggested that paragraph (a) should be placed at the end of the list.

78. It was observed that dismissal of proceedings (which may be needed, for example, where an application by a debtor functioned as automatic commencement) and costs and sanctions were not addressed in the recommendations. Where an application functioned as automatic commencement (and notice would have been given of commencement) and the proceedings were subsequently dismissed, it was suggested that notice of the dismissal may also be required to protect the debtor’s business. Those proposals were supported.

79. A proposal was made that recommendation (26) should distinguish between individual and corporate debtors. Recalling paragraphs 52 to 54 of the commentary, it was suggested that recommendation (26) should apply only to those situations where the debtor was not an individual who was entitled to a discharge, since in that case the application should not be denied. It was observed that the first sentence should refer to absence of “unencumbered” assets, not to assets in general.

80. After discussion, the following draft recommendations on dismissal, and costs and sanctions were proposed for future consideration by the Working Group.

*Termination and dismissal of an insolvency proceeding*

(26A) The insolvency law may provide that the court may terminate or dismiss a proceeding that has been commenced, if the court determines, for example, that:

- (a) The proceeding constitutes an improper use of the insolvency law;
- (b) The debtor has failed to comply with the orders of the court or the provisions of the insolvency law;
- (c) The debtor has failed to cooperate with the insolvency representative; or
- (d) There has been [unreasonable] delay in the proceedings [that has been prejudicial to creditors].

[Note: The above grounds would apply to either a liquidation or reorganization proceeding. Although chapter V.A(14) discusses potential grounds for conversion of a reorganization to a liquidation proceeding, there exists no recommendation on this topic. Additional grounds for conversion might include: continuing to incur losses during the reorganization period; and failure to confirm a plan of reorganization within [a reasonable period] [the statutorily prescribed period] of time. The grounds for dismissal may need to be distinguished from grounds for conversion.]

(26B) The insolvency law should provide notice to creditors of a determination to terminate or dismiss an insolvency proceeding.

[*Note: The same provision may need to be included in respect of conversion from reorganization to liquidation.*]

#### *Costs and sanctions*

(26C) The insolvency law should impose a reasonable fee for the privilege of making an application to commence an insolvency proceeding.

(26D) The insolvency law may provide that the court should have the power to determine whether an application for commencement constitutes an improper use of the insolvency law. In the event of such a finding, the court may permit assessment of costs or sanctions against the applicant.

[*Note: The applicant might be a debtor in the case of a voluntary petition or creditors in the case of an involuntary petition.*]

## **2. Chapter III. Treatment of assets on commencement of insolvency proceedings**

### *A. Assets to be affected (A/CN.9/WG.V/WP.63/Add.5)*

81. It was suggested that the words in parentheses at the end of paragraph 57 either should be deleted as they were confusing or amended to refer to the replacement or interruption of the powers of the debtor by the insolvency representative.

#### *Paragraphs 59 to 65—assets of the insolvency estate*

82. With respect to terminology, it was proposed that the Guide should refer consistently to the “assets and rights” of the debtor that would constitute the estate.

83. It was observed that footnote 1 to paragraph 59 would only apply where the debtor was an individual and that in at least one insolvency law, the debtor would retain the right to sue for personal bodily injury and loss of reputation, but not for any associated loss of earnings.

84. The view was expressed that paragraph 60 should include a clear statement that recognized the need to affect the rights of secured creditors in order to achieve the goal of reorganization. A related suggestion was that paragraph 62 should indicate the need for a clear definition of the rights of secured creditors in order to enable the pricing of credit risk, along the lines of “An insolvency law should set forth clearly the rights of secured creditors in dealing with their security.” That proposal was supported.

85. The substance of paragraph 61 was found to be acceptable.

86. It was observed that paragraph 63 related only to individual debtors and could be moved to paragraph 68 for greater clarity. A further suggestion was that additional discussion, addressing the relevance of non-insolvency law to the treatment of joint assets in insolvency and examples

of the jointly owned assets that may be accessed in insolvency, should be added. That suggestion was supported.

87. Concerns were expressed as to whether third-party-owned assets were to be included in the insolvency estate and the circumstances under which they could be used in the insolvency proceedings (whether or not they were a part of the estate). Whilst noting that the issue of use was addressed in chapter III.C, it was agreed that greater clarity was required in paragraph 64.

#### *Paragraphs 66 to 68—assets excluded from the insolvency estate*

88. The suggestion was made that a further example of assets to be excluded was assets that might be subject, under some laws, to reclamation, such as goods supplied before commencement but not paid for and recoverable by the supplier (subject to identification and other applicable conditions).

89. The substance of paragraph 66 was generally acceptable.

90. The view that paragraph 67 should not be included within the exclusion section but under a separate section was supported. In addition, some support was expressed in favour of the proposal that the paragraph should state clearly the desirability of the estate comprising all assets of the debtor wherever they were located. It was noted in particular that the exclusion of foreign assets could affect the ability to reorganize a debtor.

#### *Paragraphs 69 and 70—recovered assets*

91. It was generally agreed that paragraph 69 should be aligned with the discussion of avoidance provisions in chapter III.E and the various types of transactions subject to avoidance mentioned. Several additions were proposed to the first sentence: the addition of the word “encumbered” after “improperly”; a reference to transactions that resulted in insolvency, not simply to those occurring at “a time of insolvency”; and a reference to transactions involving gifts to parties other than creditors, for example to a spouse at a time when the debtor was insolvent, or became insolvent as a result of the gift. It was observed that in the cross-border context, jurisdictions that did not provide for the avoidance of certain types of transfers may encounter difficulties with recognition and cooperation.

92. It was agreed that paragraph 70 should be cross-referenced to other sections of the Guide addressing unauthorized transactions.

#### *Recommendations*

93. With regard to the purpose clause, it was proposed that paragraph (d) should be reinstated in the light of the discussion on secured creditors and third-party-owned assets, with appropriate changes to (d) and to the chapeau to reflect the substance of the section, i.e. constitution of the estate, not the effect of commencement.

94. The Working Group considered two proposals concerning recommendations (27) and (28). The first was that the words “wherever situated” should be added to (27)(a) at the end of the first phrase and recommendation (28) deleted, and the second that recommendation (28) should be amended to read “... the insolvency law should specify that the insolvency estate would include all assets wherever located.” Some support was expressed in favour of both proposals, and the prevailing view was that in the light of the Working Group’s decision to incorporate the UNCITRAL Model Law on Cross-Border Insolvency into the Guide, it was appropriate for the Guide to adopt a strong statement in favour of the universal approach. It was suggested that if a country were to adopt a universalist approach, the Guide should flag the need for an insolvency law to adopt clear rules to provide certainty for creditors, and should address the issue of recognition (and include a cross reference to the Model Law on Cross-Border Insolvency). It was also determined that the commentary should recognize that some countries may wish to adopt a different approach.

95. Two changes were proposed to recommendation (29): that the reference to natural persons in the heading be reinstated and that the words “which may include assets acquired after commencement of the insolvency proceedings” be deleted.

*B. Protection and preservation of the insolvency estate (A/CN.9/WG.V/WP.63/Add.6)*

96. As a working method, the Working Group discussed and agreed to focus on the recommendations in the Guide, with alterations to be made to the commentary to reflect the relevant deliberations and considerations. The Working Group requested the secretariat to reflect the issues discussed in the context of the recommendations in the relevant parts of the commentary and to align the texts.

*Recommendations*

97. Support was expressed for the specific detail of the second alternative in square brackets in clause (a) of the purpose section. Otherwise, the substance of the section was acceptable.

98. It was suggested, with some support, that the Working Group’s earlier deliberations regarding the possibility that the debtor might not need to be notified in exceptional circumstances should inform the drafting of recommendations in this section to minimize the potential for damage.

99. The following changes were suggested regarding the text of the chapeau to recommendation (30): that the phrase, “any interested party” in the second line be replaced with “debtor, creditors or third parties” to reflect the agreement on the purpose clause; that the third line be amended to read, “the assets *and rights* of the debtor”; and that the word, “urgently” be removed from the text in the square brackets and the square brackets be deleted. Those changes were supported.

100. It was suggested the words “as requested” might be added to the end of recommendation (30)(a).

101. Some concern was expressed that the powers to be given to the insolvency representative in recommendation (30)(b) may be too broad for all cases, as it might depend upon whether the insolvency representative was appointed to supervise or control the debtor’s business. It was felt that the ability to sell should be more limited to avoid possible abuse by the insolvency representative, such as the sale of all the assets. Support was expressed, however, for the suggestion that the phrase, “in the ordinary course of business” and the phrase “including” (which could be changed to “may include”) should adequately address that concern. It was also noted that some regimes required the posting of a fidelity bond by the insolvency representative to protect against any defalcation. It was suggested it should be made clear that the term, “other person” did not refer to the debtor. Some support was expressed in favour of removing the brackets from both sets of text in recommendation (30)(b), although it was pointed out that the second phrase may not be necessary as it was already contained in the chapeau.

102. It was suggested that the cross reference in recommendation (30)(d) should extend to all of recommendation (35) and not be limited to (35)(d).

103. It was suggested that the first sentence of recommendation (31) should refer to the individual or body authorized to carry out the provisional measures rather than to a balancing of the responsibilities of the debtor and the interim insolvency representative. Another suggestion, referring to the second sentence of the recommendation, was that the powers of the debtor to continue to manage its business should be able to be restricted even if no interim insolvency representative was appointed. A number of drafting suggestions to recommendation (31) were also made: in the second sentence, the word “unless” be replaced by “except to the extent”; and, in the same sentence, the word, “powers”, be altered to either “powers and rights” or “rights and obligations”.

104. It was agreed that the word, “may”, in recommendation (32) should be replaced by “should” and that the opening words should be “Where appropriate ...”, on the basis that, in conjunction with recommendation (33), it would account for situations where no notice was provided to the debtor. In response, it was suggested that that approach may not be needed as notification of provisional measures could be distinguished from notification of commencement.

105. It was generally agreed that the following words be added to recommendation (33): “where the debtor has not been given prior notice, the court shall order that [within ... days] [upon urgent application] [within a reasonable period of time] [promptly], the debtor may be heard in opposition to all or part of the relief given”. Emphasis should be placed on limiting the time period to prevent the entire value of the business disappearing, and a footnote to the recommendation could provide that emphasis. It was suggested that the Guide note that preliminary measures should in any event be subject to periodic review and renewal. A further addition to the recommendation was suggested to provide for sanctions against improper use—“To the extent that the court finds relief was improperly

obtained, it should retain the discretion to assess costs and fees". A drafting suggestion regarding recommendation (33) was that "the debtor" be added after "the insolvency representative". It was also suggested that the phrase, "at its own motion", should be replaced with words to the effect that the debtor could always be heard by the court and the decision to modify must be notified. An alternative suggestion was that the phrase be followed by the words, "after proper notice of hearing".

106. It was suggested that the following words be added to the end of recommendation (34): "... or the application to commence proceedings is denied or dismissed". It was agreed that a note might be made in the discussion on competence issues to address whether the composition of the court reviewing such measures would be the same as the court granting the measures.

107. It was noted that recommendation (35)(a) was derived from, but did not mirror article 23 of the Model Law on Cross-Border Insolvency. To address the issue of preservation of claims, it was agreed that the words of the Model Law and its Guide to Enactment be incorporated in some form in the recommendation. With respect to quantification of claims, it was suggested that the reference should be deleted from recommendation (35)(a) and the commentary could indicate that the court could always entertain relief from the stay on that issue. There was support for the proposition that recommendation (35)(c) should not operate to preclude the termination of a contract if the contract provided for a termination date that happened to fall after commencement of proceedings.

108. It was suggested that a list of exceptions to an automatic stay might be usefully added to the Guide, including, for example, proceedings in which the debtor had personal injury or family law claims. There was agreement that the exception should not extend to situations of mass tort, although claimants might have the right to seek relief from the stay on an individual basis. After discussion, the Working Group agreed the Guide should state that an insolvency law may provide some exceptions to the stay, and if so, those exceptions should be stated clearly.

109. A number of drafting amendments to recommendation (35) were made: that the second line of (35)(a) refer to, "the assets *and rights* of the insolvency estate"; and, that the bracketed words in recommendation (35)(a) be amended to "are considered *urgent and* necessary by the court". It was also suggested that the second part of clause (a) beginning, "except to the extent", may not be necessary. A further suggestion was that the phrase, "including perfection or enforcement of security interests", could be deleted from (35)(a) as the matter was dealt with by recommendation (40), which included a cross reference to recommendation (35).

110. It was suggested that recommendation (36) should indicate some limitations or restrictions to the relief envisaged by the clause.

111. There was general agreement that "may provide" be amended to "should provide" in recommendation (37) and the words "after commencement" be added after the word "court".

112. After discussion, it was agreed that recommendation (38) required a statement of when and for how long provisional measures (including those referred to in recommendation (36)) would be effective. With respect to measures automatically applicable on commencement, it was suggested that it should be made clear in the recommendations that they would be applicable "at the time of making the decision to commence".

113. The substance of recommendation (39) was found to be acceptable.

114. After discussion, the Working Group agreed that the term, "for the duration of that proceeding", in recommendation (40)(a) was inadequate as it conveyed the impression the stay may apply for an open-ended period. The Working Group was unable to reach final agreement on an alternative phrase, although it was agreed that it should be clear the period was finite. Suggestions made included that the stay would remain in place during the period leading to the formulation or approval of a reorganization plan, or the earliest of the time when (i) the plan became effective or any stipulated period for duration of the measures automatically applicable ceased, (ii) the proceedings were closed or (iii) the court granted relief to the secured creditor from the measures automatically applicable. Some support was expressed in favour of the latter formulation. The Working Group agreed to amend the reference to the number of days in recommendation (30)(b) which might be moved from the clause to a footnote with an accompanying note to the effect that the period was indicative. By way of clarification, it was suggested that the Guide should make it clear that if secured creditors were excluded from the insolvency estate, they would not be covered by the stay under recommendation (40).

115. It was also agreed that the reference to harm in recommendation (40)(b)(ii) be changed to a statement that the secured creditor would not be adequately protected, a concept which should be explained in the commentary.

116. Some concerns were expressed with respect to the scope of recommendation (41)(a). In particular, it was questioned whether it should apply to both liquidation and reorganization. After discussion it was agreed that it should apply in both types of proceedings and appropriate clarification should be made in the text. A number of preliminary suggestions were made as to drafting: the replacement of "on grounds that may include" with "on a determination by the court"; the addition of the words "and the insolvency representative demonstrates that it" before "is not necessary" in recommendation (41)(a) and the deletion of "as a going concern" in (41)(a)(ii).

117. A second concern related to the interpretation of recommendation (41)(a) to (c) and in particular whether paragraphs (a) and (b) were cumulative or exclusive. After discussion, the prevailing view was that to prevent the lifting of the stay it would have to be shown that the asset was of value to the estate, and that it was necessary either for a reorganization or for a sale of the business. To implement that requirement more clearly, it was suggested that paragraph (a) be split into two parts, addressing value and the need to retain the asset separately. Another suggestion

was that a more appropriate test could be achieved by linking recommendations (40) and (41) more closely and adopting the test of maximization of value rather than necessity for a sale in prospect. It was observed that the chapeau only used the words “that may include” which did not indicate exclusive requirements and should be sufficiently flexible to accommodate the concerns discussed. It was suggested that part of the difficulty encountered in the discussion might be due to different interpretations of “no value”. Since it could mean literally of no value, or it could mean that the secured creditor was undersecured and the value of the claim exceeded the value of the secured asset, that issue should be clarified in the text.

118. With respect to recommendation (41)(b) it was suggested that the reference to “[...] days” should be substituted with a less specific reference to a deadline or time period set by the insolvency law or by the court. It was recalled that a similar change was to be made in respect of recommendation (40)(b).

119. As a matter of drafting, it was suggested that the second reference in (41)(c) to “asset” should be replaced by “secured creditor”. It was also queried whether the use of “secured asset” was appropriate and it was agreed that that usage needed to be considered in the context of the Guide as a whole.

120. In response to a concern as to how recommendation (42) would be invoked, in other words when would diminution of value be considered and what factors would it be assessed against, it was suggested that it would only be relevant in the event that the relief sought under recommendation (41) was not granted; the recommendation properly related to protection of secured creditors rather than diminution of value. It was observed that while recommendation (41) made it clear the creditor needed to seek the relief from the stay, it was not clear in (42) which party could make the request for court consideration.

121. It was proposed that the drafting of recommendation (42) could be clarified as follows: “The insolvency law should provide for the court to address an assertion by the secured creditor of the diminution of value of secured assets and consider appropriate protection.” The second sentence and the first part of the third sentence would remain as drafted and the words “as a result of the imposition of automatic measures or the use of the secured assets by the estate” added after the word “erodes” in the third sentence. Paragraphs (a) to (c) would remain as drafted. That proposal received some support, although some reservations were made pending a closer examination of the proposed language. One concern expressed was that application of the stay, by itself, would not be sufficient grounds for considering diminution of value, as that might cover incidental loss of value for which the creditor should not be compensated. In response it was pointed out that the proposal did not mandate the provision of protection and some examples were discussed in which it was clear that diminution in value could in fact result from application of the stay without use of the asset.

122. A further proposal was that the recommendation should be drafted as a general principle providing that a

balance had to be reached between insolvency objectives and secured creditor protection and where necessary appropriate safeguards should be provided.

123. It was suggested that in addition to recommendations (41) and (42) a provision allowing the secured creditor to ask the insolvency representative to release the secured asset in certain circumstances (particularly where the asset was of no value to the estate) without having to formally seek relief from the stay and providing the insolvency representative with the power to do so, might be useful.

124. After discussion, the following revised draft of recommendation (42) was proposed for future consideration by the Working Group.

(42) The insolvency law should provide that where the value of the secured assets does not exceed the amount of the secured claim or will be insufficient to meet the secured claim if the value of the secured asset erodes as a result of the imposition of automatic measures or the use of the secured assets by the estate, protection may be provided to the secured creditor. The insolvency law should [also] provide for the court to address an assertion by the secured creditor of the diminution of the value of secured assets and consider appropriate protections such as:

- (a) Cash payments by the estate;
- (b) Provision of additional security; or
- (c) Such other means as the court determines will provide appropriate protection.

[*Note: The commentary of the Guide would note, to the extent that it did not already, that where the value of the secured assets exceeded the amount of the secured claim and would be sufficient to meet the secured claim, protection may not be required.*]

### C. Use and disposition of assets (A/CN.9/WG.V/WP.63/Add.7)

#### Recommendations

125. The substance of the purpose clause was generally found to be acceptable.

126. With respect to the chapeau of recommendation (43), it was observed that it might be inappropriate to refer to continuation of the business being “authorized” and a formulation along the lines of “Where the operation of the business is to continue ...” was suggested. That proposal was supported. It was also pointed out that while in liquidation the debtor would generally lose the ability to deal with assets, that was not true in reorganization, and the recommendation might need to be divided to address those differences more clearly. That suggestion received some support.

127. It was observed that an insolvency representative did not always have, under all legal systems, the right to sell assets, but could be a trustee or supervisor. In that case, the terms of recommendation (43)(a) could not apply. A

related observation was that the recommendation only dealt with those cases where an insolvency representative was appointed and it may be inappropriate to provide those powers to a debtor in possession. In response, it was noted that some insolvency laws did allow the debtor in possession to retain those powers. A further view was that paragraph (a) could refer to the debtor under the supervision or control of an insolvency representative. That approach received some support. After discussion, it was agreed that different possibilities might need to be reflected.

128. Concern was expressed that the phrase “use, sell or lease” was too narrow and should be expanded to cover other means by which assets could be alienated from the estate, such as charge, encumber, or other disposal.

129. Support was expressed in favour of retaining the language in square brackets in recommendation (43)(b) that referred to the court and to other recommendations on use of secured and third-party-owned assets; and of amending the reference to “creditors” to the “creditor committee” and stating it as an alternative to approval by the court. An opposing view was that requiring approval by creditors or the creditor committee might be too cumbersome, and all that was required was the provision of notice to creditors and an opportunity for them to challenge the proposed action. A different view, which received some support, was that the focus should be upon the creditor committee and that approval of the court should not be required. In response to concern as to the meaning of “ordinary course of business” it was pointed out that that phrase was one commonly used in the insolvency context, but some further explanation could be included in the commentary.

130. After discussion, the following revised draft of recommendation (43) was proposed for future consideration by the Working Group.

(43) Where the operation of the business of the debtor is to continue under a reorganization proceeding, the insolvency law should:

(a) Permit the debtor, under supervision of the insolvency representative, to use, sell, charge, lease or otherwise dispose of or encumber assets of the insolvency estate in the ordinary course of business;

(b) Permit the insolvency representative to use, sell, charge, lease or otherwise dispose of or encumber assets of the insolvency estate other than in the ordinary course of business, subject to approval by the court, unless the affected creditors consent, [and in accordance with recommendations in the Guide on the use of secured assets and third-party assets].

(43A) Where the operation of the business of the debtor is to continue under a liquidation proceeding, the insolvency law should permit the insolvency representative to use, sell, lease, charge or otherwise dispose of or encumber assets of the insolvency estate in the ordinary course of business, but should require approval by the court if assets are to be used, sold or leased out of the ordinary course of business.

131. With respect to recommendations (44) and (45) some concern was expressed that those provisions repeated

matters dealt with in recommendations (41) and (42) and could be replaced by a general recommendation to the effect that secured assets could be used in the proceedings subject to the protections provided in those earlier recommendations. In support of that proposal it was observed that if the secured assets were to be included in the estate as recommended in (27), there would be no need to include a further provision such as recommendation (44). Support was expressed in favour of including a general reference to recommendations (41) and (42) along the lines of “The property subject to security interests may be used but the rights and interests of the secured creditors [or owner] must be protected as set forth in recommendations (40) to (42)”, with some alignment to be made with recommendation (43).

132. To the extent that recommendation (46) addressed assets in the possession of the debtor subject to contractual arrangements, it was suggested that it properly belonged in chapter III.D Treatment of contracts. It was also proposed that the language should be more limited, and a formulation along the lines that assets owned by a third party that were not part of the insolvency estate but were in the possession or control of the debtor and could lawfully be used by the debtor (or used by the debtor with the consent of the third party) could be used by the insolvency representative.

133. With respect to recommendation (47), it was suggested that it repeated the protections to be afforded to secured creditors and could perhaps be dealt with by way of cross reference to other recommendations. After discussion, some support was expressed in favour of deleting the substance of both recommendations (46) and (47) from chapter III.C and substituting a cross reference to chapters III.B or III.D, and ensuring that the issues were dealt with adequately in chapters III.B and III.D.

134. It was proposed that approval of creditors was not appropriate under recommendation (48) and that notice and an opportunity to object to the proposed action was all that was required. It was observed that it might be inappropriate to provide such powers to a debtor in possession where no insolvency representative was appointed.

135. It was observed that the reference in recommendation (49) to “a reasonable indication” that the secured creditor could sell the asset more easily than the insolvency representative was too subjective a test and there was broad support for adopting a more objective approach. In reference to the use of the phrase, “of no value”, it was noted those words were used elsewhere in the Guide and it was suggested that they be replaced with, “where the value of the secured claim exceeds the value of the asset”. It was also suggested that a cross reference be added to the discussion on claims, specifically to the point that a limitation should be placed on the claim of a secured creditor where an asset was released to it. Of the bracketed words in the second sentence, “may” was agreed to be more appropriate.

136. Following discussion of recommendation (50), the Working Group agreed (i) that of the bracketed words in the last sentence of (50), “approval by the court” should be

retained; (ii) that the approval by creditors should be amended to refer to the creditors committee or other creditor body and stated as an alternative; (iii) that the provision should focus on sales outside the ordinary course of business; and, (iv) that an addition should be made to the commentary regarding notification and publicity requirements for a public auction. There was some support for allowing for the notification, rather than the approval, of creditors, provided there be an opportunity for creditors to challenge a sale in the court if they disapproved. Some support was also given to the notion that recommendation (50) should focus on methods of sale only.

137. Drafting suggestions included inserting the phrase, “outside the ordinary course of business”, after the words, “notice of any sale”, and again after the words, “private sales” and removing the two bracketed phrases in the first sentence. An alternative suggestion was that the phrase “outside the ordinary course of business” be removed from square brackets and placed after the words, “method of sale”, and also that the brackets be removed from, “whether in liquidation or reorganization”.

138. Support was expressed in favour of providing that in circumstances where an urgent sale of assets was required, for example, where the assets might be subject to rapid deterioration of value, notification and/or approval of creditors or the court might not be necessary, or that approval might be given after the sale. A suggested addition to recommendation (50) was that proposed sales to insiders be carefully scrutinized before being allowed to proceed. It was also suggested that the recommendations be reordered so (50) came before or followed (48), (49) and (51).

139. There was general agreement that footnote 5 to recommendation (51) should be deleted, as it unnecessarily restricted the grounds on which a secured creditor could object to a sale, and that a new clause should be added to (51) to the effect that if the proceeds of a sale exceeded the value of a secured claim, no protections for the secured creditor were required. With regard to (51)(b), different views were expressed regarding the party to whom the creditor should object, with some support being given to the suggestion to amend the sentence to, “object to [the court or the insolvency representative regarding]”.

140. It was suggested that some detail was needed regarding the procedure for valuing the asset to be sold and that that could be included in the commentary. A proposal was made that a clause be added to recommendation (51) providing that, even where the court approved a sale, if the offer for the asset was inadequate, the secured creditor retained the right to offset the bid to protect its interest.

#### *D. Treatment of contracts (A/CN.9/WG.V/WP.63/Add.8)*

##### *Recommendations*

141. It was agreed that the phrase, “and by whom”, in square brackets in clause (b) of the purpose clause be retained and the brackets removed.

142. The substance of recommendation (52) was found to be acceptable.

143. The Working Group agreed to the following changes to recommendation (53): that in the opening words “should” was preferable to “may”; that the phrase “a right to terminate” be replaced with “for the automatic termination of”, to remove the impression that (53) might also refer to election to terminate; and, that the substance of (53)(c) and (53)(d) be moved to the commentary. It was also agreed that the commentary should note that (53) applied only to those situations where contracts could be overridden and that its provisions were non-exclusive. It was suggested that the commentary include an explanation that the court could look at similar types of contractual clauses that would have the effect of terminating on such events.

144. It was noted that recommendation (53) as drafted applied all types of contracts but that some, such as contracts to lend money, should be excluded. Drafting suggestions included that: the phrase, “upon the commencement of insolvency proceedings” be added to the start of recommendation (53); the square brackets around the phrase, “as against the insolvency representative” be removed and the words “and the debtor” added; and the words, “or identify as an event of default”, be deleted.

145. The Working Group agreed that the substance of recommendation (54) was acceptable, if the question of the effect on, and rights of the other contracting party were dealt with in recommendations (53) and (56). That included notification of the insolvency representative’s decision to the contracting party and the ability of that party to challenge that decision. It was also noted that there were differing views regarding the necessity of approval of the court in such circumstances, which might be discussed in the commentary.

146. With respect to the exception included in parentheses in recommendation (55), it was suggested that it should be deleted on the basis that once a contract had been continued, all terms should be enforceable. On the basis that the insolvency representative should not be responsible for a breach of an automatic termination clause, it was proposed that the exception should be moved to after “and” and before the word “damages” to link it specifically to damages rather than enforceability. Some concerns were expressed as to the potential liability of the insolvency representative on the basis of the words in the last line “breach of the contract by the insolvency representative” and after discussion it was agreed that the reference to the insolvency representative should be deleted, and that the exception should also be deleted. With respect to the use of the word “continues” it was suggested that a different term should be used, such as “adopted” or “assumed”, to make it clear that damages would be relevant only for those contracts that the insolvency representative affirmatively decided to continue. A concern was raised that the recommendations did not address contracts of which the insolvency representative was unaware and how they would be treated. In particular, it was suggested that failure by the insolvency representative to address such contracts should not amount to a decision to continue.

147. Proposals with respect to the drafting of recommendation (56) were that the phrase “time of commencement” should be amended to “before commencement”; paragraph (a) should refer to the “insolvency estate’s” ability; the



references to “continuation” should refer to “continuation of performance”, both in (56) and throughout the Guide; the use of the words “decide to” should be used consistently throughout the Guide, or a different formulation used to indicate contracts in respect of which the insolvency representative had made an affirmative decision to continue; and the words “will have” be retained in (56)(b).

148. It was agreed that because the formulation “is capable of being cured” in recommendation (56)(a) was too broad and susceptible of abuse it should be deleted. It was noted however, that an obligation to cure breach should not be absolute and the word “substantially” should be added to (56)(a) after “returned”. Use of the phrase “appropriate assurances” was questioned and in response it was suggested that what was required was a guarantee of performance from the insolvency representative. It was agreed that contracts, however described, for the provision of essential services, such as water and electricity may need to be addressed, but that the formulation in square brackets in (56)(b) was not appropriate. The debtor must be assured access to those services, especially where the application for commencement was an involuntary application, and on the basis that it could perform its post-commencement obligations, the service should continue to be provided. It was suggested that some examples of the types of contracts under consideration could be added to the commentary.

149. With respect to rejection, it was observed that some jurisdictions did not provide a power to reject contracts as performance of a contract simply ceased unless the contract was adopted by the insolvency representative. On that basis, it was suggested that that option be discussed in the commentary, and the word “should” in recommendation (57) be changed to “may”. After discussion, the substance of the recommendation was found to be acceptable with the suggested amendment.

150. The substance of recommendations (58) and (59) was found to be acceptable as drafted. The substance of recommendation (60) was found to be acceptable with the removal of the square brackets and retention of both texts.

151. In response to a concern that the time of rejection in recommendation (61) should not be effective retroactively, it was suggested that the requirement for the insolvency law to set the time should overcome that problem. Any issues with respect to the desirability of retroactive effectiveness should be addressed in the Guide.

152. With respect to recommendation (62), changes suggested were that the word “affirmatively” be added before “decide to” and the parentheses removed from the following text; that the word “may” in the opening phrase be changed to “should”; that “may” in the second sentence be changed to “should”; and the word “limit” be replaced by “period”. With respect to the text in parentheses, it was proposed that the insolvency law should set specific time periods in those cases where a decision was required to be taken. With respect to the second sentence of recommendation (62), it was suggested that the consequences of failure to act should be discussed in the commentary. One example proposed was that the contract would be unenforceable and it was suggested that any provisions added with respect to consequences should address the potential

difference between liquidation and reorganization. It was recalled that paragraph 140 of the commentary perhaps adequately addressed that issue, an approach which received support. A further suggestion was that a reference to provision of a list of contracts could be added to recommendation (92)(d).

153. The Working Group agreed that the words in square brackets at the beginning of recommendation (63) be retained and the brackets removed, and that the drafting of recommendation (63) be improved to read “to take a prompt decision”. A suggestion that was supported was that prejudice should never be a condition for a request to make a decision and the words following “with respect to a contract” should be deleted. To address what could occur if the insolvency representative failed to take a decision, it was suggested that the text be adjusted to read, “the insolvency law should permit a counterparty to request of the insolvency representative, or the court in the event that the insolvency representative failed to act, that the insolvency representative take a prompt decision”. That would enable the counterparty to ask the court to order the insolvency representative to act where it failed to do so.

154. After discussion it was agreed that recommendation (64) was not needed and could be deleted together with the opening words of (65) up to “the insolvency law” and that recommendation (65) should retain the words “might provide”. It was also agreed that paragraph (c) of recommendation (66) properly belonged to recommendation (65) as a pre-condition for assignment. In recommendation (66)(a) it was suggested that the phrase “post-commencement” be added before “obligations” for greater clarity. It was agreed that the words in square brackets in recommendation (66)(c) be retained and the phrase amended to read “is necessary or of benefit to the estate”, which would cover both reorganization and liquidation. The remaining words could then be deleted. A proposal for an additional sentence to be added to recommendation (66) along the lines of “The insolvency law may further provide that if the contract is assigned, the assignee is substituted for the debtor as the contracting party from and after the date of the assignment” received some support. In terms of the language on unreasonable harm or disadvantage, it was decided after discussion that both options should be retained as possible alternatives. In response to a question concerning the need to cure defaults before assignment of a contract, it was agreed that that issue should be addressed in the commentary.

155. Some concerns were expressed as to the intention of recommendation (67) and the contracts that should be included. There was general agreement that labour contracts should be addressed in view of the applicable international regimes. After discussion, the Working Group agreed on the need for a general provision referring to the special treatment of certain types of contracts, with the addition of some examples, such as labour contracts.

156. The Working Group agreed to delete the reference in recommendation (68) to “the ordinary course of business”. It was suggested that a cross reference could be added to address post-commencement contracts that might be avoidable or unauthorized.

*E. Avoidance proceedings (A/CN.9/WG.V/WP.63/Add.9)*

*Recommendations*

157. With respect to the purpose clause, the Working Group agreed to the use of “reconstitute” and “equitable” in paragraph (a) and in paragraph (b) to retain all of the words in square brackets and to change “or” to “and”.

158. With respect to recommendation (69), the Working Group agreed that the reference to “net worth” should be changed to “value of the insolvency estate” and that the term “equitable” rather than “fair” should be retained. The words in square brackets “[or authorized transactions occurring after [application for] commencement]” should be aligned with the wording agreed in the purpose clause.

159. The Working Group discussed a number of aspects of the criteria under recommendation (70) for avoidance of transactions and agreed, in respect of paragraph (a), that the words “by, for example, the transfer of assets to any third party” should be deleted and the underlined text retained. With respect to the issue of the knowledge of the third party, the prevailing view was in favour of amending the requirement to “the third party knew or should have known” of the debtor’s intent. Defences available to the third party should be further addressed in the context of recommendations (79) and (80) on evidentiary issues. To address an alternative suggestion that the types of transactions referred to in paragraph (a) might be avoidable where the debtor was insolvent, in which case the knowledge required of the third party would relate to the fact of insolvency, further discussion could be included in the Guide. It was also agreed that in paragraphs (b) and (c), the word “insolvent” should be retained and the words “had ceased making payments” should be deleted, where the term “insolvent” should be defined by reference to the Working Group’s previous discussion in the context of commencement criteria and further explained both in the commentary and the glossary.

160. The Working Group agreed that recommendation (71) addressed two ideas that should be retained in the Guide: (i) where a security interest was valid or effective and enforceable under law other than the insolvency law, the insolvency law should recognize that validity or effectiveness and enforceability; and (ii) notwithstanding that a security interest might be valid or effective and enforceable under other law, it may still be subject to the avoidance provisions of the insolvency law. The Working Group did not resolve the placement of the first principle in the Guide. With regard to the second principle, support was expressed in favour of incorporating the substance of footnote 3 into recommendation (69) to better explain what was intended.

161. Several changes were proposed with respect to recommendation (72). It was proposed that paragraph (a) was not necessary and should be deleted. In response to a suggestion that “may” be substituted with “should” in paragraph (b), the view was expressed that since no particular times were recommended, it was difficult to see how or why the period should be longer for related persons if the suspect period applicable in the case where no related person was involved was already a long period of time, and the word “may” should be retained. It was proposed that paragraph (c) be divided into two paragraphs, with one

addressing the issue of presumptions and the other shifts in the burden of proof required to facilitate avoidance of transactions detrimental to the insolvency estate. It was noted that since the term “related persons” could cover a variety of persons, both natural and legal, it should be defined in the glossary.

162. The substance of recommendations (73) and (74) was agreed to be acceptable.

163. With respect to recommendation (75), the Working Group agreed that the suspect period should be “calculated retrospectively from” either the date of application for commencement or the date of commencement of proceedings, with both options to be retained in the recommendation and further explained in the commentary.

164. Different views were expressed with respect to the desirability of creditors commencing avoidance actions and whether that ability should be in addition or substitution to that of the insolvency representative, and whether approval of the court would be required (recommendation (76)). One view was that creditors could only commence avoidance actions in cases where the insolvency representative decided not to or where the insolvency representative was in agreement that the action should be taken by creditors. The need to respect the central role and responsibilities of the insolvency representative in administering the estate was cited in support of that view. In any event, it was observed that the insolvency law should emphasize that the purpose of avoidance actions was to return value or assets to the estate, not to benefit some other party. As a different approach, it was noted that some insolvency laws provided that the agreement of creditors or the majority of creditors was required in order for the insolvency representative to commence an avoidance action. Creditors who did not agree to the insolvency representative taking such action could themselves take that action at their own risk.

165. Another view was that where creditors were permitted to commence an avoidance action, that ability should be subject to approval by the court, although it was also noted that in some countries it might be problematic to require court approval to commence such an action. Where an issue of creditor abuse might arise if creditors were able freely to commence avoidance actions, sanctions could be imposed against the creditor or the creditor could be required to pay the costs of the action. A further view was that court approval should not be required as a matter of course, but rather that the power of creditors to commence such actions should be dependent upon agreement in the first instance by the insolvency representative. If the insolvency representative did not agree, then creditors could seek court approval and the insolvency representative would have the right to be heard as to why the avoidance action should not be pursued. It was noted that that approach was desirable also to prevent possible deal-making between the various parties. After discussion, the prevailing view was that creditors could have the power to pursue avoidance actions, but should first be required to consult with the insolvency representative and where the insolvency representative did not agree, could seek approval of the court (which might give leave to commence the avoidance action or hear the case on the merits).

**B. Working paper submitted to the Working Group on Insolvency Law at its twenty-seventh session: Draft Legislative Guide on Insolvency Law: note by the secretariat (A/CN.9/WG.V/WP.63 and Add.3-15) [Original: English]**

BACKGROUND REMARKS

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of model laws on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a “front-line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session in 2000 the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.<sup>1</sup>

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the Secretariat, in cooperation with INSOL and the IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December 2000.

6. At its thirty-fourth session in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished so far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the Guide, should be included as far as possible.<sup>2</sup>

8. The twenty-fourth session of the Working Group on Insolvency Law (New York, 23 July to 3 August 2001) commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504. Work continued at the twenty-fifth (Vienna, 3-14 December 2001) and twenty-sixth (New York, 13-17 May 2002) sessions of the Working Group. The reports of those meetings are contained in documents A/CN.9/507 and A/CN.9/511 respectively.

9. At its thirty-fifth session in 2002, the Commission had before it the reports of the twenty-fourth, twenty-fifth and twenty-sixth sessions of the Working Group. The Commission noted that, at its twenty-sixth session, the Working Group had discussed the likely timing for the completion of its work and had considered that it would be in a better position to make a recommendation to the Commission after its twenty-seventh session (Vienna, 9-13 December 2002) when it would have the opportunity to review a further draft of the legislative guide. The Commission requested the

<sup>1</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 400-409.

<sup>2</sup>Ibid., Fifty-sixth Session, Supplement No. 17 (A/56/17), paras. 296-308.

Working Group to continue the preparation of the legislative guide and to consider its position with respect to completion of its work at its twenty-seventh session.<sup>3</sup>

10. This note and the accompanying addenda set forth the revised draft Legislative Guide on Insolvency Law. Documents A/CN.9/WG.V/WP.63/Add.3-15 will be available for consideration by the Working Group at its twenty-seventh session; documents A/CN.9/WG.V/WP.63/Add.1, 2, 16 and 17 will be available for consideration at the twenty-eighth session (24-28 February 2003, New York) of the Working Group. Document A/CN.9/WG.V/WP.64 is intended to assist the deliberations of Working Groups V and VI at their joint session on 16 December 2002 and sets forth those paragraphs and recommendations of the draft insolvency guide that refer to the treatment of secured creditors in insolvency.

11. The chapters of the draft Guide are set out in the following addenda:

**Part one**

Add.1 Glossary and preamble (key objectives)

**Part two**

*Chapter I. Introduction to insolvency procedures*

Add.2 A (General features of an insolvency regime); B (Types of insolvency procedures); C (Structuring an insolvency regime)

*Chapter II. Application and commencement*

Add.3 A (Eligibility and jurisdiction)

Add.4 B (Commencement)

*Chapter III. Treatment of assets on commencement of insolvency proceedings*

Add.5 A (Assets to be affected)

Add.6 B (Protection and preservation of the insolvency estate)

Add.7 C (Use and disposition of assets)

Add.8 D (Treatment of contracts)

Add.9 E (Avoidance proceedings); F (Setoff, netting and financial contracts)

*Chapter IV. Participants and institutions*

Add.10 A (The debtor); B (The insolvency representative)

Add.11 C (Creditors); D (Institutions)

*Chapter V. Reorganization*

Add.12 A (Reorganization); B (Expedited reorganization procedures)

*Chapter VI. Management of proceedings*

Add.13 A (Creditor claims)

Add.14 B (Post-commencement finance); C (Priorities and distribution)

Add.16 D (Creditor and debtor protection); E (Consolidation of proceedings) [new sections]

*Chapter VII. Resolution of proceedings*

Add.15 A (Discharge); B (Conclusion of proceedings)

Add.17 Choice of law [new section]

12. The commentary and recommendations contained in these addenda have been revised on the basis of the previous discussions of the Working Group. Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide. Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated by underlined text and deletions are indicated by strike through. The version of the Glossary, preamble and part one of the draft Guide that will be available to the Working Group is contained in document A/CN.9/WG.V/WP.57.

<sup>3</sup>Ibid., *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, para. 194.

## Draft Legislative Guide on Insolvency Law

### Note by the secretariat (A/CN.9/WG.V/WP.63/Add.3)

[Original: English]

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.B appears in document A/CN.9/WG.V/WP.63/Add.4. chapters III-VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

## Part two (continued)

### II. APPLICATIONS AND COMMENCEMENT

#### A. Eligibility and jurisdiction

##### 1. *Eligibility: debtors to be covered by an insolvency law*

1. An important threshold issue in designing a general insolvency law focused on debtors engaged in commercial activities is determining and clearly defining which debtors will be subject to the law. To the extent that any debtor is excluded from the process, it will not enjoy the protections offered by the process, nor will it be subject to the discipline of the process. This argues in favour of an all-inclusive approach to the design of an insolvency law, with limited exceptions. The design of eligibility provisions that will identify the types of debtors whose assets may be liquidated or reorganized and any debtors that are to be excluded from the application of the law raises two questions. Firstly, whether the law should distinguish between individual debtors and debtors which are some form of limited liability enterprise or corporation, each of which will raise not only different policy considerations, but also considerations concerning social and other attitudes, and secondly, what types of debtors (regardless of the question of whether the debtor is an entity or an individual), if any, should be excluded from the application of the insolvency law.

2. Countries adopt different approaches to defining the scope of application of their insolvency laws. Some insolvency laws apply to all debtors with certain specified exceptions, such as those discussed below. Other countries distinguish between individual (natural person) debtors and juridical or legal person debtors and provide different insolvency laws for each. A further approach distinguishes between entities or individuals on the basis of their engagement in commercial (or consumer) activities. Some of these laws address the insolvency of “merchants” which are defined by reference to engagement in commercial activities as an ordinary occupation, or companies incorporated in accordance with commercial laws and other entities that regularly undertake commercial activities. Some laws also include different procedures on the basis of levels of indebtedness, and a number of countries have developed special insolvency regimes for different sectors of the economy, particularly the agricultural sector.

##### (a) *Debtors: individuals engaged in commercial activities*

3. [1] Policies towards individual or personal debt and insolvency often evidence cultural attitudes that are not as relevant to commercial debtors and may include, for exam-

ple, attitudes toward the incurring of personal debt; the availability of relief for unmanageable debt; the social effect of bankruptcy on the status of individuals; the need for counselling and educational assistance with respect to individual debt; and the provision of a fresh start for debtors through a discharge from debts and claims. Policies applicable to insolvency in the commercial sector, in comparison, are generally restricted to economic and commercial considerations such as the important role that business plays in the economy; the need to preserve and encourage commercial and entrepreneurial activity; and the need to encourage the provision of credit and to protect creditors where credit is provided.

4. [2] The principal issue for consideration relates to individuals involved in commercial activity (including, for example, partnerships of individuals and sole traders) and deciding whether they should be included within the scope of a commercial insolvency law. The interests of individual commercial debtors differ from those of individual consumer debtors, at least in some aspects of their indebtedness, but it is often difficult to separate an individual’s personal indebtedness from their commercial indebtedness for the purposes of determining how they should be treated in insolvency. Different tests may be developed to facilitate that determination, such as focusing upon the nature of the activity being undertaken, the level of debt and the connection between the debt and the commercial activity. Indicators of involvement in commercial activity may include whether the business is registered as a trader or other commercial operative; whether it is a corporate entity under the commercial law; the nature of its regular activities; information concerning turnover and assets and liabilities; and [...]. Many countries include individual debtors involved in commercial activity within the scope of their commercial insolvency laws. The experience of other countries suggests that although individual business activities form part of commercial activity, these cases often are best dealt with under the regime for individual insolvency because ultimately the proprietor of a personal business will conduct its activities through a structure that does not enjoy any limits on liability and will remain personally liable, without limitation, for the debts of the business. These cases also raise difficult issues of discharge (release of the debtor from liability for part or all of certain debts after the conclusion of the proceedings) such as the length of time required to expire before the debtor can be discharged and the obligations which can be discharged or exempted from discharge. Debts which cannot be discharged often involve personal matters such as settlements in divorce proceedings or child support obligations. An additional consideration is that the inclusion of individual insolvency within the commercial insolvency regime may have the potential, in some countries, to act as a disincentive to use of the commercial regime because of the social attitude towards individual insolvency, irre-



spective of its commercial nature. It is desirable that these concerns be considered in designing an insolvency law to address commercial insolvency. This Guide focuses upon the conduct of commercial activities, irrespective of the vehicle through which those activities are conducted, and identifies those issues where additional or different provisions will be required if individual debtors are included in the insolvency law.

(b) *State-owned enterprises*

5. [3] A general insolvency law can apply to all forms of entity engaged in commercial activities, both private and State-owned, especially those State-owned enterprises which compete in the market place as distinct commercial or business entities and are otherwise subject to the same commercial and economic processes as privately-owned entities. Government ownership of an enterprise may not, in and of itself, provide a sufficient basis for excluding the enterprise from the coverage of the insolvency law, although a number of countries do adopt that approach. Where the State plays different roles with respect to the enterprise not only as owner, but also as lender and largest creditor, normal incentives will not apply, compromise solutions may be difficult to achieve and there is clear ground for conflicts of interest to arise. Inclusion of these enterprises in the insolvency regime therefore has the advantages of subjecting them to the discipline of the regime, sending a clear signal that government financial support for such enterprises will not be unlimited, and providing a procedure which has the potential to minimize conflicts of interest. The need for exceptions to a general policy of inclusion may arise where the Government has adopted a policy of extending an explicit guarantee in respect of the liabilities of such enterprises, and where the treatment of State enterprises is part of a change in macroeconomic policy, such as a large-scale privatization programme. In these cases, independent legislation dealing with relevant issues, including insolvency, may be warranted. The Guide does not address issues specifically relevant to that independent legislation.

(c) *Entities requiring special treatment*

6. [4] Although it may be desirable to extend the protections and discipline of an insolvency law to as wide a range of entities as possible, separate treatment may be provided for certain entities of a specialized nature, such as banking and insurance institutions, utility companies, and stock or commodity brokers. Exceptions for these types of entities are widely reflected in insolvency laws and are generally justified on the basis of the detailed regulatory legal regimes to which they are often subjected outside of the insolvency context. These regulatory regimes often include provisions addressing the insolvency of the regulated entity. The special considerations arising from the insolvency of such entities and consumer insolvency are not specifically addressed in the Guide.

## 2. *Jurisdiction*

7. [5] In addition to possessing the necessary business or commercial attributes, a debtor must have a sufficient connection to the State to be subject to its insolvency laws. In

many cases, no issue as to the applicability of the insolvency law will arise as the debtor will be a national or resident of the State and will conduct its commercial activities in the State through an entity registered or incorporated in the State. Where there is a question of the debtor's connection with the State, however, insolvency laws adopt different tests including that the debtor has its centre of main interests in the State, that the debtor has an establishment in the State and that the debtor has assets in the State.

(a) *Centre of main interests*

8. [6] Although some insolvency laws use tests such as principal place of business, UNCITRAL has adopted, in the Model Law on Cross-Border Insolvency ("the UNCITRAL Model Law"), the test of "centre of main interests" of the debtor to determine the proper location of what is termed the "main proceedings" for that debtor. Although the Model Law deals with matters of international insolvency, the test of "centre of main interests" is also relevant to domestic insolvency. In addition to the UNCITRAL Model Law, that term is used in the UNCITRAL Convention on the Assignment of Receivables in International Trade and in the Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings ("the EC Regulation"). The UNCITRAL Model Law does not define the term; the EC Regulation (13th Recital) indicates that the term should correspond to "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties." An appropriate test would be the one provided in article 16(3) of the UNCITRAL Model Law and article 3 of the EC Regulation: the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of main interests, unless it can be shown that the centre of main interests is elsewhere. A debtor which has the centre of its main interests in a State should be subject to that State's insolvency law.

9. [7] Notwithstanding the adoption of the "centre of main interests" test, a debtor which has assets in more than one State may find itself satisfying the requirements to be subject to the insolvency law of more than one State because of the different tests of debtor eligibility or different interpretations of the same test, with the possibility of separate insolvency proceedings in those countries. In such cases, it will be appropriate to have in place legislation based on the UNCITRAL Model Law to address questions of co-ordination and cooperation (see Part two, chapter VIII).<sup>1</sup>

(b) *Establishment*

10. [8] Some laws provide that insolvency proceedings may be commenced in a jurisdiction where the debtor has an establishment. The term "establishment" is defined in article 2 of the UNCITRAL Model Law to mean "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services." Article 2 of the EC Regulation includes a similar definition but omits the reference to "services". Essentially,

<sup>1</sup>It has been proposed that the Model Law and Guide to Enactment (revised to take account of developments in cross-border insolvency practice since the adoption of the Model Law) should be included as an additional chapter of this Guide.

an establishment is a place of business that is not necessarily the centre of main interests. The definition, like the term “centre of main interests”, is important to the overall structure of the UNCITRAL Model Law and its treatment of cross-border insolvency cases as a criterion for recognition of foreign insolvency proceedings and the application of measures for relief. It is therefore of relevance to a domestic insolvency regime and the commencement of proceedings in respect of the assets of a debtor’s establishment in a particular State. In many countries, managers of an establishment that is unable to pay its debts will have personal liability to creditors unless they commence an insolvency proceeding. Eligibility to commence proceedings under the insolvency law of the State on the basis of an establishment therefore is necessary.

11. [8] The EC Regulation similarly provides that secondary insolvency proceedings may be opened in a jurisdiction where a debtor has an establishment. Generally those proceedings will be restricted to liquidation proceedings covering the assets of the debtor situated in the territory of that State. Depending upon the nature of the debtor’s business and the assets concerned, there may be limited situations where reorganization proceedings could be based upon establishment.

(c) *Presence of assets*

12. [9] Some laws provide that insolvency proceedings may be commenced by or against a debtor that has assets within the jurisdiction or has had assets within the jurisdiction without requiring an establishment or centre of main interests within the jurisdiction. The UNCITRAL Model Law does not provide for the recognition of foreign proceedings commenced on the basis of presence of assets. It does provide, however, that once proceedings commenced in the jurisdiction where the debtor has its centre of main interests have been recognized in the foreign State, local proceedings based on presence of assets can be commenced in the recognizing State to deal with those local assets.<sup>2</sup>

13. [9] A distinction can perhaps be made between liquidation and reorganization proceedings commenced on the basis of presence of assets; while presence of assets may be an appropriate basis for commencement of liquidation proceedings involving specific assets located in a State, it may not be sufficient for the commencement of reorganization proceedings, particularly where proceedings commenced in the centre of man interests are liquidation proceedings. Although one country does provide that the presence of assets will be sufficient to commence reorganization proceedings (and that those proceedings can involve the assets of the debtor wherever located), there will be a need to coordinate those proceedings with other jurisdictions where the debtor will have its centre of main interests and possibly establishments. The test of presence of assets may therefore raise multi-jurisdictional issues, including multiple proceedings and questions of coordination and cooperation between proceedings that may implicate the UNCITRAL Model Law (see part two chapter VIII).

<sup>2</sup>UNCITRAL Model Law, article 28.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on eligibility and jurisdiction is to establish:

- (a) which types of debtors can be subject to the [general] insolvency law;
- (b) which types of debtors may be excluded from the [general] insolvency law;
- (c) which debtors have sufficient connection to a State to be subject to its insolvency laws; and
- (d) which courts have jurisdiction over insolvency matters.

### Content of legislative provisions

#### *Eligibility*

(11) The insolvency law should govern insolvency proceedings of all debtors, including individuals and State-owned enterprises, which engage in commercial activities.

(12) Exclusions from the application of the [general] insolvency law should be limited and clearly identified in the law.<sup>3</sup>

#### *Jurisdiction*

(13) The insolvency law should specify which debtors have sufficient connection to a State to be subject to its insolvency laws. Different approaches may be taken to identifying appropriate connecting factors, but the grounds upon which a debtor can be subject to the insolvency law should include:

- (a) that the debtor has its centre of main interests in the State; or
- (b) that the debtor has an establishment in the State.

(14) In interpreting the phrase “centre of main interests”, the insolvency law should provide a presumption that, in the absence of proof to the contrary, a legal person’s centre of main interests is in the State in which it has its registered office, and a natural person’s centre of main interests is in the State in which it has its habitual residence.

(15) The insolvency law should define “establishment” to mean “any place of operations where the debtor carries out non-transitory economic activity with human means and goods or services”.<sup>4</sup>

(16) [(15)] The insolvency law should clearly indicate which court has jurisdiction over insolvency proceedings and over matters arising in the conduct of an insolvency proceeding.

<sup>3</sup>Highly regulated entities such as banks and insurance companies may require specialized treatment which can appropriately be provided in a separate insolvency regime or through special provisions in the general insolvency law. Where a special regime or special provisions have been developed, those entities may be excluded from the provisions of the general insolvency regime.

<sup>4</sup>UNCITRAL Model Law on Cross-Border Insolvency, art. 2(f).

## A/CN.9/WG.V/WP.63/Add.4

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63 and part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A appears in document A/CN.9/WG.V/WP.63/Add.3. chapters III-VII appear in subsequent addenda]*

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**Part two (continued)****II. Applications and commencement****B. Application and commencement criteria****1. Introduction**

14. [10] Application and commencement criteria are central to the design of an insolvency law. By providing the basis upon which an application for the commencement of insolvency proceedings can be made, these criteria are instrumental to identifying the entities that can be brought within the protective and disciplinary mechanisms of the insolvency process and determining who may make an application, whether the debtor, creditors or other parties.

15. [11] As a general principle it is desirable that access to the insolvency process be convenient, inexpensive and quick in order to encourage financially distressed or insolvent businesses to voluntarily submit themselves to the process. It is also desirable that access is flexible in terms of the types of insolvency procedures available (liquidation and reorganization), the ease with which the procedure most relevant to a particular debtor can be accessed and conversion between the different types of procedures can be achieved. Restrictive access can deter both debtors and creditors from commencing procedures, while delay can be harmful in terms of its effect on the value of assets and the successful completion of the process, particularly in cases

of reorganization. Ease of access needs to be balanced with proper and adequate safeguards to prevent improper use of the process. Examples of improper use may include where a debtor that is not in financial difficulty applies for the commencement of insolvency proceedings in order to take advantage of the protections provided by the law, such as the automatic stay, to avoid or delay payment to creditors and where creditors who are competitors of the debtor take advantage of the process to disrupt the debtor's business and thus gain a competitive edge.<sup>1</sup>

16. [12] Laws differ on the specific criteria that must be satisfied before insolvency proceedings can commence. A number of laws include alternative criteria, and distinguish between the criteria applicable to commencement of liquidation and reorganization proceedings, as well as to applications by a debtor and creditors.

**2. Application criteria***(a) Liquidity or cash flow standard*

17. [14] A criterion that is used extensively for commencement of insolvency proceedings is what is known as the liquidity, cash flow or general cessation of payments standard. This requires that the debtor has generally ceased making payments and will not have sufficient cash flow to

<sup>1</sup>This is discussed further in the context of denial of the commencement application and dismissal of proceedings.



service its current obligations as they come due in the ordinary course of business. Reliance on this standard is designed to activate proceedings sufficiently early in the period of the debtor's financial distress to minimize dissipation of assets and avoid a race by creditors to grab assets that would cause dismemberment of the debtor to the collective disadvantage of all creditors. Allowing commencement to take place only at a later stage when the debtor can demonstrate greater financial distress, such as balance sheet insolvency (when the balance sheet of the entity shows that the value of the debtor's liabilities exceed its assets—discussed below), may only serve to delay the inevitable and diminish recoveries.

18. [15] One problem associated with the general cessation of payments standard is that the inability of the debtor to pay its debts as they become due may point to only a temporary cash flow or liquidity problem in a business that is otherwise viable. In today's competitive markets, where competition may compel market participants to accept ever lower profits or even losses in order to become competitive, the concept of inability to pay debts and the manner in which it is incorporated into the insolvency law as a commencement criteria may need to be carefully considered.

(b) *Balance sheet standard*

19. [17] An alternative to the general cessation of payments standard would be the balance sheet approach which is based on excess of liabilities over assets as an indication of financial distress. A practical limitation of this approach is that it is rarely possible for parties other than the debtor to ascertain the true state of the debtor's financial affairs until after it has become a settled and often irreversible fact, and thus may not easily form the basis for a creditor application. This approach has a number of other disadvantages. Where accounting standards and valuation techniques give rise to results that do not reflect the fair market value<sup>2</sup> of a debtor's assets or where markets are not sufficiently developed or stable to enable that value to be established, this approach can be an inaccurate measure of insolvency. This may also be true in the case of service businesses that under this test may technically be insolvent, even when the business is essentially viable. This test can also lead to delay and difficulties of proof as an expert would generally be required to review books, records and financial data<sup>3</sup> to reach a determination of the entity's fair market value. This is especially difficult where those records are not properly maintained or readily available. For these reasons the balance sheet test often leads to proceedings being commenced after the possibilities of reorganization have disappeared, and negatively affects

<sup>2</sup>Fair market value is generally considered to be the value that reasonably can be expected to be obtained in an arm's length sale between a buyer and a seller, where neither party is under a compulsion to buy or sell. In the absence of a real sale, value may be somewhat speculative, as values are based on assumptions made regarding the conditions for the sale of the assets in question. To reduce the speculation, techniques have been developed to approximate value on the basis of sale of comparable businesses and assets, or on the basis of a multiple of the enterprises earnings potential. In markets where assets cannot be easily sold, because the market is saturated or because a market for the assets in question does not exist, value is difficult to measure.

<sup>3</sup>Book value—to be completed.

the debtor's ability to deal collectively with its creditors when the debtor maintains an operating business. It may thus circumvent the objective of maximization of value. While the balance sheet approach may be used to assist in defining insolvency, for the reasons outlined above it may not be sufficiently reliable to constitute the sole basis of that definition.

(c) *Designing the commencement standard*

20. Insolvency laws use the general cessation of payments standard and the balance sheet approach in different combinations to establish a commencement test. Some laws adopt a simple form of the general cessation of payments standard, requiring that the debtor be unable to meet its obligations as they fall due. Other laws adopt that test and add further requirements, for example, that the cessation of payments must reflect a difficult financial situation that is not temporary, that the creditworthiness of the debtor must be at stake and that it be just and equitable for the debtor to be liquidated. Another approach is that in addition to having ceased making payments, the debtor must be overindebted where overindebtedness is determined, for example, by the debtor's inability to satisfy its debts as they become mature because its liabilities exceed its assets.

(i) *Imminent insolvency (Prospective illiquidity)*

21. Some laws which adopt the cessation of payments test also make provision for a debtor to apply for commencement on the basis of imminent insolvency or prospective inability to pay, where the debtor will be unable to meet its future obligations as they fall due. While in some cases the prospective inability might relate to a short period into the future, there may be cases where it will relate to a significantly longer term, depending upon the nature of the obligation to be met. Factual circumstances which could establish prospective inability might include that the debtor has a long-term obligation to make a bond payment that it knows it will not be able to make, or that it is the defendant to a mass tort claim that it knows it cannot successfully defend and will not be able to pay the associated damages.

(ii) *Types of proceedings that may be commenced*

22. [16] A second dimension of the commencement standard is the type of proceeding that can be commenced. In some laws the commencement standard, whether based on general cessation of payments or the balance sheet test, provides the basis for commencement of either a liquidation or reorganization procedure. Where the liquidation application is made by creditors, the insolvency law may permit the debtor to apply for the proceedings to be converted from liquidation to reorganization. Under other insolvency laws where reorganization is favoured, a reorganization procedure must be commenced, but can be converted to liquidation when it is shown that the debtor cannot be reorganized. Under a further approach, the effect of the application is neutral and the choice between liquidation and reorganization will only be made after a period of assessment of the debtor's financial situation.

### 3. Liquidation

#### (a) Parties who may apply

23. [13] Insolvency laws generally provide for an application for liquidation proceedings to be made by the debtor (often described as voluntary proceedings), by one or more creditors (often described as involuntary proceedings), by a government authority or by operation of law where the failure by the debtor to meet some statutory requirement (such as maintenance of a specified level of assets) automatically triggers insolvency proceedings (also described as involuntary).

#### (b) Debtor application

24. [18] Many insolvency laws adopt the general cessation of payments standard for debtor applications for liquidation. As a matter of practice, an application by a debtor to commence liquidation proceedings will generally be a last resort where it is unable to pay its debts and, in the absence of opposition, satisfaction of those requirements will not be strictly followed. That practice is reflected in some laws that allow a debtor to make an application either on the basis that it has ceased to repay its debts as they become due or, in the alternative, on the basis of a simple declaration of its financial condition, such as that it is unable to or does not intend to pay its debts (which in the case of a legal person may be made by the directors or other members of a governing body). At least one insolvency law dispenses with the need for the debtor to allege any particular financial state.

#### (i) Establishing an obligation for debtor to apply

25. [19] A matter related to debtor applications is the question of whether or not the debtor should have an obligation to make an application for commencement of proceedings at a certain stage of its financial difficulty. There is no widely agreed approach to this issue. Some insolvency or business governance laws include provisions such as that the debtor must make an application within a period of time varying from two weeks to 60 days after being unable to pay its debts as they become due or after learning of its overindebtedness determined by reference to its balance sheet. Some laws specify how cessation of payments is to be determined which may include, for example, by reference to bank records that show that the debtor has failed to pay a certain percentage of its aggregate debts for a certain period of time, such as two months. In the case of liquidation, the imposition of such a duty may protect creditors' interests by preventing further dissipation of the debtor's assets and, in the case of reorganization, increase the chances of success by encouraging early action. This may be important in countries where there isn't an active creditor class that can be relied upon to commence proceedings. Experience in some countries suggests, however, that imposing an obligation on the debtor to apply after a certain number of days or weeks of inability to pay or cessation of payments simply leads to debtor applications which do not reflect a true position of insolvency (and thus a real need for liquidation or reorganization). In some countries it has also placed additional strain on the insol-

veny infrastructure where it may not have been sufficiently developed to handle a large number of such applications.

26. [19] Establishing such an obligation may also raise difficult practical questions of how and when it should apply, particularly where a delay in applying for formal proceedings could lead to personal liability of members of the debtor, its governing body or its managers. In those circumstances it may operate to discourage the debtor from pursuing alternative solutions to its financial difficulties, such as an out-of-court reorganization agreement, which may be a more appropriate alternative in particular cases. In addition, an obligation to file will be of no effect where it is not combined with enforceable (and enforced) sanctions for the failure to comply. The adoption of incentives (such as the application of a stay to protect the debtor against enforcement and other actions—see part two, chapter III.B) may be a more effective means of encouraging debtors to initiate proceedings at an early stage.

#### (c) Creditor application

27. [20] Many insolvency laws also adopt the cessation of payments requirement for creditor applications for liquidation, often with the additional requirement that the debt be undisputed. In a few laws, that debt must be based upon a court judgement. Where the standard of general cessation of payments is adopted for creditor applications, problems of proof may arise. While creditors may be able to show that the debtor has failed to pay their own claim or claims, providing evidence of a general cessation of payments may not be so easy. There is a practical need for a creditor to be able to present proof, in relatively simple form, which establishes a presumption of insolvency on the part of the debtor, without placing an unreasonably heavy burden of proof on creditors. To refine the standard of general cessation of payments in order to establish a threshold of proof that creditors may satisfy, a reasonably convenient and objective test may be the failure of a debtor to pay a matured debt within a specified period of time after a written demand for payment has been made, or a specified time after the debt became due. A number of insolvency laws include such provisions, with the specified time ranging from eight days to 24 weeks in those cases where a formal demand is required. Some insolvency laws also include provision for the application to be based upon an unsuccessful debt recovery action that took place within a specified period of time, such as three months, before the application for commencement is made.

28. [20] Creditors holding unmatured claims also have a legitimate interest in the commencement of insolvency proceedings. A particular concern may arise, for example, in the case of holders of long-term debt. Where the test is one of maturity of debt those creditors might never be eligible to seek commencement of proceedings, although it may be clear that the debtor will be unable to meet the obligation when the time comes. However, developing a test that would allow such a creditor to make an application may raise difficult issues of proof, particularly in connection with the debtor's financial status. Where an insolvency law provides that applications may be made by

creditors not holding mature debt, the issues of proof may need to be balanced against the objective of convenient, inexpensive and quick access.

29. [23] There may also be exceptional circumstances where there is no mature claim, but that would otherwise justify commencement of insolvency proceedings. These circumstances may include where there is evidence that the debtor is treating some creditors preferentially or where the debtor is acting fraudulently with regard to its financial situation. Some of these situations may more appropriately be addressed through laws dealing with fraud rather than by application of the insolvency law in the absence of evidence of insolvency.

30. [21] In addition to the requirements for cessation of payments, maturity of the debt and that the claim be undisputed, some insolvency laws include requirements such as that the application be made by more than one creditor (each of which may be required to be an unsecured creditor holding an undisputed claim); and that creditors not only hold mature claims, but that their claims represent a specified composite value of claims (or a combination of both a specified number of creditors and a composite value of claims). Another approach (in the case of an application by a single creditor) requires that the debtor furnish information to the court that will enable the court to determine whether non-payment of the debt is the result of a dispute with the particular creditor or is evidence of a lack of liquid assets.

31. [22] The requirement that more than one creditor make the application is often based upon the desire to minimize possible improper use by a single creditor who may seek to use the insolvency process as a substitute for a debt enforcement mechanism, particularly where the debt in question is small. That concern may need to be balanced, however, against the objective of facilitating quick and easy access to the insolvency process. Furthermore, the concern may be addressed by taking into account the value of the claim of the single creditor (although specifying a particular value for claims may not always be an optimal drafting technique as currency fluctuations may necessitate amendment of the law) or adopting a procedure like that outlined in the previous paragraph which requires the debtor to provide information to the court. It can also be addressed by providing for certain consequences, such as damages for harm done to the debtor, where the creditor application is an improper use of the insolvency process. These damages may relate not only the costs and expenses incurred by the debtor, but also to disruption to the debtor's business.

*(d) Application by a governmental authority*

32. [24] An insolvency law may give a governmental agency (normally the public prosecutor's office or the equivalent) or other supervisory authority non-exclusive authority to initiate liquidation proceedings against any entity if it ceases to make payments, in which case the same commencement criteria as apply in the case of applications by other creditors should generally apply.

33. [24] Some countries provide a more broadly-based power for governmental or other authorities to commence insolvency proceedings where initiation is considered to be in the public interest. In that case, a demonstration of illiquidity may not be necessary, enabling the Government to terminate the operations of otherwise healthy businesses that have been engaged in certain activities, for example, of a fraudulent or criminal nature. The exercise of such police powers is only appropriate in certain limited circumstances which involve actual indications of insolvency, and it is clearly desirable that they are used only as a last resort in the absence of appropriate remedies under other laws. A preliminary investigation of the affairs of the debtor may be required before proceedings can be commenced, or preliminary measures, such as application of a stay and appointment of an interim insolvency representative, granted to address a current situation with the court to decide, at the expiry of that period, on the commencement of insolvency proceedings. These powers would generally only be available to commence liquidation proceedings, although there may be circumstances where liquidation could be converted to reorganization, subject to certain controls. These controls might include that the business activity is lawful and that management of the entity is taken over by an insolvency representative or governmental agency.

#### **4. Reorganization**

*(a) Debtor application*

34. [25] One of the objectives of reorganization proceedings is to establish a framework that will encourage debtors to address their financial difficulties at an early stage. A commencement criterion which is consistent with that objective may be one which does not require the debtor to wait until it has ceased making payments generally (i.e. wait until it is illiquid) before making an application, but allows an application in financial circumstances which, if not addressed, will result in a state of insolvency. Approaches to debtor applications for reorganization vary between insolvency laws. In some laws, the reorganization procedure does not actually require the satisfaction of any substantive criterion: the debtor may make an application whenever it wishes and is only required to file a simple petition in the appropriate court. Other laws, including those that adopt a unitary approach (see part two, chapter I), specify that the debtor may make an application if it envisages that, in the future, it will not be in a position to pay its debts when they come due (prospective or imminent insolvency or illiquidity). A number of reorganization laws also require evidence of a real or reasonable prospect of survival of the debtor or of the economic viability of the debtor.

35. [26] It may be suggested that a relaxation of the commencement criteria could invite abuse of the procedure. For example, a debtor that is not in financial difficulty may apply to commence proceedings and submit a reorganization plan that is designed to allow it to shed onerous obligations, such as labour contracts, to allow it to renegotiate its debt or to prevaricate and deprive creditors of prompt payment of debts in full. Whether such improper

use could arise is a question of how the elements of the reorganization procedure are designed including the commencement criteria, requirements for preparation of the reorganization plan, debtor control of the business after commencement and sanctions for improper use of the process. Means of addressing possible improper use by the debtor could include providing that the relevant court has the power to dismiss the application and, in that event that the debtor should be liable to creditors for their costs associated with resisting the application and for any harm caused by the application.

(b) *Creditor application*

36. [27] Although insolvency laws generally provide for liquidation proceedings to be initiated by either a creditor or a debtor, there is no consensus as to whether reorganization proceedings can also be initiated by a creditor and a number of laws include provision only for debtor applications. Given that one of the objectives of reorganization proceedings is to provide an opportunity for creditors to enhance the value of their claims through the continued operation and reorganization of the entity, it may be desirable that the ability to apply not be given exclusively to the debtor. The ability of creditors to apply for reorganization is also central to the question of whether creditors can propose a reorganization plan (see part two, chapter V). A number of countries take the position that, since in many cases creditors are the primary beneficiaries of a successful reorganization, creditors should have an opportunity to propose the plan. If that approach is followed, it seems reasonable to provide that creditors can make an application for reorganization proceedings.

37. [28] Where creditors can make an application for reorganization of the debtor, different views are taken as to the commencement criteria. One view is reflected in those insolvency laws which adopt the same criterion of prospective illiquidity as applies in the case of a debtor application for reorganization. A different view is that that approach is difficult to justify not only because of the difficulties associated with creditors being able to prove that a standard of prospective illiquidity has been met. It is also because, as a general matter, it would seem unreasonable for any form of insolvency proceeding to be commenced against the debtor's will, unless creditors can demonstrate that their rights already have been impaired. To address those difficulties, commencement criteria could require creditors to demonstrate, for example, that ongoing cash will be available to pay for the day to day running of the business, that the value of the assets will support reorganization and that the return to creditors in a reorganization is likely to exceed the return in liquidation. One disadvantage of that approach is that it requires the creditors to have made, or be able to make, a thorough assessment of the business before making an application. To address any problem associated with creditors gaining access to relevant information, an insolvency law could provide, on the making of an application by creditors, for an assessment of the debtor's financial situation to be undertaken by an independent authority. Such a procedure may have the advantage of ensuring that proceedings are only commenced in appropriate cases, but care may be

needed to ensure that the additional requirements do not delay commencement of the proceedings with consequences for maximization of value of the assets and the likelihood of successful completion of the reorganization.

38. [31] Some laws adopt a variation of the cessation of payments standard, and require the application to be made by a specified number of creditors or by creditors holding a specified composite value of matured claims, or both. Other laws require creditors, on making an application, to provide a bond or payment to cover the costs of the commencement proceedings.<sup>4</sup>

39. [29] The question of the complexity or simplicity of commencement standards is closely linked to the consequences of commencement and the conduct of the insolvency proceedings. For example, in insolvency laws that apply a stay automatically on commencement of the proceedings, the ability of the business to continue trading and be successfully reorganized can be assessed after commencement (and conversion of the proceedings to liquidation can occur if reorganization is determined to be inappropriate, where the law allows this course). In other systems, that information may be needed before an application is made because the choice of reorganization presupposes that it will lead to a greater return for creditors than liquidation.

40. [30] For these reasons, it may be appropriate to apply the same commencement standard to applications by creditors for both liquidation and reorganization of the debtor (i.e. general cessation of payments). Such a standard would appear to be consistent with both the two-track approach and the unitary approach (see part two, chapter I.C), where the application of a different commencement standard is not so much a function of the type of proceedings being initiated, but rather whether the applicant is the debtor or a creditor. The exception to the approach of having the same commencement criteria for both liquidation and reorganization would be those systems that favour reorganization and where both a debtor and a creditor are precluded from initiating liquidation proceedings until it has been determined that reorganization is impossible. In that case, the commencement criterion for liquidation would not be general cessation of payments, but rather a determination that reorganization cannot succeed.

## 5. *Procedural issues*

### (a) *Initiation of the process*

41. The insolvency law should specify how the application for insolvency can be made. Many insolvency laws require an application to be filed with a specified court, although there are other examples such as a law that provides for the process to be initiated by lodgement of a declaration by the debtor with the corporate regulatory authority. This raises the question of the involvement of the court in the insolvency process, which is discussed in part one.

<sup>4</sup>Such a payment may also provide remuneration for the insolvency representative (see chapter V.B, and see also the discussion on costs of the insolvency proceeding, chapter II.B.7).

*(b) The decision to commence insolvency proceedings*

42. [32] A preliminary procedural issue relates to the manner in which the proceeding is commenced once the application has been made. In many countries the normal practice is for a court of competent jurisdiction to determine, on the basis of the application for commencement, whether the requisite conditions for commencement have been met. In some countries, that determination can also be made by the appropriate administrative agency, where that agency plays a central supervisory role in the insolvency process. The central issue, however, is not so much who makes the decision to commence proceedings but rather what that body is required to do in order to reach its decision. Entry conditions which are designed to facilitate early and easy access to the insolvency process not only will facilitate the court's consideration of the application by reducing complexity and assisting it to reach a decision in a timely manner, but also have the potential to reduce the cost of proceedings and increase transparency and predictability. The issue of cost may be of particular importance in the case of the insolvency of small and medium business entities.

43. [33] In addressing requirements for commencement, some insolvency laws draw a distinction between voluntary and involuntary applications. In some laws, a voluntary application by a debtor functions as an acknowledgement of insolvency and leads to an automatic commencement of proceedings, unless it can be shown that the process is being abused by the debtor to evade its creditors. In contrast, in the case of an involuntary application, the court is required to consider whether the commencement criteria have been met before deciding to commence the proceedings. In other laws, irrespective of whether the application is voluntary or involuntary, the court is required not only to determine whether the entry conditions have been met, but also to determine whether the type of proceedings applied for are appropriate to the particular circumstances of the debtor. If the assessment to be made is complex and there is a potential for delay between application and commencement, there is also the potential for further debts to be incurred in that period, as the debtor continues to trade and allows trade debts to increase in order to preserve cash flow, and for assets to be dissipated by the actions of creditors. Where that approach is followed, one means of reducing the potential complexity of the assessment is to provide, firstly, for the assessment to be made after commencement when the court can be assisted by the insolvency representative and other experts and, secondly, for conversion between liquidation and reorganization. Where this approach is adopted, an insolvency law may need to provide clear rules regarding the priority for repayment of debts incurred during such period, the debtor's authority to dispose of assets during this period, and the potential for avoidance or unauthorized transactions occurring during the assessment period.

*(c) Establishing a time limit for making the commencement decision*

44. [34] Where a court is required to make a decision as to commencement, it is desirable that that decision be

made in a timely manner to ensure both certainty and predictability of the decision-making process and the efficient conduct of the proceedings without delay. Some insolvency laws prescribe set time limits for the period after the application within which the decision to commence must be made. These laws tend to distinguish between voluntary and involuntary applications with voluntary applications tending to be determined more quickly. Any additional period for involuntary applications is to allow for prompt notice to be given to the debtor and to provide the debtor with an opportunity to respond to the application.

45. [34] Although the approach of fixing time limits may serve the objectives of providing certainty and transparency for both the debtor and creditors, the achievement of these objectives may need to be balanced against possible disadvantages. For example, a fixed time limit may be insufficiently flexible to take account of the circumstances of the particular case. It may establish an arbitrary limit which takes no account of the resources available to the body responsible for supervision of the insolvency process or of the local priorities of that body (especially where insolvency is only one of the matters for which it has responsibility). It may also prove difficult to ensure that the decision-making body adheres to the established limit and to provide for what should occur where there is no compliance. The time period between application and the decision to commence proceedings should also reflect the proceedings applied for, the application process, and the consequences of commencement in any particular regime. For example, the extent to which notification of interested parties and information gathering must be completed prior to commencement will vary between regimes, requiring different periods of time. For these reasons, it is desirable that an insolvency law adopt a flexible approach that emphasizes the advantages of quick decision-making and provides guidance as to what is reasonable, but at the same time also recognizes local constraints and priorities.

*(d) Denial of the application to commence*

46. [15] The preceding paragraphs refer to a number of instances where it is desirable for the court to have the power to deny the application for commencement, either because of questions of improper use of the process or for technical reasons relating to satisfaction of the commencement criteria. The cases referred to include examples of both voluntary and involuntary applications. Principal amongst the grounds for denial of the application are those cases where the debtor is found not to satisfy the commencement criteria; where the debt is subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt; where the debtor uses insolvency as a means of prevaricating and depriving creditors of prompt payment of debts in full or to obtain relief from onerous obligations, such as labour contracts; where a creditor uses insolvency as a substitute for debt enforcement procedures (which may not be well developed) or to attempt to force a viable business out of the marketplace or to obtain preferential payments. A related issue is that of conversion of the application or the proceedings from, for example, liquidation to reorganization. (Conversion is

discussed in part two, chapter I.C and chapter V.A.14.) Where there is evidence of improper use of the process by either the debtor or creditors, the insolvency law may provide that sanctions can be imposed on a party that abuses the process or that the party improperly using the process should pay costs and possibly damages to the other party. Remedies may also be available under non-insolvency law.

(e) *Notice of commencement*

47. [35] Provision of notice of the commencement of insolvency proceedings is central to several key objectives of an insolvency regime—it ensures the transparency of the process and that all creditors are equally well-informed in the case of voluntary proceedings.

(i) *Notice to creditors*

48. [36] In the event of a voluntary or debtor application, creditors and other interested parties have a direct interest in receiving notice of the proceedings and an opportunity to dispute the presumptions of eligibility and insolvency (perhaps within a specified time period to prevent the proceedings from being prolonged unnecessarily). The question arises, however, as to the time at which creditors should be notified—at the time the application is made or the time the proceedings commence. The interests of creditors in knowing that the application has been made may need to be balanced, in certain circumstances, against the possibility, where notice of the application is provided, that the position of the debtor may be unnecessarily affected if its application is rejected or that creditors may be encouraged to take last-minute action to enforce their claims. These concerns may be addressed by providing that creditors be notified of commencement of the proceedings.

(ii) *Notice to the debtor*

49. [37] In the event of an involuntary or creditor application for insolvency proceedings, however, the debtor should be entitled to immediate notice of the application and should have an opportunity to be heard and to dispute the creditors' claims as to its financial position (see part two, chapter IV.A). [35] Nevertheless, there may be exceptional circumstances where provision could be made, with the consent of the court, for notice to the debtor to be dispensed with on the basis that it may be impossible to provide or may thwart the purpose of a particular application. These circumstances may include where the debtor or management of the debtor has disappeared or where giving notice of the application may lead to assets being placed by the debtor beyond the reach of the creditors or the insolvency representative. Where the court dispenses with notice of the application and commences the proceedings, the debtor should nevertheless receive notice of the court's order as soon as possible.

(iii) *Notice to parties other than creditors*

50. There may be a number of parties other than creditors who may require notice of the commencement of proceed-

ings. These parties may include the postal administration (especially where mail for the debtor is to be delivered to the insolvency representative), tax authorities, social service authorities, and corporate regulators.

(iv) *Manner of providing notice and content of the notice*

51. [38] In addition to the question of the time at which notice should be given, an insolvency law may need to address the manner in which notice is provided and the information to be included in the notice to ensure its effectiveness. The manner of providing the notice could address both the party required to give the notice (e.g. the court or the party making the application) and how the information can be made available. For example, while notice may be provided directly to known creditors, the need to inform unknown creditors has led legislators to require publication in an official government publication or a commercial or widely circulated national newspaper (see article 14, UNCITRAL Model Law on Cross-Border Insolvency). Consideration may need to be given to whether such a requirement will be cost effective in all cases. The information required in the notice may include the effect of the commencement of proceedings (especially as to the application of the stay—see chapter III); the time for submission of claims; the manner in which claims should be submitted and the place at which they should be submitted; the procedure and any form requirements necessary for submitting a claim; advice as to which creditors should make claims (i.e. whether secured creditors need to submit a claim—see part two, chapter VI.A); consequences of failure to make a claim; and information concerning meetings of creditors.

(f) *Assetless estates*

52. [175] Many debtors which would satisfy the criteria for commencement of insolvency proceedings never progress to be formally liquidated because it appears to creditors that there are no assets in the insolvency estate to fund the administration of the insolvency and debtors in such a position will rarely take steps to commence proceedings. Some insolvency laws provide that where an application for commencement is made, it will be dismissed where there is an assessment of absence of assets by the court, while others provide a mechanism for appointment and remuneration of an insolvency representative (see part two, chapter IV.B). Some other laws provide for a surcharge on creditors to pay for the administration of estates (see Costs below).

53. There are a number of reasons, particularly of a public interest nature, for devising a mechanism to enable the administration of an apparently assetless debtor under a formal proceeding. Where an insolvency law does not provide for exploratory investigations of insolvent assetless companies, it does little to ensure the observance of fair commercial conduct or to further standards of good governance of commercial entities. Assets can be moved out of companies or into related companies prior to liquidation with no fear of investigation or the application of avoid-



ance provisions or other civil or criminal provisions of the law. A mechanism for administration will assist in overcoming any perception that such abuse is tolerated, may provide a return for creditors where antecedent transactions can be avoided and may provide a means of investigating the conduct of the management of such debtors.

54. Mechanisms for pursuing the administration of such estates may include, as noted above, levying a surcharge on creditors to fund administration; establishing a public office or utilizing an existing office to administer insolvent debtors; establishing a fund out of which the costs may be met; [176] appointing an insolvency professional on the basis of a roster or rotation system, which is designed to ensure a fair and ordered distribution of all insolvency cases, whether assetless or otherwise where the insolvency representative will be paid a prescribed stipend by the State or the costs will be borne directly by the insolvency representative and cross-subsidized by their clients generally (since their remunerative rates can be adjusted to take into account unremunerative work). Where such a mechanism is included in an insolvency law, consideration may also need to be given to defining those debtors to which the provisions will apply, such as by reference to a debtor having available less than a prescribed value of unencumbered assets that would otherwise enable the liquidation to proceed.

#### 6. Costs of the insolvency proceedings

55. Cost effectiveness, in addition to speed and efficiency, is an important aspect of an effective insolvency regime and one that bears upon all phases of the insolvency process. It is thus important, when designing an insolvency regime, to avoid the situation where the procedure is subject to cost burdens that will deter creditors and frustrate the basic objectives of the procedure. This is of particular importance in the case of insolvency of small and medium business. It may also be particularly important where, for example, the debtor has a large debt which comprises a number of smaller creditors whose individual debts may not support the costs of the application procedure or where the estate has few assets.

56. [39] Applications by both debtors and creditors for commencement of insolvency proceedings may be subject to the payment of fees. Different approaches may be taken to the level of fee imposed. One approach may be to set a fee that can be used to help defray the costs of the insolvency system. [39] Where the resultant fee is high, however, it may operate as a deterrent and run counter to the objective of convenient, cost effective and quick access to the insolvency process. A very low fee, on the other hand, may not be sufficient to deter frivolous applications and it is therefore desirable that a balance between these objectives be reached. Some insolvency laws require the creditors making an application to guarantee the payment of the costs of the proceedings up to a certain fixed amount, to pay a certain percentage of the total of claims or a fixed amount as a guarantee for costs. In some laws where a payment as security for costs is required, that

amount may be refunded from the estate if there are sufficient assets and certain creditors, such as employees, are exempted from providing the required security. Other laws require, as a condition of commencement, that the unencumbered assets of the estate must be sufficient to cover the costs of the proceedings. Where they are insufficient, the insolvency generally provides for the application to be dismissed or for it to be treated in accordance with provisions on assetless estates (see above).

### Recommendations

#### Purpose of legislative provisions

The purpose of provisions on application and commencement criteria of insolvency proceedings is to:

- (a) facilitate access for debtors and creditors to the remedies provided by the insolvency law;
- (b) identify the court that will have jurisdiction over insolvency proceedings and over any matter arising in the conduct of an insolvency proceeding;
- (c) establish application and commencement criteria that are transparent and certain;
- (d) enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and cost effective inexpensive manner;
- (e) establish effective requirements for notification of commencement of proceedings;
- (f) establish basic safeguards to protect both debtors and creditors from improper use of the [insolvency law] the application procedure.

#### Content of legislative provisions

##### *Eligibility for application*

(17) [(16)] The insolvency law should provide that an application to commence insolvency proceedings is to be made to the specified court and clearly state who may make an application. This should include the debtor and creditors.

##### *Commencement criteria*

(18) [(17)] The insolvency law should provide that the criteria for commencement of insolvency proceedings, both liquidation and reorganization, should be:

- (a) in the case of a debtor application, that the debtor is or will be unable to pay its mature debts as they mature [or alternatively, that its liabilities exceed the value of its assets];
- (b) in the case of a creditor application, that the debtor is unable to pay its mature debts [or alternatively, that its liabilities exceed the value of its assets].

*Presumption that the debtor is unable to pay*

## Version 1

(19) [(18)] The insolvency law ~~should~~ may provide that if the debtor fails to pay one or more of its mature debts, and the debt is not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt, the debtor is presumed to be unable to pay its debts.<sup>5</sup>

## Version 2

(19) [(18)] The insolvency law might include a presumption to the effect that the debtor is presumed unable to pay its debts in specified circumstances in order to facilitate commencement of proceedings by one or more creditors.<sup>6</sup> Those circumstances might include:

(a) that the debtor has failed to pay a specified number of creditors, whether by reference to a number of matured claims (such as one or more), a particular value of matured claims (such as ...) or both; and

(b) that the matured debts are not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt.

*Commencement on debtor application*

(20) [(19)] Where the application for commencement is made by the debtor, the insolvency law should provide that proceedings will ~~should~~ be commenced by either:

(a) the application functioning as automatic commencement of proceedings; or

(b) the court, which should be required to promptly determine whether the insolvency proceeding should be commenced.

*Commencement on creditor application*

(21) [(20)] Where the application for commencement is made by a creditor, the insolvency law should require that:

(a) notice of the application promptly be given to the debtor;

(b) the debtor be given the opportunity to respond to the application; and

(c) the court promptly determine whether the insolvency proceeding should be commenced.

*Notification of commencement*

(22) [(21)] The insolvency law should provide that notification of the commencement of insolvency proceedings

<sup>5</sup>Where the debtor has not paid a mature debt and the creditor has obtained a judgement against the debtor in respect of that debt, there would be no need for a presumption to establish that the debtor was unable to pay its debts.

<sup>6</sup>The debtor could rebut the presumption by showing, for example, that it was able to pay its debts; that the debt was subject to a legitimate dispute; or that the debt was not mature. The recommendations on notice of commencement provide protection for the debtor by requiring notice of the application for commencement of proceedings to be given to the debtor and providing the debtor with an opportunity to rebut the presumption.

be made generally available in a publication such as the official government gazette or a widely circulated national newspaper, as appropriate and cost effective, or be made available through [appropriate][relevant] public registries [whether electronic or not]. The insolvency law may identify who has the obligation to provide such notification.

(23) [(22)] The insolvency law should require all known creditors [who may be identified from the books and records of the debtor] to be notified individually, unless the court considers that, under the circumstances, some other or additional form of notification would be more appropriate.

(24) [(22)] The insolvency law should require that the notification of commencement of proceedings to creditors ~~should~~ specify:

(a) any applicable time period for submitting a claim, the manner in which the claim should be submitted and the place at which the claim can be submitted;

(b) the procedure and any form requirements necessary for submitting a claim;

(c) the consequences of failure to submit a claim; and

[(d) information concerning meetings of creditors].

*Denial of an application to commence proceedings*

(25) [(23)] Where the decision to commence proceedings is made by the court, (whether on the application of the debtor or creditors),<sup>7</sup> the insolvency law should allow the court to deny the application ~~or refuse to commence proceedings~~ if the court determines that:<sup>8</sup>

(a) the application is an improper use of the insolvency law;

(b) in the case of a creditor application, the debt is subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt; or

(c) in an application for liquidation, ~~{that the debtor is solvent}~~ the commencement criteria have not been met.

*Assetless estates*

(26) The insolvency law should address the treatment of those estates where there are no assets. Different approaches may be taken including denial of the application upon an assessment by the court that there are no assets, or commencement of the proceedings and appointment of an insolvency representative to administer the estate, where different mechanisms for appointment and remuneration of the insolvency representative may be available [see chapter IV.B].

<sup>7</sup>Refer recommendations (20) and (21).

<sup>8</sup>In certain circumstances it may be appropriate for the proceedings, once commenced, to be converted from liquidation to reorganization or from reorganization to liquidation: see chapter I, section B.



## A/CN.9/WG.V/WP.63/Add.5

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.B-F and chapters IV-VII appear in subsequent addenda]*

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**Part two (continued)**

### III. TREATMENT OF ASSETS ON COMMENCEMENT OF INSOLVENCY PROCEEDINGS

#### A. Assets to be affected

##### 1. Introduction

57. [40] Fundamental to the insolvency process is the need to identify, collect, preserve and dispose of assets belonging to the debtor. Many insolvency systems place the assets of the insolvent debtor under a special regime sometimes referred to as the insolvency estate, over which the insolvency representative will have specified powers. This Guide uses the term “estate” in its functional sense to refer to assets owned by the debtor that are controlled by the insolvency representative and are subject to the insolvency proceedings. There are some important differences in the way in which the concept of the insolvency estate is understood in various jurisdictions. In some countries, the insolvency law provides that legal title over the assets is transferred to the designated official. In other countries, the debtor continues to be the legal owner of the assets, but its powers to administer and dispose of the assets are limited (e.g. either the debtor will have no such power, or its powers will be limited to dealing with assets in the ordinary course of business and disposition, including by the creation of security rights, will require the consent of the insolvency representative or the court).

58. [41] Irrespective of the applicable legal tradition, an insolvency law will need to clearly identify the assets that will be subject to the insolvency proceedings (and therefore included within the concept of the “estate” where that term is used) and indicate how they will be affected by those proceedings, including clarifying the relative powers of the various participants with respect to the assets. Identification of assets and their treatment will determine the scope and conduct of the proceedings and, particularly in reorganization, will have a significant bearing on the likely success of those proceedings. A clear statement will ensure transparency and certainty for both creditors and the debtor.

##### 2. Assets of the insolvency estate

###### (a) General definition of the insolvency estate

59. [43] The estate may be expected to include all assets in which the debtor has an interest, whether or not they are in the possession of the debtor at the time of commencement, including all tangible and intangible assets. Generally, assets acquired after commencement of the insolvency proceedings by either the debtor or the insolvency representative would also be included. Tangible assets should be readily found on the debtor’s balance sheets, such as cash, equipment, inventory, works in progress, bank accounts, accounts receivable and real estate. The assets to be included within the category of intangible assets may be

defined differently in different States, depending upon the national law, but may include intellectual property, bills of lading, securities and financial instruments, policies of insurance, contract rights (including those relating to property owned by third parties), and rights of action arising from a tort<sup>1</sup> to the extent of the debtor's interest. In the case of natural persons, the estate may also include assets such as inheritance rights in which the debtor has an interest or to which the debtor is entitled at the commencement of the insolvency or which come into existence during the insolvency proceedings.

(b) *Secured assets*

60. One question of some importance is whether the insolvency law includes secured assets as part of the insolvency estate. [46] Insolvency laws adopt different approaches to the treatment of assets subject to security interests. Many laws provide that secured assets are included in the insolvency estate, with the commencement of proceedings giving rise to different effects, such as restricting the exercise of security rights held by creditors or third parties (such as by application of a stay and other effects of commencement). Where the secured assets are included in the insolvency estate, they may be subject to certain protections such as those relating to maintaining the value of the secured asset and to specified situations where the secured asset may be separated from the estate (see for example, chapter III.C). Where secured assets are to be included in the estate, an insolvency law should make it clear that such an inclusion will not deprive secured creditors of their property rights in the secured assets, even if it does operate to limit the exercise of those rights.

61. [46] Other insolvency laws provide that the security right is unaffected by the insolvency and secured creditors may proceed to enforce their legal and contractual rights. There are examples of laws which provide that even where secured assets are unaffected by the insolvency, the debtor, with the insolvency representative's consent, can ask the court to prevent enforcement where the asset is necessary for the business to continue operating. [47] Exclusion of secured assets may have the advantage of generally enhancing the availability of credit because secured creditors would be reassured that their interests would not be adversely affected by the commencement of insolvency proceedings. However, this general advantage to an economy may need to be weighed against other advantages to be derived in specific insolvency cases, particularly in reorganization and where the business is to be sold as a going concern in liquidation, from having all assets of the debtor available to the insolvency proceedings from the time of commencement. Restricting the exercise of rights by secured creditors may assist not only in ensuring equal treatment of creditors, but may be crucial to the proceedings where the secured asset is essential to the business. For example, where manufacturing equipment or a leased factory building is central to the debtor's business operations, reorganization or sale of the business as a going concern

<sup>1</sup>Some jurisdictions exclude torts of a personal nature such as defamation, injury to credit or reputation, where the debtor remains personally entitled to sue and to retain what is recovered on the basis that the incentive to vindicate wrongdoing otherwise would be diminished. [What is the position regarding personal bodily injury?]

cannot take place unless the equipment and the lease can be retained for the proceedings.

62. Insolvency laws may provide secured creditors with different options for dealing with their security. These may include, for example, realizing the security where the insolvency law permits this to be done, with the creditor submitting a claim as an unsecured creditor for any shortfall if the amount realized is less than the amount of the claim (where the amount realized is in excess of the claim, the secured creditor will have to account to the insolvency representative for the surplus); having the property valued and submitting a claim as an unsecured creditor for the balance; and surrendering the secured asset to the insolvency representative subject to payment for its value.

(c) *Joint assets*

63. Where the debtor is an individual and personal property is owned jointly by the debtor and the debtor's spouse insolvency laws adopt different approaches to the treatment of these assets. One approach is to completely exclude the property from the estate. Another approach provides that where the proceedings are opened against the assets of one spouse, the part of the mutual assets belonging to that spouse can become part of the insolvency estate if, under the general law, they can be divided for purposes of execution (where division of the assets will be conducted outside of the insolvency law and proceedings).

(d) *Third-party owned assets*

64. [48] Complex issues may arise in determining whether an asset is owned by the debtor or by another party, and whether assets of a third party that are in the possession of the debtor, subject to use, lease or licensing arrangements at the time of commencement should be included in the assets of the estate. Some insolvency laws treat those assets as subject to the estate. In other cases the estate will generally include, as indicated above in the general definition of the estate, any rights that the debtor might have in respect of the third-party owned assets. [48] There will be cases where the third-party owned assets, like secured assets, may be crucial to the continued operation of the business, whether in reorganization or sale as a going concern in liquidation, and it will be advantageous for the insolvency law to include a mechanism that will permit those assets to remain at the disposal of the insolvency proceedings. This issue is discussed further in chapter III.C.

(e) *Time of constitution of the estate*

65. [42] The insolvency law should specify the date by reference to which assets will be considered to be part of the estate to provide certainty for the debtor and for creditors. The estate may be expected to include the assets of the debtor as of the date of commencement of the insolvency proceedings as well as assets acquired by the insolvency representative and the debtor after that date, whether in the exercise of avoidance powers (see chapter III.F) or in the normal course of operating the debtor's business.

### 3. *Assets excluded from the insolvency estate*

#### (a) *General exclusions*

66. The insolvency law may specify the exclusion of certain assets from the estate. Insolvency laws adopt different approaches to this issue. Assets excluded from the estate may include certain assets owned by a third party that are in the possession of the debtor when the proceedings commence, such as trust assets and assets that are in the possession of the debtor subject to an arrangement (whether contractual or otherwise) that does not involve a transfer of title but rather use of the assets and return to the owner once the purpose for which they were in the possession of the debtor has been fulfilled.<sup>2</sup> The treatment of assets being used by the debtor pursuant to a lease agreement where the lessor retains legal title may require special attention. In some jurisdictions, assets in which a creditor retains legal title or ownership (for example, retention of title by the secured creditor, or under a lease arrangement) may be separated from the insolvency estate. In other jurisdictions, if the economic terms of the transaction (that does not involve a transfer of the title to the debtor) demonstrate that it is a device to finance the acquisition of an asset, although structured as a lease, the arrangement may be treated as a secured lending arrangement and the lessor will be subject to the same treatment as other secured creditors. A transaction will be a financing device where, at the end of the term of the lease, either the debtor can retain the asset for the payment of a nominal sum or the remaining value of the asset is negligible. Under either approach, the asset may be used by the insolvency representative subject to certain conditions as described in chapter III.C.

[Note that the current draft of the *UNCITRAL Legislative Guide on Secured Transactions* recommends that all such legal devices be grouped with other forms of secured credit arrangements into a general category of “security interests” and be treated similarly in insolvency proceedings, but this approach is yet to be finalized by Working Group VI.]

#### (b) *Foreign assets*

67. Whether the debtor’s property outside the country where the proceedings are taking place will become part of the estate raises issues of cross-border insolvency. Some insolvency laws take the approach that there should be a single insolvency procedure, based in the country where the debtor has its head office or place of registration or incorporation (centre of main interests), that will apply to the debtor’s assets wherever situated (the universal approach). Other insolvency laws are based upon the approach of commencing different proceedings in the jurisdictions in which the enterprise has assets or in which different branches or establishments of the debtor are located (the territorial approach). The diversity of approaches creates considerable uncertainty and undermines the effective application of national insolvency laws. The UNCITRAL Model Law on Cross-Border Insolvency estab-

lishes a regime for effective cooperation in cross-border insolvency cases through recognition of foreign decisions and access for foreign insolvency representatives to local court proceedings. The regime is intended to be compatible with all legal systems and is discussed in more detail in chapter VIII.

#### (c) *Where the debtor is a natural person*

68. [45] In the case of insolvency of a natural person, the insolvency law may provide that the estate should exclude certain assets such as those relating to post-application earnings from the provision of personal services, assets that are necessary for the debtor to earn a living and personal and household assets, such as furniture, household equipment, bedding, clothing and other assets which are necessary to satisfy the basic domestic needs of the debtor and its family. Where an insolvency law provides exclusions in respect of the assets of a natural person, they should be clearly identified and their number limited to the minimum necessary to preserve the personal rights of the debtor and allow the debtor to lead a productive life. In identifying these exclusions, consideration might need to be given to applicable human rights obligations, including international obligations, which are intended to protect the debtor and relevant family members and may affect the exclusions that can be made.<sup>3</sup>

### 4. *Recovered assets*

#### (a) *Avoidance proceedings*

69. [50] Assets that will be subject to the proceedings will include any assets recovered by the insolvency representative that were improperly transferred or transferred at a time of insolvency with the result that the *pari passu* principle (i.e. that creditors of the same class are treated equally and are paid in proportion to their claim out of the assets of the estate) has been violated. Most legal systems provide a means of setting aside and recovering the value of antecedent transactions that result in preferential treatment to some creditors or were fraudulent in nature or made in an effort to defeat the rights of creditors (see part two, chapter III.F).

#### (b) *Unauthorized transactions*

70. Many insolvency laws adopt measures intended to limit the extent to which a debtor subject to insolvency proceedings can deal with its assets without the authorization of the court or the insolvency representative. These restrictions generally will apply after the application for commencement of proceedings (in those cases where the powers to deal with assets of the estate are given to an interim insolvency representative) and after the commencement of insolvency proceedings. Some insolvency laws treat transactions that result in the unauthorized transfer of assets as invalid and unenforceable as against the insolvency estate, and enable the assets transferred to be reclaimed, except in some cases where the counterparty gave value or can prove that the transaction did not impair

<sup>2</sup>Such an arrangement may be known as a bailment, depositum or [...].

<sup>3</sup>In Europe, for example, the European Convention on Human Rights is relevant.

creditors' rights. Other insolvency laws achieve the same result by addressing unauthorized contracts in terms of avoidance provisions. Some of these laws specify the types of transactions that can be avoided in such cases, including performance of obligations arising before commencement, payment of pre-application debts, creation of security over assets of the estate and disposal of any right or asset forming part of the estate.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions relating to assets affected by the commencement of insolvency proceedings is to:

- (a) identify those assets that will constitute the insolvency estate;
- (b) ~~indicate the manner in which rights in those assets will be affected by the commencement of insolvency proceedings;~~
- (b) identify those assets that will specifically be excluded from the insolvency estate;
- (d) ~~indicate the manner in which assets owned by third parties and assets subject to a security interest will be affected by the commencement of insolvency proceedings.~~

### Content of legislative provisions

#### *Assets constituting the insolvency estate*

(27) [(24)] The insolvency law should identify the assets to be included in the insolvency estate. Those

assets ~~might constituting the insolvency estate should include:~~

- (a) assets owned by the debtor, including both tangible and intangible assets,<sup>4</sup> irrespective of whether they are in the possession of the debtor and whether they are subject to a security interest in favour of a creditor [*determined in accordance with the property and secured transactions law of the State*];
- (b) assets acquired after commencement of the insolvency proceedings; and
- (c) assets recovered through avoidance and other actions commenced by the insolvency representative, including in respect of unauthorized transactions.

(28) In the case of an insolvency proceeding where the debtor has its centre of main interests, the insolvency law should specify whether the insolvency estate would include all assets wherever located.

#### *Assets that may be excluded—natural persons*

(29) [(25)] The insolvency law should specify which assets are to be excluded from the insolvency estate. Where the debtor is a natural person, ~~the insolvency law should specify the assets to be excluded from the insolvency estate, specifically~~ exclusions will include those assets required to preserve the personal rights of the debtor, which may include assets acquired after commencement of the insolvency proceedings. Exclusions generally are not provided for entity debtors.

<sup>4</sup>Intangible assets may be differently defined according to national law, but may include intellectual property, bills of lading, securities and financial instruments, policies of insurance, contract rights (including those relating to property owned by third parties), and rights of action arising from a tort.

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter IIA and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A appears in document A/CN.9/WG.V/WP.63/Add.5; chapter III.C-F and chapters IV-VII appear in subsequent addenda]*

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## **Part two (continued)**

### **III. TREATMENT OF ASSETS ON COMMENCEMENT OF INSOLVENCY PROCEEDINGS**

#### **B. Protection and preservation of the insolvency estate**

##### **1. Introduction**

71. [53] An essential objective of an effective insolvency system is the establishment of a protective mechanism to ensure that the value of the insolvency estate's assets is not diminished by the actions of the various parties in interest and that the insolvency proceedings can be administered in a fair and orderly manner. The parties from whom the estate needs the greatest protection are the debtor and its creditors.

##### **2. Protection of the estate by application of a stay**

72. [54] With regard to creditors, one of the fundamental principles of insolvency law is that it is a collective proceeding, which requires that the interests of all creditors be protected against individual action by one of them. Many insolvency laws provide for the imposition of a mechanism that not only prevents creditors from enforcing their rights through legal remedies during some or all of the period of the liquidation or reorganization proceedings, but also suspends actions already underway and prevents the commencement of new actions. This mechanism is variously termed a moratorium, suspension or stay, depending on the scope of the mechanism. For the purposes of this Guide, the term "stay" is used in a broad sense to refer to both suspension of actions and a moratorium against the commencement of actions.

73. [55] As a general principle, the emphasis in liquidation is on selling the assets, in whole or in part, so that creditors can be repaid from the proceeds of sale as quickly as possible. Maximizing value is an overriding objective. The imposition of a stay in liquidation can ensure a fair and orderly administration of the proceedings, providing the insolvency representative with adequate time to avoid making a forced sale that fails to maximize the value of the assets being liquidated, and also an opportunity to see if the business can be sold as a going concern, where the collective value of assets may be greater than if the assets were to be sold piecemeal. The difficult balance is between the competing interests of secured creditors, who will often hold security in some of the most important assets of the business, and the interests of unsecured creditors.

74. [55] In reorganization proceedings, a stay of proceedings allows the debtor a breathing space to organize its affairs, time for preparation and approval of a reorganization plan and for the other steps necessary to ensure successful implementation of the reorganization to be taken, including shedding unprofitable activities and onerous contracts. Given the goals of reorganization, the impact of the stay is greater and therefore more crucial than in liquidation and can provide an important incentive to encourage debtors to initiate reorganization proceedings. At the same time, the commencement of proceedings and the imposition of the stay give notice to all those who do business with the debtor that the future of the business is uncertain. This can cause a crisis of confidence and uncertainty as to how the insolvency will impact upon them as suppliers, customers and employees of the debtor's business.

75. [56] One of the key issues in the design of an effective insolvency law is how to balance these concerns—the immediate benefits that accrue to the debtor by having a broad stay quickly imposed to limit the actions of creditors and the longer-term benefits that are derived from limiting the degree to which the stay interferes with contractual relations between debtors and creditors, especially secured creditors.

76. [57] The scope of rights that are affected by the stay varies considerably among insolvency laws. There is little debate regarding the need for the suspension of actions by unsecured creditors against the debtor or its assets. The application of the stay to secured creditors, however, is potentially more difficult and requires a number of competing interests to be balanced. These include, for example, observing commercial bargains and contracts; respecting the pre-insolvency priorities of secured creditors as regards their rights over the security; protecting the value of secured interests; ensuring that creditors are paid out of the assets of the estate in proportion to their claim; maximizing asset values for all creditors; and, in cases of reorganization, ensuring the successful reorganization of a viable entity.

*[(b) Provisional measures moved to 4(b) Time of application of the stay]*

##### **3. Scope of application of the stay**

###### **(a) Actions to which the stay will apply**

77. [60] Some countries adopt the approach that to ensure the effectiveness of the stay, it must be very wide, applying to all remedies and proceedings against the

debtor and its assets, whether administrative, judicial or self-help and restraining both unsecured and secured creditors from exercising enforcement rights, as well as Governments from exercising priority rights. Examples of the types of actions that may be stayed could include: the commencement or continuation of actions or proceedings against the debtor or in relation to its assets; the commencement or continuation of enforcement proceedings in relation to assets of the debtor, including the execution of a judgement and perfection or enforcement of a security interest; recovery by any owner or lessor of property that is used or occupied by, or is in the possession of, the debtor; payment or provision of security in respect of a debt incurred by the debtor prior to the commencement date; the right to transfer, encumber or otherwise dispose of any assets of the debtor (in reorganization, this might be limited to transfer, encumbrance or disposal outside the ordinary course of business); and termination, suspension or interruption of supplies of essential services (for example, water, gas, electricity and telephone) to the debtor. Article 20 of the UNCITRAL Model Law on Cross-Border Insolvency (see chapter VIII), for example, provides that commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities and execution against the debtor's assets are stayed.

78. [61] Some insolvency laws provide that, where legal proceedings against the debtor (including both continuation and commencement of those proceedings) are within the scope of the stay in liquidation, those proceedings can be continued at the discretion of the court if it is considered necessary to preserve a claim or establish the quantum of a claim. Article 20(3) of the UNCITRAL Model Law on Cross-Border Insolvency, for example, provides that the application of the stay to commencement or continuation of individual actions or proceedings against the debtor is not to affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor. Other insolvency laws allow the commencement or continuation of legal proceedings, but the application of the stay prevents enforcement of any resulting order. In some insolvency laws a distinction is made between regulatory and pecuniary actions; some laws allow claims of both a regulatory and pecuniary nature to be continued, others only regulatory claims. Other insolvency laws provide that specific actions, such as employee actions against the debtor, can be commenced or continued, but any enforcement action resulting from those proceedings will be stayed. Some insolvency laws also allow commencement or continuation of actions seeking to restrain the debtor from undertaking certain activities, such as those causing environmental damage. Where claims can be pursued against the debtor, the insolvency representative will need to be involved where the debtor is divested of control.

79. [62] To ensure transparency and predictability, it is highly desirable that an insolvency law clearly identify the actions that are to be included within and excluded from the scope of the stay, irrespective of who may commence those actions, whether unsecured creditors (including preferential creditors such as employees, legislative lienholders or Governments), third parties (such as a lessor or owner of property in the possession or use of the debtor

or occupied by the debtor), secured creditors or other parties. Exclusions might include: [63] set-off rights and netting of financial contracts (see part two, chapter III.F), actions to protect public policy interests, such as to restrain environmental damage, or to prevent abuse, such as the use of insolvency proceedings as a shield for illegal activities.

(b) *Secured creditors*

80. [69] Creditors generally seek security for the purpose of protecting their interests in the event that the debtor fails to repay. If security is to achieve this objective, it can be argued that, upon commencement of insolvency proceedings, the secured creditor should not be delayed or prevented from immediately realizing its security. The secured creditor has, after all, bargained for security in exchange for value that reflects the reliance on the security. For that reason, the introduction of any measure that will diminish certainty in the ability of the secured creditor to recover debt or erode the value of security interests, such as applying the stay to secured creditors, may need to be carefully considered. Such a measure may ultimately undermine not only the autonomy of the parties in their commercial dealings and the importance of observing commercial bargains, but also the availability of affordable credit; as the protection provided by security interests declines, the price of credit may need to increase to offset the greater risk. [72] Some of the insolvency laws that exclude secured creditors from the stay focus on encouraging pre-commencement negotiations between the debtor and creditors to achieve agreement on how to proceed. Where that process is effective, a stay may not need to apply to secured creditors. [70] A growing number of insolvency laws recognize, however, that in some cases permitting secured creditors to freely separate their security (in order to satisfy their claims) from the insolvency estate can frustrate the basic objectives of the insolvency proceedings, particularly in reorganization, but also where the business can be sold as a going concern in liquidation.

81. [71] Where secured interests are included within the scope of the stay, an insolvency law can adopt measures that will ensure the secured rights are not diminished by the stay. These measures may relate to the duration of the stay, protection of the value of the security, payment of interest and provision of relief from the stay where the secured interests are not sufficiently protected or where the security is not necessary to the sale of the entire business or a productive part of it.

(i) *Reorganization*

82. [70] In reorganization proceedings, [74] where there is a genuine possibility of effecting a reorganization, it is desirable that the extent of the stay be very wide and all embracing. [70] Where assets essential to the operation of the debtor's business are encumbered by security interests, enforcement by secured creditors of their claims at the commencement of the proceedings may make it impossible for the debtor to keep the business operating while it formulates a reorganization plan and, where secured creditors are not bound by the plan, make it impossible to implement the plan (see part two, chapter V.A).



*(ii) Liquidation*

83. [72] Insolvency laws take different approaches to the application of the stay to secured creditors in liquidation proceedings. As a general principle, where the insolvency representative's function is to collect and realize assets and distribute proceeds among creditors by way of dividend, the secured creditor may be permitted to freely realize its security to satisfy its claim despite the liquidation. Some insolvency laws thus exclude secured creditors from the scope of the stay on the basis that where the assets are to be liquidated the balance will weigh in favour of allowing secured creditors to enforce their rights. Where that approach is adopted, some flexibility may be needed, however, where the insolvency representative may be able to achieve a better result that maximizes the value of the assets for the collective benefit of all creditors if the stay is applied to restrict realization of the security. This may be particularly relevant where the business can be sold as a going concern in the context of the liquidation proceeding. It may also be true in some cases where even though assets are to be sold in a piecemeal manner, some time is needed to arrange a sale that will give the highest return for the benefit of all unsecured creditors.

**4. Procedural issues***(a) Discretionary or automatic application of the stay*

84. [64] A preliminary question on application of the stay is whether it should apply automatically (by operation of the insolvency law) or at the discretion of the court. Local policy concerns and factors such as the availability of reliable financial information and the ability of the debtor and creditors to have access to an independent judiciary with insolvency experience may affect the decision on this issue. Applying the stay on a discretionary basis may allow the stay to be tailored to the needs of the specific case (as regards the debtor, its assets and its creditors) and avoid both unnecessary applications of the stay and unnecessary interference with the rights of secured creditors. This approach, however, has the potential to cause delay while the court considers the relevant issues; does not create a predictable situation for those creditors and third parties to whom the stay may apply; and may create a need for some mechanism, such as provisional measures, to address the period before the court decides on the application of the stay; as well as requirements for the provision of notice as to application of the stay. An alternative approach which minimizes delay, will assist the achievement of the maximization of the value of the assets and ensure that the insolvency process is fair and ordered as well as transparent and predictable, might be to provide for the stay to apply automatically to specified actions, with the possibility of extension of the stay to other actions at the discretion of the court. This approach is adopted in the UNCITRAL Model Law on Cross-Border Insolvency: article 20 specifies the types of actions that will be stayed automatically upon recognition of foreign main proceedings, while article 21 indicates examples of additional relief that may be provided upon recognition, at the discretion of the court. The automatic stay is a feature of many modern insolvency law regimes.

*(b) Time of application of the stay*

85. [65] A further concern related to application of the stay is the time at which it will apply in both liquidation and reorganization proceedings.

*(i) From commencement—the need for provisional measures*

86. [66] Different approaches may be taken to the time of application of the stay. The most common approach is for the stay to apply on commencement of the proceedings, when issues of eligibility, jurisdiction and satisfaction of the commencement criteria will have been resolved and it is clear that proceedings should be commenced rather than the application be denied. In some insolvency laws, the application of the stay on commencement is combined with provisional measures to address the period between application and commencement, [58] when there is the potential for the debtor's business situation to change and for dissipation of the debtor's assets—the debtor may be tempted to transfer assets out of the business, and creditors, on learning of the application, may take remedial action against the debtor to pre-empt the effect of any stay that may be imposed upon commencement of the proceedings. Where an insolvency law provides for the granting of provisional measures, it is important that it also address what happens to those measures on commencement of the insolvency proceedings.

87. [59] These provisional measures may be available on the application of the debtor, creditors or ordered by the court on its own motion and may include: appointing a preliminary insolvency representative; prohibiting the debtor from disposing of assets; taking control of some or all of the debtor's assets; suspending enforcement by creditors of security interests against the debtor; staying any action by creditors to separate a debtor's assets, such as by a secured creditor or holder of a retained title; or preventing the commencement of individual actions by creditors to enforce their claims. Since these measures are provisional in nature and are granted before the court's determination that the commencement criteria have been met, applicants may be required by the court to provide evidence that the measure is necessary to preserve the value of the insolvency estate and avoid dissipation of assets. Where the application is made by a creditor, some form of security for costs or damages that may be incurred may also be required in case proceedings are not subsequently commenced. The insolvency law may also need to consider the question of provision of notice of an order for provisional measures and the parties to whom that notice needs to be given. Bearing in mind the need to avoid unnecessary damage to a debtor against whom insolvency proceedings are not subsequently commenced, that notice may need to be limited to parties directly affected by the order. Relief from the application of provisional measures, such as modification or termination, may also be appropriate in cases where the interests of the persons affected are being harmed. Such relief might be available on the application of the affected party, the insolvency representative or on the motion of the court itself.

(ii) *From the time of the application for commencement*

88. [66] A different approach is for the stay to apply from the making of an application for either liquidation or reorganization proceedings, irrespective of whether it is a debtor or creditor application. This approach may avoid the need to consider the availability of interim or provisional measures of protection to cover the period between the making of the application and the commencement of proceedings, but will require the application of the stay at a time when a number of factual matters are not necessarily clear, in particular whether the debtor will satisfy the commencement criteria. To balance against the risk of abuse in this situation, it is desirable if this approach is followed, that clear procedures for seeking relief from the application of the stay on an expedited basis be included in the insolvency law.

(iii) *Specifying the exact time of application of the stay*

89. Whether the stay is to be applicable by reference to the time of application or commencement, it is important that an insolvency law address the question of the exact time at which the stay will become effective to ensure protection of the estate, especially in relation to payments. Different approaches are taken to this issue. In some laws, the stay becomes effective as of the time of the court's decision to commence proceedings, in others when the decision as to commencement becomes publicly available, while in yet other laws the stay has effect retroactively from the first hour of the day of the commencement order. A similar diversity of approaches is taken where the stay has effect upon the making of the application for proceedings.

(c) *Duration of application of the stay*

(i) *Unsecured creditors*

90. Many insolvency laws provide for the stay to apply to unsecured creditors for the duration of both liquidation and reorganization proceedings.

(ii) *Secured creditors*

—*Reorganization*

91. [74] In some cases it may be desirable for the stay to apply to secured creditors for the duration of the proceedings<sup>1</sup> to ensure that the reorganization can proceed in an orderly manner without the possibility of assets being separated before the reorganization can be finalised. However, to avoid delay and encourage a speedy resolution of the proceedings, there may also be some advantage in limiting the application of the stay to the time that it may reasonably take for a reorganization plan to be approved to avoid application of the stay for an uncertain or unnecessarily lengthy period. Such a limitation may also have

<sup>1</sup>This provision will be affected by the time at which the insolvency law treats proceedings as completed: under some laws proceedings are treated as completed when the plan is approved (and confirmed where this is required under the insolvency law); under other laws on completion of implementation of the plan.

the advantage of providing secured creditors with a degree of certainty and predictability as to the duration of the period of interference with their rights. The difficulty with establishing a fixed time limit, however, is that it may not always be sufficiently long, depending on the size and complexity of the reorganization, and may be difficult to enforce. A solution may be to establish clear time limits, with the possibility of extension (see below). Provision may also be made in an insolvency law for relief from the stay to be provided to secured creditors in certain circumstances. (see below).

—*Liquidation*

92. [72] Some insolvency laws that apply the stay to secured creditors adopt the approach that the stay automatically applies upon commencement of liquidation proceedings but only for a brief period, such as 30 or 60 days, except in those cases where the security is essential to the sale of the business as a going concern (in which case the stay may be extended). This period would allow the insolvency representative to assume its duties and take stock of the assets and liabilities of the estate. Where the secured asset was not required for the sale of the business, the stay could be lifted (see below). Another approach extends the stay to secured creditors for the duration of the liquidation proceedings, subject to a court order for relief where it can be shown that the value of the security is being adversely affected.

(d) *Extension of the duration of the stay*

93. [73] Where the stay is limited to a specified period, the law may include provision for extension of the stay. This could be on application of the insolvency representative when it can be demonstrated that an extension is required in order to maximize value (e.g. there is a reasonable possibility that the debtor, or business units of the debtor, can be sold as a going concern) provided that secured creditors will not suffer unreasonable harm. To provide additional protection and avoid the stay being applied for an uncertain or unnecessarily lengthy period, an insolvency law may limit the period for which the stay can be extended.

(e) *Relief from the stay*

94. [81] In liquidation and reorganization proceedings, circumstances may arise where it is appropriate to provide relief from the stay by providing that the secured creditor can apply to the court or that the insolvency representative can be given the power to release the security without approval of the court. Relevant circumstances may include where the secured creditor is not receiving protection for the value of its security, where the provision of protection may not be feasible or would be overly burdensome to the estate; where the security is not needed for the reorganization or sale of the business as a going concern in liquidation; or where the asset is of no value to the estate. There may be other circumstances where it may be appropriate to provide relief from the stay, such as actions involving perishable goods.



95. [82] While provisions on relief from the stay principally address the interests of secured creditors, there are examples of insolvency laws which provide that relief from the stay may be granted to an unsecured creditor. This may be relevant, for example, in those cases where the insolvency law does not allow commencement or continuation of claims, to allow a claim to be determined in another forum where litigation may be well advanced and it would be efficient for it to be completed, or a claim against an insurer of the debtor to be pursued.

### 5. *Protection of secured creditors*

96. It is desirable that an insolvency law address the issue of protection of the value of the secured creditor's interest against erosion in value or improper conduct during the period of application of the stay.

97. [76] One of the set of measures designed to address the negative impact of the stay on secured creditors is that directed at maintaining the economic value of secured claims during the period of the stay (in some jurisdictions referred to as "adequate protection"). One approach is to protect the value of the security itself on the understanding that, upon liquidation, the proceeds of sale of the security will be distributed directly to the creditor to the extent of the value of the secured portion of their claim. This approach may require a number of steps to be taken.

98. [77] During the period of the stay it is possible that the value of the creditor's security will diminish. Since, at the time of eventual distribution, the extent to which the secured creditor will receive priority will be limited by the value of the secured asset, such a depreciation can prejudice the secured creditor's interests. Some insolvency laws provide that the insolvency representative should compensate secured creditors for the amount of this diminution either by providing additional or substitute security or making periodic cash payments corresponding to the amount of the diminution in value. This approach is only necessary where the value of the security is less than the amount of the secured claim. If the value exceeds the claim, the secured creditor will not be harmed by the erosion of value until that value becomes insufficient to pay the secured claim. [77] Some countries that preserve the value of the security as outlined also allow for payment of interest during the period of the stay to compensate for delay imposed by the proceedings. Provision of interest may be limited however to the extent that the value of the security exceeds the value of the secured claim. [78] Otherwise, compensation for delay may deplete the assets available to unsecured creditors. [77] Such an approach may encourage lenders to seek adequate security that will exceed the value of their claims.

99. [77] In some liquidation cases the insolvency representative may find it necessary to use or sell encumbered assets (see part two, chapter II.C) in order to maximize the value of the estate. For example, to the extent that the insolvency representative is of the view that the value of the estate can best be maximized if the business continues to operate for a temporary period, it may wish to sell

inventory that is partially encumbered. Thus, in cases where secured creditors are protected by preserving the value of the security, it may be desirable for an insolvency law to allow the insolvency representative the choice of providing the creditor with substitute equivalent security or paying out the full amount of the value of the assets that secure the secured claim.

100. [78] Another approach to protecting the interests of secured creditors is to protect the value of the secured portion of the claim. Immediately upon commencement, the encumbered asset is valued and, based on that valuation, the amount of the secured portion of the creditor's claim is determined. This amount remains fixed throughout the proceedings and, upon distribution following liquidation, the secured creditor receives a first-priority claim to the extent of that amount. During the proceedings, the secured creditor could also receive the contractual rate of interest on the secured portion of the claim to compensate for delay imposed by the proceedings.

101. A further means of protecting the secured asset is to provide for relief from the stay, as noted above (see part two, chapter III.C), and to allow the secured creditor to enforce its security.

102. [79] The desirability of the types of approaches that provide protection for the security may need to be weighed against the potential complexity and cost of those measures and the need for the court to be able to make difficult commercial decisions on the question of appropriate protection. Where protection is provided, it may be desirable for an insolvency law to provide guidance to determine when and how creditors holding some type of security over the debtor's assets would be entitled to the types of protection described above.

### 6. *Limitations on disposal of assets by the debtor*

103. [83] In addition to measures designed to protect the insolvency estate against the actions of creditors and third parties, insolvency laws generally adopt measures which are intended to limit the extent to which the debtor can deal with the assets of the estate, both after an application for commencement is made and after proceedings have commenced. Where an interim insolvency representative is appointed as a provisional measure before commencement of the proceedings, the debtor may be subject to supervision or control of that insolvency representative, and will have limited powers to deal with its assets.

104. Where an insolvency representative is appointed on commencement of the insolvency proceedings, many insolvency laws provide that the debtor will lose either all control of the insolvency estate and will not be able to enter into any transactions after commencement, or will have continuing, but limited, powers in relation to the day-to-day conduct of the business and can enter into transactions in the ordinary course of business. Transactions which do not fall into that category, such as the sale of significant assets, may require authorization by the insol-

veny representative, the court or in some cases, the creditors.<sup>2</sup> Some insolvency laws address contracts entered into and transactions implemented by the debtor between application and commencement and after commencement that are not authorized, whether by the insolvency law, the insolvency representative, the court or creditors (as required), in terms of avoidance provisions (see part two, chapter III.E).

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on protection and preservation of the insolvency estate is to:

- (a) provide for the application of measures that will ensure the assets are not diminished by the actions of the [various interested parties] [debtor, creditors or third parties];
- (b) determine the scope of those measures and the parties to whom they will apply;
- (c) establish the conditions for application of those measures, including method, time and duration of application;
- (d) establish the grounds for relief from the application of those measures.

### Content of legislative provisions

#### *Provisional measures*<sup>3</sup>

(30) [(26)] The insolvency law should provide that the court may grant relief of a provisional nature, at the request of any interested party, [where relief is urgently needed to protect the assets of the debtor or the interests of the creditors,] between the making of an application to commence an insolvency proceeding and commencement of the proceedings, including:

- (a) staying execution, enforcement and steps to create valid security rights against the debtor's assets;<sup>4</sup>
- (b) entrusting the administration or supervision of the debtor's business [including the power to use and dispose of assets in the ordinary course of business] to an interim insolvency representative or other person designated by the court[, in order to protect and preserve the value of assets];
- (c) entrusting the realization of all or part of the debtor's assets<sup>5</sup> to an interim insolvency representative or other person designated by the court, in order to

protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and

(d) any other relief of the type applicable automatically on commencement of proceedings (recommendation (35)(d)).<sup>6</sup>

(31) The insolvency law should clearly indicate the balance of the [powers][responsibilities] of the debtor and any interim insolvency representative appointed as a provisional measure (recommendation (30)). Between the time of an application for commencement of insolvency proceedings and commencement of those proceedings, the debtor should be able to continue to operate its business and to use and dispose of assets in the ordinary course of business unless those powers have been granted to an interim insolvency representative.

(32) The insolvency law may provide for appropriate notice to be given to those parties affected by a court order for provisional measures.

#### *Modification or termination of provisional measures*

(33) [(34)] The insolvency law should provide that the court, at the request of the insolvency representative or any person affected by provisional measures (of the kind referred to in recommendation (30) ~~and 28~~), or at its own motion, may modify or terminate those measures [if such modification would not be detrimental to the estate or the interests of creditors and if the party seeking such modification would be harmed by the continuation of such measures].

(34) [(27)] Where provisional measures (of the kind referred to in recommendation (30) are not terminated by the court (recommendation (33)), the insolvency law should provide that they terminate when the measures automatically applicable on commencement (recommendation (35) take effect, unless they are continued by the court (recommendation (36)).

#### *Measures automatically applicable on commencement*

(35) [(28)] Upon the commencement of an insolvency proceeding, the insolvency law should provide that:

- (a) commencement or continuation of individual actions or proceedings<sup>7</sup> concerning the assets of the insol-

<sup>2</sup>Further aspects of these transactions are discussed in part two, chapters III.A.4(b), III.D.7 and IV.

<sup>3</sup>See art. 19, UNCITRAL Model Law on Cross-Border Insolvency.

<sup>4</sup>The reference to assets is intended to be limited to assets that would be part of the insolvency estate upon commencement of insolvency proceedings.

<sup>5</sup>Ibid.

<sup>6</sup>The application, on a provisional basis, of the relief mentioned in recommendation (35)(d) would be limited to assets that would constitute the insolvency estate once insolvency proceedings were commenced.

<sup>7</sup>See art. 20, UNCITRAL Model Law on Cross-Border Insolvency. It is intended that the individual actions referred to in paragraph (a) of recommendation (35) would also cover actions before an arbitral tribunal. It may not always be possible, however, to implement the automatic stay of arbitral proceedings, such as where the arbitration does not take place in the State but in a foreign location. In any event, the interests of the parties may be a reason to allow the arbitral proceedings to continue, a possibility that is envisaged in paragraph (a).

veny estate and the rights, obligations or liabilities of the debtor, including perfection or enforcement of security interests, are stayed except to the extent those individual actions or proceedings [are considered necessary by the court] [may be necessary] to preserve or quantify a claim against the debtor;

(b) execution or other enforcement against the assets of the insolvency estate is stayed;

(c) termination of any contract with the debtor is stayed;<sup>8</sup> and

(d) transfer, encumbrance or other disposition of any assets of the insolvency estate is suspended.<sup>9</sup>

#### *Additional measures available on commencement*<sup>10</sup>

(36) [(29)] The insolvency law should provide that, where necessary to protect the interests of the creditors, assets of the debtor, or the ability to reorganize the debtor's business, the court may, following the commencement of an insolvency proceeding, grant relief additional to the measures automatically applicable on commencement (of the kind referred to in recommendation (35)).

(37) The insolvency law may provide for appropriate notice of any additional measures ordered by the court to be given to parties affected by those additional measures.

#### *Time and duration of application of measures of protection*

(38) [(30)] The insolvency law should clearly state the specific time at which provisional measures (recommendation (30)) and measures automatically applicable on commencement (recommendation (35)) become effective.<sup>11</sup>

(39) [(31)] The insolvency law should provide that the measures automatically applicable on commencement of insolvency proceedings (recommendation (35)), will apply (subject to recommendation (40) and its application to secured creditors) for the duration of the insolvency proceedings.

#### *Secured creditors*

(40) [(32)] The insolvency law should provide that measures automatically applicable on commencement of insol-

veny proceedings (recommendation (35)) will apply to secured creditors:

(a) in respect of a reorganization proceeding, for the duration of that proceeding;

(b) in respect of a liquidation proceeding, for a period of [30-60] days, unless the court extends that period [for an additional [...] day period] upon a showing that:

- (i) an extension is necessary to maximize the value of assets for the benefit of creditors; and
- (ii) the secured creditor will not [suffer unreasonable harm] [be harmed] as a result of an extension.

(41) [(32)] A secured creditor is entitled to relief from the type of measures automatically applicable on commencement referred to in recommendation (35)(a) and (b) on grounds that may include:

(a) that the secured asset has no value to the estate<sup>12</sup> and is not necessary,

- (i) to a reorganization of the debtor's business that is in prospect; or
- (ii) to a sale of the business as an ongoing business concern that is in prospect;

(b) that, in reorganization, a reorganization plan is not approved within [...] days (where the reorganization law includes such a time limitation); or

(c) that the economic value of the secured asset is eroding and the asset is not protected against the erosion of its value;

~~(d) that there is no reasonable prospect for a reorganization of the debtor's business.~~

(42) [(33)] The insolvency law should address the diminution of the value of secured assets and provide appropriate protections. Where the value of the secured assets exceeds the amount of the secured claim and will be sufficient to meet the secured claim, protection may not be required. Where the value of the secured assets does not exceed the amount of the secured claim or will be insufficient to meet the secured claim if the value of the secured asset erodes, protection against diminution of the value of secured assets may be provided by, for example,

- (a) cash payments;
- (b) provision of additional security; or
- (c) such other means as the court determines will provide appropriate protection.

<sup>8</sup>See Part two, chapter III.D(2)(a) and recommendation (53) [(42)].

<sup>9</sup>The limitation on the right to transfer or dispose of assets of the estate may be subject to an exception for those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

<sup>10</sup>See art. 21, UNCITRAL Model Law on Cross-Border Insolvency.

<sup>11</sup>E.g. at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time.

<sup>12</sup>See also recommendations on burdensome, no value and hard to realize assets: chapter III.C.

## A/CN.9/WG.V/WP.63/Add.7

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; Part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A and B appear in documents A/CN.9/WG.V/WP.63/Add.5 and Add.6; chapter III.D-F and chapters IV-VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

**III. TREATMENT OF ASSETS ON COMMENCEMENT OF INSOLVENCY PROCEEDINGS**

**C. Use and disposition of assets**

**1. Introduction**

105. Although as a general principle it is desirable that an insolvency law not unduly interfere with the ownership rights of third parties or those of secured creditors, the conduct of insolvency proceedings will often require assets of the insolvency estate and assets in the possession of the debtor being used in the debtor's business to continue to be used or disposed of in order to enable the goal of the particular proceedings to be realized. This will be especially important in reorganization, but also in liquidation where the business is to be sold as a going concern. It may also be relevant in some cases of liquidation where the business needs to be continued in liquidation for a short period to enable the value of the assets to be maximized even if they are to be sold off piecemeal. For these reasons, it is desirable that an insolvency law include provisions on the use, lease or disposal of assets of the insolvency estate and third party owned assets, addressing the conditions upon which those assets may be used and the provision of protection for the interests of third party owners and the secured creditors.

**2. Assets of the insolvency estate**

106. With respect to use and disposition of assets of the insolvency estate, some insolvency laws draw a distinction between the exercise of these powers in the ordinary course of conducting the business of the debtor and their exercise other than in the ordinary course of business in terms of who may exercise the powers and the protections that are required. For example, decisions as to sale, use and lease of property in the ordinary course of business may be taken by the insolvency representative without requiring notice to be given to creditors or a hearing of the court. Where the sale, use or lease is not in the ordinary course of business, approval of the court or of the creditors may be required. Some insolvency laws also distinguish between different types of property in terms of how it may be used and the conditions that will apply. Special provisions may be made, for example, with respect to perishable or other assets that will diminish in value if not sold quickly, or for cash, and property held jointly by the debtor and another person.

*(a) Methods of sale*

107. Where assets of the insolvency estate are to be sold it is important that they are sold in a manner that will maximize the sale price and that creditors receive adequate notice of the sale. Different approaches are taken to achieving this goal. Many insolvency laws require as-

sets to be sold by auction, with some providing that creditors or the insolvency representative can approve some other means of sale if it will be more profitable. Some insolvency laws give the power of sale to the insolvency representative and impose a duty to obtain the best price reasonably obtainable at the time of sale. Some of those laws also impose limits on the insolvency representative's discretion to choose the method of sale. In cases where the insolvency representative chooses to conduct the sale privately rather than through a public auction, the law may require that the court adequately supervise the sale or that the creditors specifically approve it. Other insolvency laws provide for the court to play a significant role in the sale of assets, with the court fixing the time, the form and the conditions of sale; the insolvency representative plays a subsidiary role in collecting offers and obtaining the views of the creditors. Some insolvency laws also address issues such as sales to a creditor to offset that creditor's claim and sale of the debtor's assets in the possession of a third party to that third party for a reasonable market price.

108. Although it may be suggested that an insolvency law should specifically preclude a sale to related parties to avoid collusion, as long as the sale is adequately supervised an absolute prohibition on such a sale may not be necessary.

*(b) Sale of secured assets*

109. An insolvency law will need to address the question of disposal of secured assets and whether the insolvency representative or the secured creditor will have the power to sell those assets. To a large extent, the approach adopted will depend upon whether the insolvency law includes secured assets in the insolvency estate; if not the secured creditor will generally be free to enforce its security interest. Where secured assets are included in the estate, insolvency laws take different approaches to this issue, which in some cases depends upon the application of other provisions of the insolvency law such as application of the stay and the insolvency representative's ability to sell secured assets free and clear of interests. It may also depend on the nature of the sale proposed, whether as an individual asset or as an integral part of a sale of the business as a going concern. Some insolvency laws, for example, provide that only the insolvency representative will be able to dispose of such assets in both liquidation and reorganization. Some laws distinguish between liquidation and reorganization; only the insolvency representative will be able to dispose of the assets during reorganization, but in liquidation this ability is time limited. After the expiration of the insolvency representative's exclusive period, the secured creditor may exercise its rights. A further approach depends upon the application of the stay; while the stay applies only the insolvency representative can dispose of the assets.

*(c) Ability of the insolvency representative to sell free and clear of interests*

110. Some insolvency laws provide that the insolvency representative can sell assets of the estate free and clear of interests, including security interests, subject to certain

conditions. These may include that the sale is permitted under general law other than the insolvency law, that the interested party consents to the sale, that the sale price is in excess of the value of the interest or that the interested party could be compelled (in other legal proceedings) to accept cash in settlement of its interest. Some laws also provide that where the interested party does not consent to the sale, the insolvency representative may apply to the court for authorization of the sale. This may be granted provided the court is satisfied, for example, that the insolvency representative has made reasonable efforts to obtain the consent, that the sale is in the interests of the debtor and its creditors and that the sale will not substantially prejudice the interested party.

*(d) Joint assets*

111. Where assets are owned by the debtor and another person in some form of joint or co-ownership, different approaches may be taken to sale of the debtor's interest. Where the assets can be divided under the general law between the debtor and the co-owners for the purposes of execution, the insolvency estate's interest can be sold without affecting the co-owners. Some insolvency laws, however, provide that both the estate's interest and the interest of co-owners may be sold by the insolvency representative where certain conditions are met. A sale of both interests may be permitted where, for example, division of the property between the estate and the co-owners is impracticable, where the sale of a divided part would realize significantly less for the estate than a sale of the undivided whole free of the interests of the co-owners, and where the benefit to the estate of such a sale outweighs any detriment to the co-owner. The insolvency law may also provide that the co-owner can purchase the debtor's interest before completion of the sale to another party.

*(e) Burdensome, no value and hard to realize assets*

112. [51] It may be consistent with the objective of maximizing value and reducing the costs of the proceedings to allow the insolvency representative, subject to approval by the court or creditors, to relinquish the estate's interest in certain assets, including land, shares, contracts and other property, provided such relinquishment does not violate any compelling public interest. Situations in which this approach may be appropriate include where assets have a negative or insignificant value; where assets are not essential to a reorganization; where the asset is burdened in such a way that retention would require excessive expenditure that would exceed the proceeds of realization of the asset or give rise to an onerous obligation or a liability to pay money; or where the asset is unsaleable or not readily saleable.

*(f) Surrender of secured assets*

113. [80] Where a security is determined to be valid but the secured assets have no value to the insolvent estate, or cannot be realized in a reasonable period of time by the insolvency representative, the insolvency law may allow the insolvency representative to surrender the secured assets to the secured creditor, with or without court approval.

(g) *Receivables*

114. Where the assets of the estate include receivables (the debtor's contractual right to payment of a monetary sum), it may be advantageous for the insolvency representative to be able to assign the rights to payment to obtain, for example, value for the estate or credit. Different approaches are taken to the question of assignment in the context of insolvency (see part two, chapter III.D). [111] Some insolvency laws specify that non-assignment clauses are made null and void by the commencement of insolvency proceedings. Other insolvency laws leave the matter to general contract law. If the contract contains a non-assignment clause then the contract cannot be assigned unless the agreement of the counterparty or of all parties to the original contract is obtained. Some laws also provide that if the counterparty does not consent to assignment, the insolvency representative may assign with permission from the court if it can be shown that the counterparty is withholding consent unreasonably or if the insolvency representative can demonstrate to the counterparty that the assignee can adequately perform the contract. The insolvency representative is then free to assign the contract for the benefit of the estate. This approach is consistent with the approach taken in the UNCITRAL Convention on the Assignment of Receivables in International Trade (2001), article 9.

3. *Third-party owned assets*

115. [48] Complex issues may be raised in determining whether an asset is owned by the debtor or by another party, and whether assets of a third party that are in the possession of the debtor (subject to use, lease or licensing arrangements) at the time of commencement should be included within the assets of the estate (see part two, chapter III.A.(3)(a) and the discussion on retention of title arrangements). Irrespective of the answer to that question, there will be insolvency cases where third party owned assets, similarly to secured assets, may be crucial to the continued operation of the business, particularly in reorganization proceedings but also to a lesser extent in some liquidation proceedings. In those cases, it will be advantageous for an insolvency law to provide some mechanism which will enable these assets to be used in the insolvency proceedings. Some insolvency laws address this issue in terms of the types of assets to be included within the scope of the insolvency estate. Other insolvency laws, where the possession of the asset by the debtor is subject to a contractual arrangement, address it in the context of the treatment of contracts. This may include, for example, imposing restrictions on the termination of the contract pursuant to which the debtor holds the assets, preventing the owner from reclaiming its assets in the insolvency (at least without the approval of the court or the insolvency representative) and allowing the insolvency representative to continue to use it (see part two, chapter III.D).

116. [49] Assets subject to a lease agreement that are being used by the debtor as lessee, where the lessor retains

legal title, may require special attention. In countries where arrangements allowing the provider of finance to retain title or ownership of the asset as opposed to a mortgage or security interest are of considerable importance, there may be a need to respect the creditor's legal title in the asset and allow it to be separated from the estate (subject to the rules on treatment of contracts: the right to separate may be limited if, for example, the insolvency representative elects to continue the lease contract). By way of comparison, there are also examples of laws which provide for a court-ordered moratorium that prevents third parties from claiming their assets for a limited period of time after commencement. A balance between these two approaches may be desirable, with a view to achieving maximization of value and ensuring that the sale of the business as a going concern or a reorganization will not be rendered impossible by the free separation of the relevant asset. [*Note to the Working Group: This section is to be aligned with the secured transactions guide—see note in part two, chapter III.A above at para. 66 under Assets to be affected.*] There may also be circumstances where these types of financing arrangements should be scrutinized in order to determine whether the lease is, in fact, a disguised secured lending arrangement. In that case the lessor would be subject to the same restrictions in the insolvency proceedings as the secured lender.

117. Where third party owned assets are used in the insolvency proceedings, an insolvency law may also need to consider protection of the interest of the owner of the assets, much in the same way as appropriate protection is provided for secured creditors. It is desirable that any benefits conferred on the estate by the continued use of the asset be paid for by the estate as an expense of administering the estate. It is also desirable that an insolvency law provide appropriate protection against diminution of the value of third party owned assets.

**Recommendations****Purpose of legislative provisions**

The purpose of provisions on use and disposition of assets is to:

(a) address the manner in which assets may be used and disposed of in the insolvency proceedings, including methods for sale of assets;

(b) establish the limits to powers of use and disposition;

(c) provide for the treatment of burdensome assets, assets determined to be of no value to the insolvency estate and assets which cannot be realised in a reasonable period of time by the insolvency representative. ~~abandonment of burdensome assets and for the surrender of unprofitable securities.~~



## Content of legislative provisions

### *Assets of the insolvency estate*

(43) [(35)] When continued operation of the business of the debtor is authorized under liquidation or reorganization, the insolvency law should:

(a) permit the insolvency representative to use, sell or lease property assets of the insolvency estate in the ordinary course of business;

(b) permit the insolvency representative to use, sell or lease property assets of the insolvency estate other than in the ordinary course of business, subject to approval by [the court] [creditors] [and in accordance with recommendations on the use of secured assets and third-party assets].

(44) For the purposes of recommendation (43), the insolvency law should provide that assets subject to security interests<sup>1</sup> can be used by the insolvency representative only where those assets will be of benefit to and are necessary for the conduct of the insolvency proceedings.<sup>2</sup>

(45) The insolvency law should address protection of the secured creditor where the insolvency representative uses assets subject to a security interest. The benefits conferred upon the insolvency estate by the use of the assets should be payable as an expense of administering the estate and the secured creditor should be entitled to protection against the diminution in value of the security.

### *Assets owned by a third party*

(46) [(36)] The insolvency law should permit assets owned by a third party that are not part of the insolvency estate but are in the possession of the debtor at the date of commencement to be used by the insolvency representative where those assets will be of benefit to and are necessary for the conduct of the insolvency proceedings.<sup>2</sup> Where assets owned by a third party are in the possession of the debtor at the time of commencement, the insolvency law should provide for them to be returned to the third party where they will be of no benefit or value to the insolvency estate.

(47) The insolvency law should address protection of the third party owner of assets where the insolvency representative uses those assets. The benefits conferred upon the insolvency estate by the use of the assets should be payable as an expense of administering the estate and the owner of the assets should be entitled to protection against the diminution in value of the assets.

### *Burdensome, no value and hard to realize assets*

(48) [(37)] The insolvency law should permit the insolvency representative to abandon determine the treatment

<sup>1</sup>Recommendation (27) includes secured assets in the insolvency estate.

<sup>2</sup>The use of these assets will be subject to other provisions of the insolvency law including on treatment of contracts.

of any assets that are burdensome<sup>3</sup> to the insolvency estate or that are not of benefit to the insolvency estate. In particular, the insolvency law may provide for the insolvency representative to relinquish the estate's interest in the assets [subject to approval by the court or creditors].

(49) [(38)] The insolvency law should permit the insolvency representative [subject to approval of the court or creditors] to surrender return to the secured creditor assets subject to a valid security interest where the asset is determined to be a burden to the insolvency estate or is determined to be of no value to the insolvency estate. The insolvency law [should] [may] also provide that where an asset subject to a valid security interest cannot be realized in a reasonable period of time by the insolvency representative, or where there is a reasonable indication that the secured creditor can sell the asset more easily and at a better price, the asset can be returned to the secured creditor.

### *Methods of sale of assets*

(50) [(39)] The insolvency law should provide for methods of sale that will maximize the value of the assets being sold [outside the ordinary course of business] [whether in liquidation or reorganization], permitting both public auctions and private sales and requiring that adequate notice of any sale be provided to creditors. Private sales should may be subject to [supervision] [approval] by the court or approval by creditors.

### *Ability to sell assets of the insolvency estate free and clear of security interests*

(51) [(40)] The insolvency law may permit the insolvency representative to sell assets of the insolvency estate free and clear of any security interest of an entity other than the estate, provided that:

~~(a) law other than insolvency law permits such a sale;~~

~~(b) the entity consents;~~

(a) the insolvency representative notifies the secured creditor of its intent to sell the secured asset;

(b) the secured creditor is given the opportunity to object to the proposed sale;<sup>4</sup>

(c) relief from the stay has not been granted; and

(d) the priority of interests in the proceeds of sale of the asset is preserved.

<sup>3</sup>The insolvency law may establish the circumstances in which an asset may be regarded as burdensome, including [51] where the assets have a negative or insignificant value; where the assets are not essential to a reorganization; where the asset is burdened in such a way that retention would require excessive expenditure that would exceed the proceeds of realization of the asset or give rise to an onerous obligation or a liability to pay money; or where the asset is unsaleable or not readily saleable.

<sup>4</sup>In the case of a secured creditor, an objection could generally only be sustained on the basis that it could sell the asset for a greater return than the sale proposed by the insolvency representative.

## A/CN.9/WG.V/WP.63/Add.8

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III. A-C appear in documents A/CN.9/WG.V/WP.63/Add.5-7; chapter III.E-F and chapters IV-VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

**III. TREATMENT OF ASSETS ON  
COMMENCEMENT OF INSOLVENCY  
PROCEEDINGS**

**D. Treatment of contracts**

**1. Introduction**

118. [86] As an economy develops, more and more of its wealth is likely to be contained in or controlled by contracts, rather than contained in land. As a result, the treatment of contracts in insolvency is of overriding importance. There are two overall difficulties in developing legal policies in that regard. The first difficulty is that contracts are unlike all other assets of the insolvency estate in that usually they are tied to liabilities or claims. That is, it is often the case that the estate must perform or pay in order to enjoy the rights that are potentially valuable assets. The result is that difficult decisions must be made about the treatment of a contract so as to produce the most value for the estate. [89] A second difficulty is that contracts are of many different types. They include simple contracts for the sale of goods; short-term or long-term leases of land or of personal property; and immensely complicated contracts

for franchises or for the construction and operation of major facilities, among many others. Additionally, the debtor could be involved in the contract as buyer or seller, lessor or lessee, licensor or licensee, provider or receiver and the problems presented in insolvency may be very different when viewed from different sides.

119. [87] Achieving the objectives of maximizing the value of the estate and reducing liabilities and, in reorganization, enabling the entity to survive and continue its affairs to the maximum extent possible in an uninterrupted manner may involve taking advantage of those contracts that are beneficial and contribute value, and rejecting those which are burdensome, or those where the ongoing cost exceeds the benefit of the contract. As an example, in a contract where the debtor has agreed to purchase particular goods at a price which is half the market price at the time of the insolvency, obviously it would be advantageous to the insolvency representative to continue to purchase at the lower price and sell at the market price. The counterparty would naturally like to get out of what is now an unprofitable agreement, but in many systems it will not be permitted to do so, although it may be entitled to an assurance that it will be paid the contract price in full. In many examples, continuation of the contract will be beneficial to both contracting parties, not just to the debtor.



120. [88] Deciding how contracts are to be treated in insolvency raises an initial question of the relative weight to be attached to upholding general contract law in insolvency on the one hand and the factors justifying interference with those established contractual principles on the other. There are a number of competing interests which may need to be balanced. These include the extent to which public policy goals outweigh the need for predictability and the particular social concerns raised by some types of contracts such as labour contracts (see below); the effect of interfering with the terms of unperformed contracts on the predictability of commercial and financial relations, and on the cost and availability of credit (the wider the powers to continue [adopt] or reject contracts in insolvency, the higher the cost and the lower the availability of credit is likely to be); as well as the extent to which interfering with contracts will enhance the recycling of economic assets.

121. [88] Where the insolvency law adopts the approach of permitting interference with general contractual principles, further considerations are the extent of the interference that is permitted and the types of contracts that can be affected. [84] It is almost inevitable that at the commencement of insolvency proceedings, the debtor will be a party to at least one contract where the debtor and the counterparty have remaining obligations to be performed other than the payment of money, such as the contract price for goods delivered. [85] No special rules are required for the situation where only one party has not fully performed its obligations. If it is the debtor that has not fully performed, the other party will have a claim for performance or damages which it can submit in the insolvency (see part two, chapter VI.A). If it is the counterparty that has not fully performed its obligations, the insolvency representative can demand performance or damages from that party. However, where both parties have not fully performed their obligations, it is a common feature of many insolvency laws that in defined circumstances, those contracts will continue or can be rejected (or possibly assigned, although this is not widely permitted). Typically, the insolvency representative is charged with making this evaluation. In some jurisdictions, court approval is also required.

122. [88] As to the types of contracts to be affected, a common solution is for insolvency laws to provide general rules for all kinds of contracts and exceptions for certain special contracts. The ability to reject labour contracts, for example, may need to be limited in view of concerns that liquidation can be used as a means of expressly eliminating the protections afforded to employees by such contracts. Other types of contracts requiring special treatment may include financial market transactions (see part two, chapter III.F) and contracts for personal services, where the identity of the party to perform the agreement, whether the debtor itself or an employee of the debtor, is of particular importance.

## 2. *Continuation [adoption]*

123. [95] In reorganization, where the objective of the proceedings is to enable the entity to survive and continue its affairs to the extent possible, the continuation of con-

tracts that are beneficial or essential to the business and contribute value may be crucial to the success of the proceedings.

124. [100] In liquidation, the desirability of contracts continuing after commencement of proceedings is likely to be less important than in reorganization, except where the contract may add value to the business or to a particular asset or promote the sale of the business as a going concern. A lease agreement, for example, where the rental is below market price and the remaining term is substantial, may prove central to any proposed sale of the business or may be sold to produce value for creditors.

### (a) *Automatic termination clauses*

125. [96] Many contracts include a clause providing that commencement of insolvency proceedings or other indication of financial distress constitutes an event of default that gives the counterparty an unconditional right, for example, of termination or acceleration, or some other right. Some laws uphold the validity of these clauses for the benefit of the estate and where the insolvency representative wants a contract to continue after commencement of proceedings, this will only be possible if the counterparty does not elect, or can be persuaded not to elect, to terminate or accelerate the contract. In these circumstances, where a counterparty can terminate a contract, an insolvency law may provide a mechanism that can be used to persuade the counterparty to allow the contract to continue, such as establishing a priority for payment for services provided after commencement of the proceedings (in some insolvency laws this may exist as a general provision which typically treats costs incurred after the commencement of proceedings as a first priority).

126. [97] The approach of upholding these types of termination clauses may be supported by a number of factors including: the desirability of respecting commercial bargains; the need to prevent the debtor from selectively performing contracts which are profitable and cancelling others (an advantage which is not available to the innocent counterparty); the effect on financial contract netting of not upholding an automatic termination provision; the belief that since an insolvent business will generally be unable to pay, delaying the termination of contracts potentially only increases existing levels of debt; the need for creators of intellectual property to be able to control the use of that property; and the effect on the counterparty's business of termination of a contract with respect to an intangible.

127. [98] Another approach provides that the insolvency representative can continue or adopt a contract over the objection of the counterparty, that is, any event of default, such as commencement of insolvency proceedings, which would give rise to a right to terminate or accelerate the contract is overridden by operation of the insolvency law. Permitting these termination and acceleration clauses to be overridden in reorganization proceedings may be crucial to the success of the proceedings where, for example, the contract is a critical lease or involves the use of intellectual property embedded in a key product. It may also enhance the earnings potential of the business; reduce the bargain-

ing power of an essential supplier; capture the value of the debtor's contracts for the benefit of creditors and assist in locking all creditors into the reorganization. Where an insolvency law provides that termination clauses can be overridden, creditors may be tempted to take pre-emptive action to avoid that outcome by terminating the contract on some other ground before the application for insolvency proceedings is made (assuming a default by the debtor other than one triggered by commencement of the proceedings). Such a result may be mitigated by providing that the insolvency representative has the power to reinstate those contracts, provided both pre- and post-commencement obligations are fulfilled.

128. [101] In liquidation, the arguments in favour of overriding termination clauses include the need to keep the business together to maximize its sale value or to enhance its earnings potential; to capture the value of the contract for the benefit of all creditors rather than forfeiting it to the counterparty; and the desirability of locking all parties into the final disposition of the business.

129. [99] Although some jurisdictions have implemented provisions allowing termination clauses to be overridden, these provisions have not yet become a general feature of insolvency laws. There is an inherent tension between promoting the debtor's survival, which may require the preservation of contracts, and injecting unpredictability and extra cost into commercial dealings by creating a variety of exceptions to the general rules. While this issue is one which may require a careful weighing of the advantages and disadvantages there are, nevertheless, circumstances where the ability of the insolvency representative to ensure that a contract continues will be crucial to the conduct and successful implementation of reorganization and also, but perhaps to a lesser extent, liquidation where the business is to be sold as a going concern. Any negative impact of a policy of overriding termination clauses can be balanced by providing compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the contract continuing after commencement of proceedings.

*(b) Procedure for continuation of contracts*

130. [92] Insolvency laws adopt different approaches to continuation, or in some cases adoption, of contracts. Under some laws, contracts are unaffected by the commencement of insolvency proceedings so that contractual obligations remain binding and the general rules of contract law will continue to apply unless the insolvency law expressly provides for different rules to be applied, as in the case of automatic termination clauses (see above). [91] Some insolvency laws, however, require the insolvency representative to make a decision as to whether the contract is required and will continue, and set a deadline by which this decision must be taken. Failure to act within the specified time results in the contract being treated as rejected. Where this approach is adopted, a distinction between liquidation and reorganization might be made. In liquidation, it may be possible to provide for contracts to be automatically terminated unless the insolvency representative takes action within a specified time period to preserve a contract. In reorganization, however, more flex-

ibility might be required to avoid a situation where the failure to take a timely decision deprives the estate of a contract that might be crucial for the procedure. One disadvantage of this approach is that in practice there may be many cases where no decision as to the contract can be taken because the contract cannot be performed, and to require an explicit choice to be made on each contract could result in an excessively costly and cumbersome procedure.

131. [92] Whatever rules are adopted with respect to the continuation of contracts, it is desirable that any rights of the insolvency representative should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue or adopt certain parts of a contract and reject others. It is also desirable that the insolvency representative's power with respect to contracts is limited to the relevant types of contracts that are known to the insolvency representative or the court (where the court is involved in making determinations with respect to contracts). If this limitation is not adopted, the consequences of failure to take a decision with respect to a contract the existence of which is not known to the insolvency representative might lead to claims for damages and possible professional liability.

*(c) Continuation of contracts where the debtor is in default*

132. [93] Where the debtor is in default under a contract at the time of the application for insolvency, the policy issue is whether it is fair to require the counterparty to continue to deal with an insolvent debtor when there was already a pre-insolvency default. Some insolvency laws require, as a condition of a contract continuing, that the insolvency representative cure any defaults under the contract and provide assurance as to future performance by providing, for example, a bond or guarantee. Other insolvency laws do not require past defaults to be cured, but may impose restrictions as to the circumstances in which this approach is possible, for example, contracts which can be divided into severable units, such as contracts for the supply of utilities. The insolvency representative may be required to give assurances of future performance and in some cases accept personal liability in the event of future default.

*(d) Claims arising from continuing contracts*

133. [94] Contracts that continue after commencement are treated as ongoing post-commencement obligations of the debtor that must be performed. Claims arising from the performance of the contract after the commencement of insolvency proceedings are treated in a number of insolvency laws as an administrative expense (see part two, chapter VI.A) as opposed to an unsecured claim and given priority in distribution. Since the granting of such a priority constitutes a potential risk for other creditors (who will be paid after the priority creditors), it is desirable that only contracts that will be profitable or essential to the continued operation of the debtor continue after commencement of insolvency proceedings. Other insolvency laws provide no priority for such claims and they will rank with other unsecured claims.

*(e) Amendment of continuing contracts*

134. [88] A further issue to be considered is the circumstances in which an insolvency representative may alter the terms and conditions of contracts that continue after commencement. Where a contract continues, the terms and conditions of the contract must be respected. As a general principle, the insolvency representative will have no greater rights in respect of amendment of the contract than the debtor itself would normally have. This will require the insolvency representative to negotiate any amendment with the counterparty, and any modification without the consent of that other party, will constitute a breach of contract for which the counterparty may claim damages.

*(f) Exceptions to the power to continue contracts*

135. [102] Exceptions to the power of the insolvency representative to decide whether a contract should continue generally fall into two categories. In respect of the first, where the insolvency representative has the power to override automatic termination provisions, specific exceptions may be made for contracts such as short-term financial contracts (e.g. swap and futures agreements—see part two, chapter III.F). The second category relates to those contracts where, irrespective of how the insolvency law treats automatic termination provisions, the contract cannot continue because it provides for performance by the debtor or an employee of the debtor of irreplaceable personal services (the contract may involve, for example, particular intellectual property, services involving a partnership agreement, provision of services by a person with highly specialized skills, or by a named person with a particular skill).

**3. Rejection**

136. [103] For the general reasons discussed in the introduction above, it is desirable that an insolvency representative has the power to reject a contract in which both parties have not fully performed their obligations. [91] It is also desirable that any right to reject a contract should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue certain parts of a contract and reject others.

137. [107] In reorganization, the prospects of success may be enhanced by allowing the insolvency representative to reject burdensome contracts, such as those contracts where the cost of performance is higher than the benefits to be received or, in the case, for example, of an unexpired lease, the contract rate exceeds the market rate.

*(a) Rejection procedure*

138. [104] As in the case of continuation of contracts different mechanisms may be used to reject a contract. Many laws link continuation and rejection in a common procedure which provides, for example, that the insolvency representative is required to take action with respect to a contract, such as by providing notice to the counterparty that the contract is to continue or be rejected. Some laws require the notice to be given within a specified period of time. Unless this time limit is included, this approach may not achieve the key

objectives of certainty, predictability and efficient progress of the proceedings if the insolvency representative does not take timely action and allows the matter to continue unresolved for some time. Where the contract in question involves an ongoing service, failure by the insolvency representative to act may also lead to the accrual of unnecessary expense (e.g. rent for real or personal property which is leased by the debtor can be a significant administrative cost if a lease is not promptly terminated), or to the provision of an essential service being terminated (where the insolvency representative is required to promptly decide that a contract should continue).

139. [105] Under a second approach the contract may be regarded as automatically rejected if the insolvency representative does not decide, within a specified time period, that it should continue. The time period may be longer in reorganization than in liquidation. This approach is aimed at ensuring certainty for both parties. It requires the insolvency representative to take timely action with respect to contracts outstanding at the time of commencement and offers the counterparty some certainty as to the continued existence of the contract within a reasonable period after commencement. Some laws also provide that the counterparty can request the insolvency representative to make a decision on a particular contract within a specified time or apply to the court to require that decision to be made; where no decision is made in those circumstances, the contract may be treated as rejected.

140. [108] As noted above with respect to continuation, it may be appropriate to draw a distinction between liquidation and reorganization in terms of providing for a default position that a contract is rejected. While in liquidation it may be reasonable to assume that the failure of the insolvency representative to take a decision with respect to a contract would most likely imply a decision to reject, the same assumption may not always be appropriate in reorganization. In reorganization, it may be appropriate to allow the insolvency representative to make a decision as to rejection up to the time of approval of the reorganization plan, provided that any benefit received under the contract is paid for up to the time of rejection as an administrative expense and that the counterparty has the ability to compel an earlier decision where it is required or desired. It is desirable that treatment of specific contracts is addressed clearly in the plan, with perhaps a provision that contracts not so addressed should be treated as automatically rejected on approval of the plan.

*(b) Effect of rejection on the counterparty*

141. [106] Pending continuation or rejection of a contract, it is desirable that the insolvency estate be required to pay for any benefits received under the contract. Where a contract is rejected, the counterparty is excused from performing the remainder of the contract and the only serious issue to be determined is calculation of the unsecured damages that result from the rejection. The counterparty becomes an unsecured creditor with a claim equal to that amount of damages. Where a contract has been performed for a period of time during the insolvency proceedings before being rejected, the counterparty may have claims both for the period before rejection (which

may rank as an administrative claim)<sup>1</sup> and for the damages resulting from the rejection. Where the contract continues, both the estate and the counterparty will be obliged to perform the terms of the contract.

(c) *Exceptions to the power to reject*

142. [109] Irrespective of the extent of the rejection powers given to an insolvency representative, exceptions may be needed for certain contracts. One important exception to the power to reject is labour contracts (see part two, chapter III.D.6) and certain financial contracts (see part two, chapter III.F). A similar limitation may appropriately be applied to the case of agreements where the debtor is a lessor or franchisor, or a licensor of intellectual property and termination of the agreement would end or seriously affect the business of the counterparty, particularly where the advantage to the debtor may be relatively minor.

#### 4. *Leases*

143. Some insolvency laws include specific provisions on unexpired leases. Under some laws, a lease of which the debtor is the lessee can be rejected without reference to the expiry date of the lease, provided the notice periods in the law or the lease are observed. Rejection would give rise to a claim by the lessor for compensation for premature termination. Where the debtor is a lessee and its lease is to continue, it may be appropriate for certain conditions to be imposed on the insolvency estate, such as that the insolvency representative must cure any default, provide compensation for any harm arising from such a default and provide assurance as to future performance under the lease. [109] It may also be desirable to set a ceiling on damages claimed by the lessor (which may be a monetary amount or a specified period of time in respect of which damages may be payable) so that the claim under a long-term lease does not overwhelm the claims of other creditors. Lessors ordinarily will have the opportunity to mitigate losses by re-letting the property.

#### 5. *Assignment*

144. [110] The ability of the insolvency representative to elect to assign contracts notwithstanding insolvency-triggered termination provisions or restrictions on transfer contained in the contract can have significant benefits to the estate, and therefore to the beneficiaries of the proceeds of distribution following liquidation or as part of a reorganization. [111] While the ability to assign is considered of critical importance to the liquidation proceedings of some countries, in other countries it is entirely foreign and is precluded. [110] There may be circumstances, such as where the contract price is lower than the market value, where rejection of the contract may result in a windfall for the counterparty. If the contract can be assigned, the insolvency estate rather than the counterparty will benefit from the difference between the contract and market prices.

145. [111] However, providing for assignment of a contract against the terms of the contract may undermine the

<sup>1</sup>See part two, chapter VI.C on ranking of claims.

contractual rights of the counterparty and raise issues of prejudice, especially where the counterparty has little or no say in the selection of the assignee, [97] and the undesirability of compelling the transfer of a contract to a transferee who may not be known to the counterparty or with whom the counterparty may not wish to do business. Different approaches are taken to this issue. Some insolvency laws specify that non-assignment clauses are made null and void by the commencement of insolvency proceedings. Other insolvency laws leave the matter to general contract law; if the contract contains a non-assignment clause then the contract cannot be assigned unless the agreement of the counterparty or of all parties to the original contract is obtained. Some laws also provide that if the counterparty does not consent to assignment, the insolvency representative may assign with permission from the court if it can be shown that the counterparty is withholding consent unreasonably or if the insolvency representative can demonstrate to the counterparty that the assignee can adequately perform the contract. The insolvency representative is then free to assign the contract for the benefit of the estate.<sup>2</sup>

146. [112] Irrespective of the powers of the insolvency representative to assign contracts, some contracts cannot be assigned because they require the performance of irreplaceable personal services or because assignment is prevented by the operation of law. Some countries, for example, prevent the assignment of government procurement contracts.

#### 6. *General exceptions to the power to continue [adopt], reject and assign contracts*

147. [112] A number of specific exceptions to the powers discussed in this section have been mentioned above. However, an insolvency law may need to consider general exceptions for some types of contracts not only to these powers but also to the application of other provisions of the insolvency law. Exceptions relating to financial contracts, netting and set-off are discussed in part two, chapter III.F.

##### *—Labour contracts*

148. [113] One important exception to the powers discussed in this section is that of labour contracts. Although particularly relevant to reorganization, such contracts are also relevant in liquidation where the insolvency representative is attempting to sell the entity as a going concern. A higher price may be obtained if the insolvency representative is able to terminate onerous labour contracts or to achieve necessary downsizing of the labour force of the debtor. However, the relationship between employee and employer raises some of the most difficult questions in insolvency law. It is not simply the contract itself, which in essence is a pending contract like any other, but the usually mandatory provisions of non-insolvency law that protect the position of employees. These may relate to, for example, unfair dismissal; minimum rates of pay; paid leave; maximum work periods; maternity leave; equal treatment and non-discrimination. The difficult question is generally the extent to which these provisions will impact upon the insol-

<sup>2</sup>This approach is consistent, for example, with the approach taken in the UNCITRAL Convention on the Assignment of Receivables in International Trade (2001), article 9.

veny, raising issues that are much broader than termination of the contract and priority of monetary claims in respect of unpaid wages and benefits (see part two, chapter VI.A and C). For these reasons, a number of countries have adopted special regimes to deal with the protection of employees' claims in insolvency and, in order to avoid insolvency proceedings being used as a means of eliminating employee protection, specifically limit the insolvency representative's ability to reject labour contracts. This approach may include limiting the use of the powers to certain specified circumstances such as where the employees remuneration is excessive in comparison to what the average employee would receive for the same work. In some countries the law provides for employees to follow the business in case of sale as a going concern in both liquidation and reorganization, in others only in reorganization.

149. [114] To enhance the transparency of the insolvency regime, it is desirable that the limitations on the powers of the insolvency representative to deal with these types of contracts are stated clearly in the insolvency law.

### 7. *Post-commencement contracts*

150. [114] A second category of contracts in insolvency are those entered into after the insolvency has commenced. In reorganization and where the business is to be sold as a going concern in liquidation, there will often be a need for contracts to be entered into (both in the ordinary course of business and otherwise) to maintain the business as a going concern and enable it to continue earning for the ultimate benefit of creditors. These contracts are generally regarded as post-commencement obligations of the estate and [90] breach of a contract in that category is usually a first claim on the available funds and therefore is paid in full as an expense of the insolvency administration (see part two, chapter VI.C).

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on treatment of contracts is to:

- (a) establish the manner in which contracts, under which both that have not or not fully been performed by either the debtor and its counterparty have not yet fully performed their respective obligations, should be addressed in the insolvency law, including the relationship between the insolvency law and general contract law, with the objective of maximizing the value and reducing the liabilities of the estate;
- (b) define the scope of the powers to deal with these contracts and the situations in which [and by whom] these powers may be exercised;
- (c) identify the types of contracts that should be excluded from the exercise of these powers.

### Content of legislative provisions

(52) [(41)] The insolvency law should address the treatment of contracts under which both that have not or not fully been performed by either the debtor and its

counterparty have not yet fully performed their respective obligations.

### *Automatic termination clauses*

(53) [(42)] The insolvency law [may] [should] render unenforceable [as against the insolvency representative] any contract provision that would provide a right to terminate a contract upon, or identify as an event of default:

- (a) an application for commencement, or commencement, of insolvency proceedings;
- (b) the appointment of an insolvency representative;
- (c) the fact that the debtor satisfies the criteria for commencement of insolvency proceedings; or
- (d) indications that the debtor is in a weakened financial position.

### *Continuation*

(54) [(43)] The insolvency law should provide that the insolvency representative can [decide to] continue a contract where continuation would be beneficial to the insolvency estate.<sup>3</sup>

### *Where a continued contract is subsequently breached*

(55) [(45)] Where a contract continues after commencement of proceedings, the insolvency law should provide that all terms of the contract are enforceable (except automatic termination clauses as provided in recommendation (53)) and damages for the subsequent breach of that contract by the insolvency representative should be payable as an expense of administering the estate.

### *Continuation of contracts where the debtor is in breach*

(56) [(46)] Where the debtor is in default under a contract at the time of commencement of proceedings, and the insolvency representative seeks to continue that contract, the insolvency law may take different approaches to the issue of curing the breach:

- (a) the insolvency representative may have the power to [decide to] continue that contract, provided the default [is] [is capable of being] cured and the non-breaching counterparty is returned to the position it was in before the breach, and the insolvency representative gives appropriate assurances as to the [debtor's][insolvency estate's] ability to perform under the continued contract;
- [(b) the insolvency representative may have the power to [decide to] continue certain contracts [for example, those that can be divided into severable parts, such as for the provision of utilities] without having to cure the breach, provided the insolvency representative gives assurance as to satisfaction of post-commencement claims arising from the contract. The counterparty [should submit][will have] a pre-commencement claim in respect of the default.]

<sup>3</sup>Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation.



### Rejection

(57) [(47)] The insolvency law should provide that the insolvency representative can [decide to reject a contract that is burdensome<sup>4</sup> to the insolvency estate.

(58) [(44)] In the period after the commencement of an insolvency proceeding, and before a contract is rejected, the insolvency law should provide that if the counterparty has performed to the benefit of the insolvency estate, the benefits conferred upon the insolvency estate pursuant to the contract are payable as an expense of administering the estate.<sup>5</sup>

(59) Where a contract is rejected, the insolvency law should provide for the counterparty to be notified of the rejection and of its rights in respect to making a claim (in particular the time in which the claim should be made).

(60) [(48)] Where a contract is rejected, the insolvency law should provide that the rejection gives rise to a [ordinary unsecured] [pre-commencement] claim for the damages arising from the rejection, which would be determined in accordance with the general rules on damages. Claims relating to the rejection of a long-term contract may be limited by the insolvency law.

(61) [(49)] Where the insolvency representative decides to reject a contract, the insolvency law should indicate the time at date on which the rejection will be effective.

### Timing of continuation and rejection

(62) [(50)] The insolvency law may provide a time limit within which the insolvency representative is to decide to continue (where the insolvency law requires a specific decision for a contract to continue) or reject a contract, which time period may be extended by the court. The insolvency law may specify the consequences of the failure of the insolvency representative to act.

(63) [Notwithstanding recommendation (62),] the insolvency law should permit a counterparty to request the insolvency representative to take prompt action to make a decision with respect to a contract where the counterparty can demonstrate prejudice as a consequence of the delay.

### Assignment of contracts

#### Variant A

[(64) [(51)] The insolvency law need not provide rules relating to assignment of contracts if this issue is addressed by other law, such as general contract law, and it is considered that such issues should be determined by the application of that other law.]

(65) [(52)] Where it is considered desirable to include special provisions relating to assignment of contracts in the insolvency law, the insolvency law might provide that the insolvency representative can [decide to] assign a contract, notwithstanding restrictions in the contract.

<sup>4</sup>The insolvency law may establish the circumstances in which an asset may be regarded as burdensome, including [51] where the assets have a negative or insignificant value; where the assets are not essential to a reorganization; where the asset is burdened in such a way that retention would require excessive expenditure that would exceed the proceeds of realization of the asset or give rise to an onerous obligation or a liability to pay money; or where the asset is unsaleable or not readily saleable.

<sup>5</sup>See part two, chapter VI.C.

(66) [(53)] Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:

(a) the assignee can perform the contractual obligations;

(b) the counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment; [and]

(c) the assignment is necessary for [or of benefit to] the reorganization of the debtor or the sale of the debtor's business as a going concern in liquidation.

#### Variant B

(51) ~~The insolvency law [may][should] provide that the insolvency representative can [elect to] assign a contract that has been continued.~~

(52) ~~Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:~~

~~(a) the assignee can perform the contractual obligations;~~

~~(b) the counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment;~~

~~(c) the assignment is necessary for the reorganization of the debtor.~~

### Special treatment of certain contracts

(67) [(54)] The insolvency law may provide special rules for the treatment of labour, financial, intellectual property and [...] contracts.<sup>6</sup>

### Review of decisions concerning treatment of contracts

(55) ~~The insolvency law should permit interested parties to seek judicial review of decisions taken by the insolvency representative with respect to continuation and rejection. Grounds for review may include: [...].<sup>7</sup>~~

### Post-commencement contracts

(68) The insolvency law should provide that contracts entered into in the ordinary course of business after the commencement of insolvency proceedings will be regarded as post-commencement obligations of the insolvency estate. Claims arising from those contracts should be treated as an administrative expense.

<sup>6</sup>For treatment of financial and related contracts, see part two, chapter III.F.

<sup>7</sup>NOTE TO THE WORKING GROUP: The Working Group may wish to consider whether this type of provision should be included under each topic heading (see for e.g. recommendations (64), (83)) or as a general provision perhaps under chapter IV, section B on "The Insolvency Representative" along the following lines:

The insolvency law need not provide rules relating to the right of interested parties to seek review of decisions taken by the insolvency representative in the administration of the proceedings if that right to review exists under other law and it is considered that that issue should be determined by the application of that other law. Where it is considered desirable for reasons of clarity and transparency to include special provisions in the insolvency law, the insolvency law might provide also the grounds upon which such a review might be sought.

## A/CN.9/WG.V/WP.63/Add.9

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-D appear in documents A/CN.9/WG.V/WP.63/Add.5-8; chapters IV-VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

**III. TREATMENT OF ASSETS ON COMMENCEMENT OF INSOLVENCY PROCEEDINGS**

**E. Avoidance proceedings****1. Introduction**

151. [124] Insolvency proceedings (both liquidation and reorganization) may commence at lengthy periods 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 to relatives and friends, or pay certain creditors to the exclusion of others or for creditors to initiate strategic action to place themselves in an advantageous position. The result of such activities, in terms of the eventual insolvency pro-

ceedings, is to disadvantage ordinary unsecured creditors who were not party to such actions and do not have the protection of security, and to undermine the key objective of equal treatment of similarly situated creditors.

152. [131] 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, a security, a guarantee, a loan or a release.

153. [125] Many insolvency laws include provisions which apply retrospectively and are designed to overturn those past transactions to which the insolvent debtor was a party or which involved the debtor’s property where they have certain effects. These include reducing the net worth of the debtor (for example, 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 class (for example, by payment of a debt to an unsecured creditor or granting a security to a

creditor who is otherwise unsecured when other unsecured creditors remain unpaid and unsecured). Many non-insolvency laws also address these types of transactions which are detrimental to creditors outside of insolvency, but they may also be relevant in 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.

154. [133] Transactions typically are made avoidable in insolvency for several reasons, including: to prevent fraud (for example, 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 generally 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 countries, 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.

155. [125] The principal goals of avoidance powers are to preserve the integrity of the insolvency estate and ensure that creditors receive a fair allocation of an insolvent debtor's assets consistent with established priorities for payment. Notwithstanding this goal, it is important to bear in mind that many of the transactions that may be subject to avoidance powers are perfectly normal and acceptable when they occur outside an insolvency context, but become suspect 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 interests of creditors that would be available under general civil or commercial law.

156. [126] 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 nature of the transactions to be included. Nevertheless, 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 and are part of appropriate standards for the governance of commercial entities.

157. [127] 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 hand, the possible undermining of contractual predictability and certainty. Even where an insolvency law adopts broad avoidance powers, the exercise of these powers can be subject to clear criteria which can assist in providing commercial certainty and predictability.

## 2. *Avoidance criteria*

158. [128] Approaches to establishing the criteria for avoidance actions vary considerably among insolvency laws in terms of specific criteria and how they are combined in each law. In terms of the applicable criteria, they can be grouped broadly as objective and subjective criteria.

159. [128] 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 a specified period prior to the application for commencement or the commencement of the insolvency proceedings (often referred to as the "suspect period") or whether the transaction evidenced any of a number of general characteristics set forth in the law (e.g. provision of appropriate value for the assets transferred or the obligation incurred, whether the debt was mature or the obligation due or the relationship between the parties to the transaction). While generalized criteria may be simple to apply, they can also have arbitrary results if relied upon exclusively. So, for example, legitimate and useful transactions that fall within the specified period might be avoided, while fraudulent or preferential transactions that fall outside the period are protected.

160. [129] Another approach emphasizes case-specific, subjective criteria such as whether there is evidence of intention to hide assets from creditors, whether the debtor had ceased making payments when the transaction took place or became unable to make payments as a result of the transaction, whether the transaction was unfair in relation to certain creditors and whether the counterparty knew that the debtor had ceased making payments. This individualized approach may require consideration in some detail of the intent of the parties to the transaction and of other factors such as the debtor's financial circumstances and what constitutes the normal course of business between the debtor and particular creditors.

161. 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. [129] In some countries a heavy reliance upon subjective criteria has led to considerable litigation and extensive cost to the insolvency estate. In order to avoid these costs, some laws have adopted a strictly objective approach of a short suspect period, such as three to four months. In some cases, this short suspect period has been 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. A number of insolvency laws combine these different approaches to address different types of transactions. 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 the more subjective elements involving questions of intent. One insolvency law that adopts a combination of objective and subjective elements provides, for example, that transactions such as gifts, security for existing debts and extraordinary payments (those that 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 has ceased making payments, the transaction is unfair or improper in relation to a group of creditors and the counterparty knew that the debtor had ceased making payments at the time the transactions occurred.

### 3. *Types of transactions subject to avoidance*

162. [132] Although variously defined, there are three broadly common types of avoidable transactions that are found in most legal systems and are used in this guide as the basis of the discussion. They are: transactions intended to defeat, hinder or delay creditors from collecting their claims (often referred to as fraudulent transactions), transactions at an undervalue, and transactions with certain creditors which 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 which 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 or to otherwise prejudice the interests of that creditor and the transaction occurs when the debtor is in a position of financial difficulty and 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, and where there is a clear intent to hinder, defeat or delay creditors, they will fall into the first category of transactions. For these reasons, it is desirable that insolvency laws specify the particular characteristics that are essential for avoidance of transactions, rather than relying on broader labels, such as “fraudulent” or “preferential”.

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

163. [134] These types of transactions involve the debtor transferring assets beyond the reach of creditors to any third party with the intent of favouring certain creditors, and generally require that the third party knows of that intent, or in some cases should have known of that intent. These transactions cannot generally be automatically avoided 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 common circumstances that are present during these types of transfers. Although these circumstances differ between jurisdictions, there are a number of common indicators, including:

- (i) the relationship between the parties to the transaction or obligation, where a transfer was made or an obligation incurred directly to a related person or via a third party to a related person;
- (ii) the lack or inadequacy of the value received for the transfer or the obligation incurred;

- (iii) the financial condition of the debtor both before and after the transfer was made or the obligation incurred, particularly where the debtor was already unable to pay its claims or became unable to pay shortly after the transfer was made or the obligation incurred;
- (iv) 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;
- (v) the general chronology of the events and transactions under inquiry, where for example, the transfer occurred shortly after a substantial debt was incurred;
- (vi) the transfer or obligation is concealed by the debtor, especially when it was not made in the usual course of business, or fictitious parties were involved; or
- (vii) the debtor absconds.

164. Some laws also specify circumstances in which there may be a presumption of intent or specify those transactions where intent or bad faith is deemed to exist, for example, transactions involving related persons occurring within a specified period prior to the commencement of proceedings (discussed further below). 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 and the beneficiary had no notice or was unaware of any intent to defraud.

165. [134] As a practical matter, in order to prove intent, if the debtor cannot explain the commercial purpose of a particular transaction which extracted value from the estate, it may be possible to show that the transaction is one which fits into this category. In designing an insolvency law, as noted above, it may be desirable to bear in mind that transactions of this type that are potentially avoidable under insolvency law are often perfectly valid under non-insolvency law.

#### (b) *Undervalued transactions*

166. [135] Many insolvency laws provide that transactions are generally avoidable where the value received by the debtor as the result of the disposal of an asset or the incurring of an obligation to a third party was either nominal, such as a gift, or much lower than the true value or market price of the asset disposed of or the obligation incurred, and where the transaction occurred within a specified period of time before a particular date (the suspect period). Some laws also require a finding that the debtor had ceased making payments at the time the transaction occurred, or became unable to make payments as a result of the transaction. These transactions include trans-

actions with both creditors and third parties. Some insolvency laws provide that these types of transactions 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, that there were reasonable grounds for believing that the transaction would benefit the debtor's ordinary business, and where cessation of payments is a relevant requirement, that the debtor's assets exceeded its liabilities at the time of the transaction.

(c) *Preferential transactions*

167. [136] Preferential transactions may be subject to avoidance where (i) the transaction took place within a defined but usually rather short period of time before the application for commencement of the insolvency proceedings (the suspect period); (ii) the transaction involves a transfer to a creditor on account of a pre-existing debt; and (iii) as a result of the transaction, the creditor receives 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 had ceased making payments or was close to being in a position where it was unable to pay its debts when the transaction took place. The rationale for including these types of transactions 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 creditors.

168. [137] Examples of preferential transactions may include payment or set-off of debts not yet due; performance of acts which the debtor was under no obligation to perform; provision of security to secure existing debts; unusual methods of payment, 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 payment of debts in response to extreme pressure from a creditor, such as litigation or attachment. A setoff, 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 setoffs. It may also be subject to avoidance where the setoff occurs in irregular circumstances such as where there is no contract between the parties to the setoff.

169. [138] One defence to an allegation of a preferential transaction 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 normal 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 of the commencement of insolvency proceedings, whereas payment of a long overdue debt could be preferential. This approach encourages suppliers of goods and services to continue to do business with a debtor which may be having financial

problems, but which is still potentially viable. Other defences available under insolvency laws include that the beneficiary extended credit to the debtor after the transaction and this credit has not been paid (the defence is limited to the amount of the new credit); the beneficiary can show that it did not know a preference would be created; the beneficiary did not know or could not have known that the debtor had generally ceased making payments; or where cessation of payments is a required element, that the debtor's assets exceeded its liabilities at the time of the transaction.

(d) *Security interests*

170. [139] While security interests valid under the laws permitting the grant of security to creditors 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—as a fraudulent, preferential or undervalued transaction. For example, the grant of a security interest shortly before commencement of proceedings, although otherwise valid, may be found to have favoured unfairly a certain creditor at the expense of the rest. Where the security interest is granted to secure a prior debt or on the basis of past consideration (permitted in some legal systems, but not in others) it may also be invalid as favouring that particular creditor unfairly. Payments received by a secured creditor might be regarded as preferential (at least in part) if an undersecured creditor is paid in full within the suspect period. The same considerations would apply to a security interest that was not perfected under the relevant secured transactions law and, under some laws, to a security interest perfected within a short period before the commencement of proceedings.

(e) *Related person transactions*

171. [146] As noted above, one criterion relevant to avoidance of certain transactions is the relationship between the debtor and the counterparty. Where the types of transactions subject to avoidance involve related persons (these may also be referred to as connected persons or insiders), insolvency laws often provide stricter rules, particularly with regard to the length of suspect periods and treatment of any claim by the related person (see part two, chapter VI.A). [130] 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.

172. 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 may include all employees of the debtor and guarantors of the debts of any person with a business connection to the debtor. Similarly, a family re-

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.

*(f) Void or voidable transactions*

173. [147] 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.

174. [148] In those laws where the transaction is voidable, the insolvency representative will be required to decide whether the 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 it may be responsible for its failure to do so.

**4. Transactions exempt from avoidance actions**

175. Some insolvency laws provide that certain transactions will be exempt from avoidance provisions. These may include transactions that occur either between the application for commencement and commencement or after commencement provided they fall within the ordinary scope of the debtor's business, that are made in good faith by, or with the consent of, the insolvency representative or the court, and are undertaken to further the conduct of the proceedings. Other transactions that it may be desirable to exclude from the scope of avoidance are those transactions that occur in the course of implementing a reorganization plan, where the implementation fails and the proceedings are subsequently converted to liquidation. Finally, certain transactions essential to the functioning of financial markets, (such as close-out netting of securities and derivative contracts) may be exempted from avoidance actions (see part two, chapter III.F).

**5. Establishing the suspect period**

176. [140] Most insolvency laws explicitly specify the duration of the suspect period with reference to the particu-

lar types of transactions 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 such as the making of the application for commencement of proceedings, the commencement of insolvency proceedings or the court's decision as to the date when the debtor ceased paying its debts in the normal way ("cessation of payments"). 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, which 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 a discretionary approach be limited to fraudulent transactions, where issues of commercial certainty are of less concern.

177. [141] Some insolvency laws provide one suspect period for all types of avoidable transactions, while others have different periods depending upon whether the basis of avoidance is fraudulent transfer or preference and upon additional factors such as whether the injury to creditors was intentional and whether the transferee was a related person, as discussed above. Because some transactions involve intentionally wrongful conduct, many insolvency laws do not limit the time period within which these types of transactions must have occurred in order for them to be avoided. Other insolvency laws establish a very long limit (examples range from one to ten years) where the suspect period is generally calculated from the date of commencement of proceedings.

178. [142] Where preferential and undervalued transactions involve creditors who are not related persons, the suspect period may be relatively brief, perhaps no more than several months (examples range from three to six months). However, where related persons are involved, many countries apply stricter rules. These rules may include longer suspect periods (for example two years as opposed to three to six months where the transactions does not involve a related person), shifted burdens of proof (see 6(d) below) and dispensing with requirements that the debtor has ceased making payments at the time of the transaction, or was rendered unable to make payments as a result of the transaction.

**6. Commencement of avoidance proceedings**

*(a) Parties who may commence*

179. Avoidance of a particular transaction generally requires an application to the court to declare the transaction void. A number of insolvency laws provide that proceedings for the avoidance of specified transactions should be

taken by the insolvency representative, although there are some laws that also provide the power to creditors and, in some cases, the creditors committee. The decision to commence such a proceeding, as noted in paragraph (174), will require a number of different considerations to be weighed, depending upon whether avoidance is sought for the benefit of the insolvency estate or, in the case of a creditor, for the benefit of that creditor.<sup>1</sup> Relevant considerations will generally relate to cost and likely benefit; in the case of actions to restore assets to the insolvency estate, they will include whether avoidance of the transaction will be beneficial to the estate, the likely cost 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.

180. [149] In those laws where the insolvency representative has the power to commence avoidance proceedings and, based on the balance of the considerations noted above, (that is for reasons other than negligence or bad faith, or for no justifiable reason<sup>2</sup>), decides not to commence proceedings to avoid certain transactions, insolvency laws adopt different approaches to the conduct and funding of those proceedings. The manner in which they may be funded may be of particular importance where there are insufficient assets in the insolvency estate to do so. 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. Where this latter action is permitted, some laws provide that the assets or value recovered by the creditor are to be treated as part of the estate; in other cases whatever is recovered can be applied in the first instance to satisfy the claim of the creditor which takes the action.

(b) *Funding of avoidance proceedings*

181. [150] As to the manner in which they may be funded, some countries make public funds available to the insolvency representative to commence avoidance proceedings. In other countries, those proceedings are to be funded from the insolvency estate. This latter approach may be appropriate where sufficient funds exist but in some circumstances could operate to 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 an avoidance proceeding. 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 the avoidance proceeding.

<sup>1</sup>Some laws provide that a creditor has the right to contest individual transactions of the debtor, and that they may personally benefit where the proceeding is successful. Some laws also specify that only creditors whose debt precedes the challenged transaction may initiate such proceedings. Other laws limit the right to pursue avoidance actions to the insolvency representative when insolvency proceedings have been commenced.

<sup>2</sup>See chapter IV.B on the rights and obligations of the insolvency representative.

In support of the use of the latter mechanisms, there are clearly significant differences between countries in the availability of public resources for such funding and 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.

(c) *Time limits for commencement*

182. Some insolvency laws establish specific time limits within which avoidance proceedings should be commenced, while others are silent on this issue. Those laws that do specify time limits provide, for example, that the proceeding should be commenced within a specified period after the date of the application for commencement (such as three or twelve months) or no later than a fixed period (for example, six months) after the insolvency representative is able to assess and pursue claims. If an insolvency law is to establish specific time limits, rather than relying on those applicable under general law, an approach that combines different limits, such as a fixed period after commencement and a period after the insolvency representative has discovered a certain transaction, would be desirable. Such an approach would provide flexibility sufficient to address those transactions that are concealed from the insolvency representative and discovered only after the expiration of the fixed period after commencement.

(d) *Evidentiary issues*

183. [151] Insolvency laws adopt different approaches to establishing the elements of an avoidance action. In some laws, the onus is on the debtor to prove that the transaction did not fall into any category of avoidable transactions.

184. [151] Some insolvency laws provide that the insolvency representative or other person permitted to challenge the transaction, such as a creditor, is required to prove the existence of each element of an avoidance action. Where these elements include intent, 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. The law may provide a presumption that the transaction was done to harm creditors, and it is up to the counterparty to prove otherwise.

185. Another approach is to provide that the requisite intent or bad faith is deemed or presumed to exist where certain types of transactions are undertaken, for example, within a specified period before the application for commencement or within a number of years before commencement. The types of transactions may include, for example, transactions with related persons, payment of non-matured debts, and payment of gratuitous or onerous transactions. A slight variation is an approach providing that a transaction will be deemed to be voidable where it occurred within a short specified period and had the effect of conferring a preference.

186. Where knowledge of cessation of payments is a required element of avoidance, some insolvency laws provide a presumption that the creditor knew of the poor financial condition of the debtor if the debtor entered into certain transactions with that creditor, such as for repayment of a non-mature debt or repayment in an unusual manner, or where the transaction occurred within a short period before an application for commencement or before commencement.

187. A further approach is to provide that where a certain type of transaction occurred within a specified period and had the effect of conferring a preference, a rebuttable presumption as to intention to prefer will arise. Unless the creditor can rebut the presumption, the transaction is avoided and the insolvency representative can recover the assets involved in the transaction or obtain judgement for the value of the asset involved.

### 7. *Liability of counterparties to avoided transactions*

188. [143] 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 generally that the transaction will be reversed and the counterparty 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 the counterparty who 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. Where the counterparty fails to disgorge assets or return value to the insolvency estate, most of the remedies available are under non-insolvency law, but some insolvency laws provide that a claim by the counterparty (for amounts owed in addition to those involved in the voidable transaction) cannot be admitted in the insolvency.

### 8. *Post-application and post-commencement contracts*

189. As noted above (part two, chapter III.B.6), some insolvency laws address contracts entered into and transactions implemented between application and commencement of proceedings and after commencement in terms of avoidance provisions when those transactions or contracts are not authorized by the insolvency law or approved, as required, by the court, the insolvency representative or creditors. Some insolvency laws specify the types of these transactions that may be avoided, such as performance of obligations arising before commencement, payment of pre-application debts, creation of security over assets of the estate and disposal of any right or asset forming part of the estate. Other laws provide for avoidance of any unauthorized transaction entered into by the debtor at these times unless the counterparty can provide that the transaction did not impair creditor's rights.

## Recommendations

### Purpose of legislative provisions

The purpose of avoidance provisions is to:

- (a) ~~preserve~~reconstitute reconstruct the integrity of the estate and ensure the [fair][equitable] treatment of creditors;
- (b) provide certainty for third parties by establishing clear rules for the circumstances in which transactions [occurring] prior to the commencement of insolvency proceedings [or unauthorized transactions occurring after [application for] commencement] involving the debtor or the debtor's property may be considered injurious and therefore subject to avoidance;
- (c) enable the ~~insolvency representative to~~ commencement of proceedings to avoid those transactions;
- (d) facilitate the recovery of money or assets from persons involved in transactions that have been avoided.

### Content of legislative provisions

(69) [(56)] The insolvency law should include provisions which apply retroactively and are designed to overturn past transactions<sup>3</sup> [or unauthorized transactions occurring after [application for] commencement] to which the debtor was a party [or which involved the debtor's property] and which have the effect of either reducing the net worth of the debtor or upsetting the principle of [fair] [equitable] treatment of creditors.

#### *Transactions subject to avoidance*

(70) [(57)] The insolvency law should provide that the following types of transactions are subject to avoidance ~~the insolvency representative may commence proceedings in court to set aside as void the following types of transactions:~~

- (a) transactions intended to defeat, delay or hinder the ability of creditors to collect claims by, for example, the transfer of assets to any third party where the purpose of the transaction was to put assets beyond the reach of a creditor or potential creditor or to otherwise prejudice the interests of that creditor and where the third party knew of the debtor's intent; ~~(fraudulent transactions)~~
- (b) transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was made in exchange for a nominal or less than equivalent value (undervalued transactions) which occurred at a time when the debtor [was insolvent][had ceased making payments] or as a result of which the debtor became [insolvent] [unable to make payments]; and
- (c) transactions involving creditors where a creditor obtains more than its pro rata share of the debtor's assets (preferential transactions) which occurred at a time when the debtor had ceased making payments [was insolvent].

<sup>3</sup>[131] 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, a security, a guarantee, a loan or a release.



*Security interests*

(71) The insolvency law should provide that although security interests valid under laws permitting the grant of security to creditors are generally valid under insolvency law, they will be subject to avoidance on the same grounds as other transactions.

*Related person transactions*

(72) [(61)] In relation to transactions of the type referred to in recommendation (70) involving related persons, the insolvency law should provide that the insolvency representative may commence proceedings in court to set aside as void undervalued and preferential transactions:

(a) those transaction are subject to avoidance;

(b) the suspect period for those transactions may be longer than for transactions with unrelated persons; and

(c) there may be presumptions or shifts in the burden of proof that favour the insolvency estate.

(73) The insolvency law should specifically define the categories of persons considered to be sufficiently related to the debtor for the purposes of recommendation (72).

(62) ~~The insolvency law should clearly establish the suspect period for the types of transactions referred to in recommendation (61), which would generally be longer than the time periods applicable to both undervalued and preferential transactions that do not involve related persons.~~

*Transactions exempt from avoidance actions*

(74) The insolvency law should specify the transactions that will be exempt from avoidance. These transactions may include transactions entered into in the ordinary course of business prior to commencement of insolvency proceedings, transactions entered into the course of reorganization proceedings which are subsequently converted to liquidation and certain financial market transactions.

*Establishing the suspect period*

(75) [(58)] The insolvency law should establish that transactions with the characteristics described in recommendation (70) may be avoided if they occurred within a specified period (the suspect period) [prior to] [calculated retroactively from] the [application for] commencement of the insolvency proceeding. The insolvency law may specify different suspect periods for different types of transactions, but in general the suspect periods for transactions referred to in recommendation (70)(a) and those involving related persons (recommendation (72)) should be longer than for other types of transactions than those not involving related persons.

*Commencement of avoidance proceedings*

(76) The insolvency law should specify that the insolvency representative [and ..] may commence avoidance proceedings.<sup>4</sup>

<sup>4</sup>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.

*Time limits for commencement of avoidance proceedings*

(77) [(59)] Following commencement of the insolvency proceedings the period within which an avoidance proceeding may be commenced in respect of a transaction of which the insolvency representative is aware, may be limited by the insolvency law or by applicable procedural law.

*Funding of avoidance proceedings*

(78) [(64)] The insolvency law may provide alternative approaches to address the funding of avoidance proceedings where the insolvency representative does not pursue the avoidance of particular transactions either on the basis of an assessment that the transactions are not likely to be avoided or that pursuing such transactions will impose [unjustifiable] [excessive] costs upon the insolvency estate. These approaches may include permitting individual creditors or the creditor committee to pursue avoidance and (a) allowing the creditor(s) to retain an amount of any sum recovered towards satisfaction of their claim, (b) paying the costs of the avoidance proceeding from the insolvency estate in the event that the proceeding is successful; or (c) modifying the priority of the claim of the creditor(s) pursuing avoidance.

*Evidentiary issues*

(79) [(60)] The insolvency law should specify the elements to be proved in order to avoid a particular transaction and possible defences to avoidance.

(80) [(63)] The insolvency law may provide that special evidentiary presumptions apply to the avoidance of certain transactions occurring within specified periods involving certain clearly specified persons [such as related persons] or classes of person.

*Liability of counterparties to avoided transactions*

(81) The insolvency law should provide that a counterparty to a transaction that has been avoided is bound to return to the estate all material benefits derived from the avoided transaction. Where the counterparty refuses to return those benefits, the insolvency law may provide that the counterparty cannot make a claim in the insolvency proceedings.

*Review of decisions concerning avoidance*

(65) ~~The insolvency law should permit interested parties to seek judicial review of decisions taken by the insolvency representative with respect to avoidance. Grounds for review may include: [...].~~

**F. Setoff, netting and financial contracts****1. General right of setoff**

190. [116] An important issue that arises in the design of an insolvency law is the treatment of a creditor who, at the time of the application for commencement of proceedings, also happens to be a debtor of the estate. If the fundamental principle of equality of treatment of similarly situated

creditors is applied, the outcome would be relatively straightforward: the insolvency representative will be able to receive the full amount owed by the creditor and the creditor's claim will be satisfied upon the liquidation of the estate or in the reorganization. However, an alternative approach permits the creditor, in these circumstances, to exercise setoff rights against the estate after the commencement of proceedings, with the effect that, depending on the size of the estate's claim on the creditor, the creditor's claim is satisfied in full. The main effect is thus that a creditor with a setoff is in substance "secured" because the debtor's cross-claim can be paid or discharged by setting it off against the creditor's claim. Setoff is not significant until insolvency, because if a counterparty could always pay, there would be no need for setoff.

191. Since claims are a major form of property in modern economies and since creditors are often also debtors to the same counterparty, the law of setoff is important in business and in financial markets (see below). Setoff is prevalent in business transactions because wherever there is a series of contracts between the same parties, there is a potential for setoff. This extends also to mutual trading transactions.

192. [119] The international position with regard to setoff in insolvency reveals considerable diversity. In some countries, setoff is restricted between solvent parties, but is compulsory on insolvency, in other countries the opposite position exists and it is permitted between solvent debtors, but prohibited on insolvency.

193. [117] There are several reasons why it may be appropriate to include the right of setoff in an insolvency law. The first is that of fairness: notwithstanding the importance of equality of treatment among creditors, it can be considered unfair for a debtor to refuse to make a payment to a creditor but, at the same time, to insist upon payment from that creditor. In addition, since many counterparties are banks, the right of setoff is particularly beneficial to the banking system and, because of the important credit creation role of banks, it is therefore considered to be of general benefit to the economy. By virtue of their core functions (lending and deposit taking) banks that have lent to an insolvent debtor often find that they have financial obligations to the debtor in the form of deposits. A post-commencement right of setoff will allow the banks to offset their unpaid claims with the debtor's deposits even though these reciprocal claims are not yet due and payable. Setoff allows the creditor to escape the difficulties created by the insolvency of the debtor and thus helps to avoid the cascade effect of bankruptcy, as well as reducing exposures and transaction costs and thus the cost of credit. Setoff also avoids circularity of payments and associated costs.

194. [118] Although there are a number of advantages to allowing setoff, these may need to be balanced against some of the arguments against a right of setoff. Insolvency setoff is a violation of the *pari passu* principle because a creditor with a setoff gets paid in full without there being general awareness, unlike publicized security interests, of the existence of reciprocal claims. Setoff can deplete a debtor's assets and inhibit reorganization particularly

where the debtor loses access to its bank accounts or cash in its bank accounts.

195. [120] The right of setoff interacts with other provisions of insolvency in a number of important respects. For example, the right of a creditor to claim the benefit of a setoff may be subject to the avoidance provisions (see part two, chapter III.E.3(c)). Where an insolvency law generally allows termination clauses to be overridden thus allowing the insolvency representative to continue unperformed contracts, a creditor will only be able to exercise setoff rights regarding mutual monetary claims where the right to override the termination clause includes an exception which expressly allows a creditor to terminate the contract and set off those claims. This is particularly important in the context of short-term financial transactions.

## 2. *Netting and setoff in the context of financial transactions*

196. In addition to its importance in business generally, setoff is also important in financial markets. Some common cases of setoff include setoff by banks of loans against deposits; setoff between institutions in financial markets such as the inter-bank deposit market; and netting of foreign exchange, swaps, futures, securities and repurchase contracts; and setoff in centralized payment systems. The amounts involved are often very large and the reduction in exposures achieved by setoff, with a resulting reduction in credit costs, and cascade risks threatening the integrity of the financial system, are correspondingly large.

197. Netting differs from setoff in that in one form it can consist of the setoff of non-monetary fungibles (e.g. securities or commodities deliverable on the same day—settlement netting) and because in its more important form it generally involves a cancellation by a counterparty of open contracts with an insolvent debtor, followed by setoff of losses and gains either way—close-out netting.

198. The international position with regard to setoff and netting is complex. The minority of countries that have not traditionally accepted insolvency setoff, [119] except for certain transactions and for current account setoffs, still mainly adhere to that position, although a few have widened their transaction setoff and some have introduced netting legislation which applies only to specified contracts. Among those States that traditionally permit insolvency setoff a small number impose a stay in reorganization proceedings, although permitting an exemption for financial contracts. Other insolvency laws do not address the question of setoff.

## 3. *Exceptions or carve-outs for financial contracts*

199. [121] Whether it is desirable that an insolvency law include provisions regarding certain types of short-term financial contracts, including derivative agreements (e.g. currency or interest rate swaps) will depend upon how issues relating to the treatment of contracts and setoff rights are addressed. The terms of the increasingly standardized master agreements which govern these individual transactions normally contain provisions that enable close-

out netting. Such provisions, which aggregate all independent payment obligations, are normally effective only upon the insolvency of one of the parties if the insolvency law contains two features. First, it must allow for the termination (or “close-out”) of all outstanding transactions under the agreement on the insolvency of a party, and second, it must allow the non-insolvent party to set off its claims against the obligations of the insolvent party.

200. [122] Many insolvency laws do not contain both of these features. As noted above in the discussion of treatment of contracts, some countries allow an insolvency representative to elect to continue the contract in contravention of the termination provisions of the contract. With respect to setoff, a number of countries do not allow for the setoff of independent financial claims that are not mature at the time of commencement.

201. [123] Many countries that do not possess these general rules providing for both termination and setoff, have nevertheless carved out exceptions to the applicable insolvency rules for the specific purposes of allowing “close-out netting” for prescribed eligible financial contracts, including security interests, repurchase agreements and securitizations. The rationale for these exceptions is the increasing importance of these transactions in the global financial market, the need for safety in markets, the complexity of these financial arrangements and the fact that access to such transactions would be restricted if there was no certainty with respect to the availability of netting upon the insolvency of one party. Notwithstanding these important advantages, it should be recognized that such “carve-outs” complicate the law and result in preferential treatment for certain types of creditors.

202. In addition to the exception discussed above, further exceptions may be required for financial contracts from the application of the stay (mentioned in part two, chapter III.B.3), the operation of avoidance provisions (mentioned in part two, chapter III.D.6) and from the power of the insolvency representative to continue and reject contracts under which the debtor and its counterparty have not yet fully performed their respective obligations (mentioned in part two, chapter III.E.4). *[Note: the Working Group may wish to consider the scope of such exceptions and whether the additional recommendations should be added to this section cover these issues—see note re recommendations 86-88 below.]*

## Recommendations

### Purpose of legislative provisions

*[Purpose clause to be drafted]*

### Content of legislative provisions

#### *General right of setoff*

~~[(82)][(67)] The insolvency law should protect a pre-commencement right of set off existing under general law should be protected during liquidation proceedings and generally should be exercisable by both creditors and the insolvency estate.~~

~~[(83) The insolvency law should permit post-commencement set off where the mutual claims arise under the same agreement. In addition, countries may also wish to consider allowing for post-commencement set off in other circumstances, particularly with respect to mutual financial obligations which derive from financial contracts defined by law.]~~

#### *Netting and financial contracts*<sup>5</sup>

~~(84) [(66) In the context of financial [contracts][master agreements] the insolvency law should provide that netting and close-out arrangements are legally protected and, to the greatest extent possible, should not be unwound in insolvency proceedings.]~~

#### *Exception to unenforceability of automatic contract termination clauses*<sup>6</sup>

~~(85) [68] Where the insolvency law does not permit post-commencement setoff for mutual financial obligations, or renders unenforceable as against the insolvency representative any contract provision that would provide a right to terminate a contract upon, or identify as an event of default, (a) the application for commencement, or commencement, of insolvency proceedings; (b) the appointment of an insolvency representative; (c) the fact that the debtor satisfies the criteria for commencement of insolvency proceedings; or (d) indications that the debtor is in a weakened financial position, it may be necessary for the insolvency law to provide an exception for financial [contracts][master agreements] so that close-out netting provisions contained in those [contracts][agreements] between the debtor and another party can be applied with certainty.~~

#### *Possible additional recommendations concerning financial contracts*

~~(86) [Exception to application of stay: chapter III.B.3]~~

~~(87) [Exception to application of avoidance provisions: chapter III.D.6]~~

~~(88) [Exception to powers of continuation and rejection of contracts: chapter III.E.4]~~

<sup>5</sup>The Working Group may wish to consider whether the term “financial contracts” should be defined, and if so, provide an appropriate definition. One example might be the definition included in the UNCITRAL Convention on the Assignment of Receivables in International Trade, art. 5(k) which provides: “Financial contract” means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above.

At the twenty-sixth session of the Working Group (May 2002), the view was expressed that that definition was too broad and should be more narrowly focussed to cover only those transactions which formed part of a broader framework contract (A/CN.9/511, para. 71). No specific drafting was proposed.

<sup>6</sup>See part two, chapter III, D Treatment of contracts, recommendation (53).



## A/CN.9/WG.V/WP.63/Add.10

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV.C and D, and chapters V-VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

## IV. PARTICIPANTS AND INSTITUTIONS

**A. The debtor****1. Introduction**

203. Insolvency laws adopt different approaches to the role the debtor plays in the insolvency proceedings once they have commenced, with a distinction generally being

drawn between liquidation and reorganization. Where the business is to be continued (either for sale as a going concern in liquidation or in reorganization) a greater need arises for some form of involvement by the debtor in management. The debtor will also have a role to play in assisting the insolvency representative to perform its own functions and in providing information on the business to the court or the insolvency representative. The debtor will also have certain rights with regard to those proceedings. To ensure the efficient and effective conduct of the proceedings, and provide certainty for those parties involved it is desirable that the insolvency law establishes the extent of the debtor's rights and obligations.

## 2. Continued operation of the debtor's business

### (a) Liquidation

204. [152] Once liquidation proceedings have commenced, the conservation of the estate requires comprehensive measures to protect the estate not only from the actions of creditors (see part two, chapter III.B) but also from the debtor or its managers or owners.<sup>1</sup> For this reason, many insolvency laws divest the debtor of all rights to control assets and manage and operate the business in liquidation, and appoint an insolvency representative to assume all responsibilities divested. In addition to the powers relating to use and disposal of assets, these responsibilities may include the right to initiate and defend legal actions on behalf of the estate and the right to receive all payments directed to the debtor. After commencement of the liquidation proceedings, [153] any transaction involving assets of the estate or transfer of those assets that are not authorized by the insolvency representative, the court or creditors (as required) generally will be void (or subject to avoidance), and the assets transferred (or their value) subject to recovery for the benefit of the insolvency estate (see part two, chapter III.D.7, III.E.8).

205. [153] Where it is determined that the most effective means of liquidating the estate is to sell the business as a going concern, some laws provide that the insolvency representative should supervise and have overall control of the business while permitting the debtor to enhance the value of the estate and facilitate the sale of the assets by continuing to serve and advise the insolvency representative. This approach may be supported by the debtor's detailed knowledge of its business and the relevant market or industry, as well as its ongoing relationship with creditors, suppliers and customers. Depending upon the level of control the insolvency representative exercises over the debtor's activities, the insolvency representative may be made liable for the wrongful acts of the debtor during the period of its control (see part two, chapter IV.B.7).

### (b) Reorganization

206. [154] In reorganization proceedings, there is no agreed approach on the extent to which displacement of the debtor is the most appropriate course of action and, where some level of displacement does occur, on the ongoing role that the debtor may perform. That ongoing role may depend in large part upon the debtor acting in good faith during the reorganization process; where it does not, its continuing role may be of questionable value. Sometimes the solution may depend upon whether the debtor commenced the proceedings voluntarily or whether they were commenced by creditors, in which case the debtor may be uncooperative or even hostile.

<sup>1</sup>Because the insolvency law will cover different types of businesses, whether individuals, partnerships or some form of company, the question of the continuing role of the debtor properly raises questions of the role of the debtor's management or owners, depending upon the circumstances. For ease of reference, the Guide refers only to "the debtor", but it is intended that management and owners should be covered by the use of that term where appropriate.

### (i) Advantages and disadvantages of the debtor's continuing involvement

207. There are a number of potential advantages in providing for the debtor to have an ongoing role. [154] In many circumstances, the debtor will have immediate and intimate knowledge of its business and the industry within which it operates. This knowledge is particularly important in the case of individual businesses and small partnerships and may, in the interests of business continuity, provide a basis for the debtor to have a role in making short-term and day-to-day management decisions. It may also assist the insolvency representative to perform its functions with a more immediate and complete understanding of the operation of the debtor's business. For similar reasons, the debtor is often well positioned to propose a reorganization plan for approval by creditors and the court. In such circumstances, total displacement of the debtor, notwithstanding its role in the financial difficulties of the business, may not only eliminate the incentive for entrepreneurial activity, risk-taking in general and for debtors to commence reorganization procedures at an early stage, but also may undermine the chances of success of the reorganization.

208. [155] The desirability of the debtor having an ongoing role may need to be balanced against a number of possible disadvantages. Creditors may have a lack of confidence in the debtor on account of the financial difficulties of the business (and the role that the debtor may have played in these difficulties occurring) and confidence will need to be rebuilt if the reorganization is to be successful. Permitting the debtor to continue to operate the business with insufficient control over its powers may not only exacerbate the breakdown of confidence but may antagonize creditors further. A system which is perceived to be excessively pro-debtor may result in creditors being apathetic about the process and unwilling to participate, which in turn may lead to problems of monitoring the conduct of the debtor where the insolvency law requires that role to be played by creditors. It may also encourage an adversarial approach to the insolvency process, adding to costs and delay. A debtor may have its own agenda which clashes with the objectives of the insolvency regime and in particular with the maximization of returns for creditors. Its overriding goal, for example, may be to ensure that it does not lose control of the business rather than to maximize value for the benefit of creditors. Furthermore, the success of reorganization may depend not only upon instituting change that the debtor may not be willing to accept, but also upon the debtor having the knowledge and experience to utilize the insolvency law to work through its financial difficulties. A related factor to be considered is whether the insolvency proceedings were commenced voluntarily or involuntarily (in which case the debtor may be hostile to creditors).

209. [note to para. 161] A number of insolvency laws draw a distinction, in terms of the debtor's role, between the period from commencement of proceedings to approval of the reorganization plan, on the one hand, and the period following approval, on the other hand. In the first period these laws set out specific rules concerning the debtor's ability to manage and control the day-to-day running of

the business and the appointment of an independent insolvency representative. Once the plan has been approved, these laws provide that the limits applicable to the debtor's control and management of the business cease to apply and the debtor will be responsible for implementation of the approved plan.

210. [156] Insolvency laws adopt different approaches to balancing these competing considerations in reorganization. These vary between displacing the debtor and appointing an insolvency representative, at one end of the scale, and allowing the debtor to remain in control of the business with minimum supervision at the other. Intermediate approaches provide for an insolvency representative to be appointed to exercise some level of supervisory function, as well as for retention of existing management.

*(ii) Possible approaches—total displacement of the debtor*

211. [156] The first approach follows the same procedure as in liquidation, removing all control of the business from the debtor and appointing an insolvency representative to undertake the debtor's functions with respect to management of the business. As noted above, however, displacing the debtor completely may cause disruption to the business and repercussions detrimental to the operation of the business at a critical point in its survival.

*(iii) Possible approaches—supervision of the debtor by the insolvency representative*

212. [157] Intermediate approaches establish different levels of control between the debtor and the insolvency representative. These generally involve some level of supervision of the debtor by the insolvency representative, such as where the latter broadly supervises the activities of the debtor and approves significant transactions, while the debtor continues to operate the business and take decisions on a day-to-day basis. This approach may need to be supported by relatively precise rules to ensure that the division of responsibility between the insolvency representative and the debtor is clear, and there is certainty as to how the reorganization will proceed. Some insolvency laws, for example, specify that certain transactions, such as entering into new debt, transferring or pledging assets and granting rights to the use of property of the insolvency estate, can be undertaken without the consent of the insolvency representative or the court provided they are undertaken in the normal course of business. If they are not in the normal course of business, consent is required. Monitoring the cash flow of the debtor's business may be an additional tool for policing the debtor and its transactions. Where the debtor fails to observe the restrictions and enters into contracts requiring consent without first obtaining that consent, the insolvency law may need to address the validity of the transactions and provide appropriate sanctions. One insolvency law, for example, provides that in these circumstances the court can dismiss the insolvency proceedings altogether. The appropriateness of this remedy may depend upon whether the proceedings were voluntary or involuntary.

213. The insolvency laws that enumerate the transactions requiring consent establish a relatively clear line of responsibility between the debtor and the insolvency representative or the court. A number of these laws also provide that the insolvency representative can take greater control of the insolvency estate and day-to-day management of the business if required to protect the insolvency estate in a particular case. [158] Appropriate circumstances may include where there is evidence of a lack of accountability on the part of the debtor, or where there is mismanagement or misappropriation of assets by the debtor. Where these circumstances arise, it may be desirable to provide for the debtor to be displaced by the court, on its own motion or on that of the insolvency representative or perhaps on that of the creditors or creditor committee.

214. [157] Creditors may have a role to play in monitoring the management activities of the debtor and ensuring that it carries them out effectively. Where creditors have such a role there may be a need for measures that would prevent possible abuse by creditors seeking to frustrate the reorganization proceedings or to gain improper leverage. The required degree of protection could be achieved by requiring, for example, the vote of an appropriate majority of creditors before allowing creditors to take action to displace the debtor or increase the supervisory role of the insolvency representative.

215. A different approach to the delineation of powers between the debtor and the insolvency representative is one where the insolvency law does not specify the transactions that the debtor may undertake, but allows the court or the insolvency representative to determine which legal acts management can perform with approval and which it cannot. While allowing some degree of flexibility, this approach may deter debtors from commencing insolvency proceedings as the effect of commencement on their management and control of the business will be unclear.

*(iv) Possible approaches—full control by the debtor*

216. [159] A further approach to the issue of the debtor's ongoing role is one that enables the debtor to retain full control over the operation of the business, with the consequence that the court does not appoint an independent representative once the proceedings begin (often known as "debtor in possession"). That approach may have the advantage of enhancing the chances of a successful reorganization if the debtor can be relied upon to carry on the business in an honest manner and obtain the trust, confidence and cooperation of creditors. There may be, however, disadvantages which include the process being used in situations where the outcome is clearly not likely to be successful, that is to delay the inevitable with the result that assets continue to be dissipated, and the possibility that the debtor may act irresponsibly and even fraudulently during the period of control, undermining the reorganization as well as the confidence of creditors. These difficulties may be mitigated by adopting certain protections such as a requirement that the debtor report regularly on the conduct of the proceedings to the court, appointment of an insolvency representative to supervise the debtor, giving the creditors a significant role in supervising or overseeing

the debtor or a mechanism that allows the court (either on its own motion or at the request of creditors) to replace the debtor with an insolvency representative or to convert the proceedings to liquidation. Nevertheless, this approach is a complex one that requires detailed consideration not only because it depends upon strong governance rules and institutional capacity, but also because it affects a number of other aspects of the design of an insolvency regime (e.g. the reorganization plan, exercise of avoidance powers, treatment of contracts).

### 3. *Rights of the debtor*

217. [168] To preserve what are regarded in some countries as fundamental rights of the debtor and to ensure its fair and impartial treatment, and perhaps more importantly to encourage debtor confidence in the insolvency process, it is desirable that the role of the debtor in the insolvency proceedings and the rights it will have with respect to the conduct of the proceedings are clearly enumerated in the insolvency law. In many countries, the rights of a natural person debtor in insolvency proceedings may be affected by obligations under international and regional treaties such as the International Covenant on Civil and Political Rights (1976) and the European Convention on Human Rights (1950).

#### *—Right to be heard, to access information and to retain personal property*

218. [168] It is desirable, for the reasons indicated above, that the debtor has the right to be heard in the insolvency proceedings and to participate generally in the decision-making that is a necessary part of the proceedings, particularly reorganization proceedings. In particular, the debtor should be able to access information relating to the progress of the proceedings in all cases, but especially where the insolvency law provides for some level of displacement of the debtor (whether in liquidation or reorganization) from management and control of the business. This access to information may be particularly important in reorganization where the insolvency law provides for some level of displacement before approval of the plan, but requires the debtor to take responsibility for the plan's implementation. It may also be appropriate, in circumstances where the debtor does not play a role in formulation of the plan, for it to be given an opportunity to express an opinion on the plan before it is submitted for approval. As noted above in part two, chapter III.A.3, where the debtor is a natural person, certain assets are generally excluded from the insolvency estate to enable the debtor to preserve its personal rights and that of its family and it is desirable that the right to retain that property be made clear in the insolvency law.

219. [169] There may be situations, however, where the exercise or observance of these rights leads to formalities and costs that impede the course of the proceedings without being of any direct benefit to the debtor. It may be the case, for example, that where the debtor is no longer available in the jurisdiction in which the proceedings are being conducted and refuses or fails to respond to all reasonable attempts by the insolvency representative or the court to

establish contact, an absolute requirement to be heard could seriously impede progress of the proceedings, if not make them impossible to undertake. While it may be desirable to provide that all reasonable efforts to allow the debtor to be heard should be made, an insolvency law may need to provide some flexibility to avoid the exercise of the right adversely affecting the proceedings.

### 4. *Obligations of the debtor*

220. As noted with respect to the rights of the debtor, it is desirable that the insolvency law clearly identify the obligations of the debtor with respect to the insolvency proceedings, including, as far as possible, the content and terms of the obligations and to whom each obligation is owed. These obligations will need to be adjusted to the role to be played by the debtor in respect of both liquidation and reorganization proceedings, especially with regard to management and control of the business in reorganization. For example, where the debtor remains in control of the business in reorganization, an obligation to surrender control of the assets of the insolvency estate will not be applicable.

#### *(a) Cooperation and assistance*

221. [167] To ensure that insolvency proceedings can be conducted effectively and efficiently, some insolvency laws impose on the debtor a general obligation to cooperate with and assist the insolvency representative in performing its duties, and in some laws to refrain from conduct that might be injurious to the conduct of the proceedings. An essential part of the obligation to cooperate will be to enable the insolvency representative to take effective control of the insolvency estate by surrendering assets, the control of assets and business records and books. It may also require the debtor to cooperate with the insolvency representative to prepare a list of creditors and their claims (see part two, chapter IV.B.4).

#### *(b) Provision of information*

222. [162] To facilitate a thorough, independent assessment of the business activities of the debtor including its immediate liquidity needs and the advisability of post-commencement financing, the prospects for the long-term survival of the business, and whether management is qualified to continue to lead the business, information concerning the debtor, its assets and liabilities, financial position and affairs generally will be required. To enable that assessment to be undertaken, in both liquidation and reorganization, but particularly in reorganization and where the business is to be sold as a going concern in liquidation, it is desirable that the debtor has a continuing obligation to disclose detailed information regarding its business and financial affairs over a substantial period, not simply the period in proximity to commencement of proceedings. That detailed information may include information concerning assets and liabilities; customer lists; projections of profit and loss; details of cash flow; marketing information; industry trends; information thought to concern the causes or reasons for the financial situation of the debtor;

disclosure of past transactions that may be capable of avoidance under the avoidance provisions of the insolvency law; and information concerning outstanding contracts, transactions involving related persons and ongoing court, arbitration or administrative proceedings, including enforcement proceedings, against the debtor or in which the debtor is involved. A number of insolvency laws also require the debtor to provide information concerning its creditors and to prepare, often in cooperation with the insolvency representative, a list of creditors against which claims can be verified. The debtor may also be required to update the list from time to time as claims are verified and admitted or not admitted.

223. [162] Although it may not be necessary for an insolvency law to exhaustively detail the information that is to be provided by the debtor, such an approach may be useful to provide guidance on the type of information that is expected to be provided. In that regard, some laws have developed standardized information schedules that set out the specific information required. These are to be completed by the debtor (with appropriate sanctions for false or misleading information) or by an independent person or administrator.

224. [163] To ensure that the information provided can be used for the purposes noted above, it needs to be up to date, complete, accurate and reliable and be provided as soon as possible after the commencement of the proceedings. Where the debtor can meet this obligation it may serve to enhance the confidence of creditors in the ability of the debtor to continue managing the business.

225. [164] Where the debtor is not a natural person, the information could be supplied to the insolvency representative by officers and other parties connected with the debtor. An alternative approach would be to require the debtor itself (where it is a natural person) or one or more of the directors of the debtor to be represented at or required to attend a main meeting of creditors to answer questions, except where this is not physically possible when directors are not located in the place in which creditors meetings may be held.

#### *(c) Confidentiality*

226. [165] Often the information in question will be commercially sensitive (such as trade secrets, lists of customers and suppliers, research and development information) and may either belong to the debtor or be in the control of the debtor but belong to a third party. It is desirable that an insolvency law include provisions to protect confidential information to prevent abuse of that information by creditors or other parties who are in a position to take advantage of it. The obligation to observe confidentiality may need to apply not only to the debtor, but also to parties connected to the debtor, the insolvency representative, creditor committees and third parties.

#### *(d) Ancillary obligations*

227. A number of insolvency laws impose additional obligations that are ancillary to the debtor's obligation to

cooperate and assist. These may include, for example, an obligation (either of the individual debtor or the managers and directors of the debtor entity) not to leave their habitual place of residence (without the permission of the court), to disclose all correspondence to the insolvency representative or the court and other limitations touching upon personal freedom. These limitations may be crucial to avoid disruption to the insolvency proceedings by the common practice of debtors leaving the place of business and of directors and managers resigning from office upon commencement. Where they are included in an insolvency law, it is desirable that these ancillary duties be proportionate to their underlying purpose and to the overall purpose of the general duty to cooperate; they may also be limited by the application of relevant human rights conventions and agreements as noted above. Some insolvency laws specify these obligations as automatically applicable, while others provide that they may be applied by the court where they are necessary for the administration of the estate. Some laws also distinguish between individual and other types of debtors; where the debtor is an individual, limitations will only apply by order of the court, but where the debtor is a corporation, some limitations may apply automatically, such as in the case of disclosure of correspondence.

#### *(e) Employment of professionals to assist the debtor*

228. [160] To assist the debtor in carrying out its duties in relation to the proceedings generally, some laws permit the debtor to employ professionals such as accountants, attorneys, appraisers and other professionals as may be necessary, subject to authorization. In some laws, that authorization is provided by the insolvency representative, in other laws by the court or the creditors.

#### *(f) Failure to observe obligations*

229. [166] Where the debtor fails to comply with its obligations, the insolvency law may need to consider how that failure should be treated. Where, for example, information is withheld by the debtor, there may be a need for some mechanism to compel the provision of relevant information such as a "public examination" of the debtor by the court or the insolvency representative. In more serious cases of withholding of information a number of countries impose criminal sanctions. Similar approaches may be appropriate for the breach of other obligations. The insolvency law may also need to consider the consequences of actions taken in violation of the obligations and whether or not those actions should be invalid.

### **5. Debtor's liability**

230. [170] When the business entity is solvent, the debtor generally owes its principal obligation to the owners of the business, and its relations with its creditors will be governed by their contractual agreements. When the business becomes insolvent, however, the focus changes and the creditors become the real financial stakeholders in the business, bearing the risk of any loss suffered as the debtor continues to trade. Notwithstanding this change of

focus, the conduct and behaviour of owners and management of a business entity is primarily a matter of law and policy outside the insolvency regime. It is not desirable that an insolvency law is used to remedy defects in that area of legal regulation or to police governance policies, although some insolvency laws may include an obligation to commence insolvency proceedings at an early stage of financial difficulty (see part two, chapter II.B). If the consequence of the past conduct and behaviour of persons connected with an insolvent business entity is damage or loss to the creditors of the entity (for example, by fraud or irresponsible behaviour), it may be appropriate, depending upon the liability regimes applicable for fraud on the one hand and negligence on the other, for an insolvency law to provide for possible recovery of the damage or loss from the individuals concerned.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions concerning the debtor is to:

- (a) establish the rights and obligations [responsibilities] of the debtor ~~and persons associated with the debtor~~ during the continuation of the insolvency proceedings;
- (b) address the remedies available for failure of the debtor to meet its obligations;
- (c) address issues relating to management of the debtor in both liquidation and reorganization.

### Content of legislative provisions

#### *Right to be heard*

(89) [(69)] The insolvency law should provide that [in both liquidation and reorganization proceedings] the debtor has a right to be heard in the proceedings.

#### *Right to participate and request information*

(90) [(70)] The insolvency law should provide that the debtor is entitled to participate in insolvency proceedings, ~~particularly reorganization proceedings~~, and to request information from the insolvency representative and the court. These rights are of particular importance in the context of reorganization proceedings.

#### *Right to retain property to preserve the personal rights of the debtor*

(91) Where the debtor is a natural person, the insolvency law should provide that the debtor is entitled to retain assets excluded from the insolvency estate on the basis that they are required to preserve the personal rights of the debtor.<sup>2</sup>

<sup>2</sup>See Chapter III, A Assets to be affected, recommendation (29).

#### *Obligations*

(92) [(71)] The insolvency law should clearly identify the debtor's obligations in respect of both liquidation and reorganization proceedings. The debtor's obligations should include:

- (a) to cooperate with and assist the insolvency representative to perform its duties [and refrain from conduct injurious to the administration of the proceedings];
- (b) to provide accurate, reliable and complete information relating to its financial position and affairs that might reasonably be requested by the court, the insolvency representative or the creditor committee, including:
  - (i) information on transactions that took place during the suspect period and involved the debtor or the assets of the debtor;
  - (ii) information on ongoing court, arbitration or administrative proceedings, including enforcement proceedings;
- (c) to enable the insolvency representative to take effective control of the insolvency estate and to surrender to the insolvency representative the assets, or control of the assets, comprising the insolvency estate, whether domestic or foreign<sup>3</sup> and business records;
- (d) to prepare a list of creditors and their claims in cooperation with the insolvency representative and revise and amend the list as claims are processed;
- (e) in the case of an individual debtor, not to leave its habitual place of residence without the permission of the court.

#### *Confidentiality*

(93) [(72)] Where information provided by the debtor is commercially sensitive, appropriate provisions to protect confidentiality should apply, whether set forth in the insolvency law or applicable procedural law. The obligation of confidentiality should apply to information in the control of the debtor, whether owned by the debtor or a third party, including trade secrets.

#### *Continued operation of the debtor's business*

(94) [(73)] The law should address the issue of the role to be played by the debtor in the continuing operation of the business [in both reorganization and sale of the business as a going concern in liquidation]. Different approaches may be taken, including:

- (a) total displacement of the debtor from any role in the business and the appointment of an insolvency representative;
- (b) limited displacement where the debtor may continue to operate the business on a day-to-day basis, subject to the supervision of an appointed insolvency representative, in which event the division of responsibilities between the debtor and the insolvency representative should be specified in the insolvency law; or

<sup>3</sup>See chapter VIII—the Model Law on Cross-Border Insolvency and appointment of a foreign representative.



(c) retention of full control of the business (debtor-in-possession) with no insolvency representative appointed, but with appropriate protections including varying levels of control of the debtor and provision for displacement of the debtor in specified circumstances.<sup>4</sup>

*Sanctions for failure to comply*

(95) [(74)] The insolvency law should provide sanctions for the failure of the debtor, whether a natural person or commercial entity, to comply with the specified obligations, including providing that actions taken in contravention of the obligations are invalid.

## B. The insolvency representative

### 1. Introduction

231. [171] Insolvency laws refer to the person responsible for administering the insolvency proceedings by a number of different titles, including administrators, trustees, liquidators, supervisors, receivers, curators, official or judicial managers, or commissioners. The term “insolvency representative” is used in this Guide to refer to the person undertaking the range of functions that may be performed in a broad sense without distinguishing between the different functions that may be performed in different types of proceedings. The insolvency representative may be an individual or, in some jurisdictions, a corporation or other separate legal entity. Whether appointed by creditors, the court, a government department or agency, a public or statutory authority or the debtor, the insolvency representative plays a central role in the effective implementation of the insolvency law, with certain powers over debtors and their assets and a duty to protect them and their value and ensure that the law is applied effectively and impartially. In some jurisdictions the nature of the appointment is seen as that of, or closely resembling a trustee exercising public interest powers and undertaking functions for the benefit of the creditors and the debtor. Where an insolvency representative is appointed on an interim basis by the court before insolvency proceedings commence, the powers and functions of that person generally will be determined by the court. To the extent that they are the same as those of an insolvency representative appointed after commencement of proceedings, the interim insolvency representative should have the same qualifications, liability and remuneration as a representative appointed after commencement.

232. [172] Insolvency laws adopt a variety of approaches to the relationship between the insolvency representative and the court and, in particular, to the delineation of powers between them. Since it normally has the most information regarding the situation of the debtor, the insolvency representative often is in the best position to make informed decisions about the conduct of the insolvency proceedings. That does not mean, however, that the insolvency representative can act as a substitute for the court, as the court would generally be required to adjudicate

<sup>4</sup>It should be noted that this option relies on a well-developed court structure and the application of protections that operate to displace the debtor in certain circumstances. For a more detailed explanation see paragraphs 204-216 of the analytical commentary.

disputes arising in the conduct of the proceedings and approval of the court is often required at a number of stages of the proceedings. Even in countries where the court plays a more limited role in insolvency, there is a limit to the amount of authority that would normally be conferred upon an insolvency representative. The powers of the insolvency representative may also be affected by the role afforded to creditors under the insolvency law.

### 2. Qualifications

233. [177] The insolvency representative can be selected from a number of different backgrounds such as from the ranks of the business community, from the employees of a specialized governmental agency or from a private panel of qualified persons (often lawyers, accountants or other professionals). Where the insolvency law provides for the appointment of a public official as insolvency representative, the specific qualifications discussed below generally will not be relevant to that appointment (although they may be relevant to the employment of the official by the government agency).

234. [177] In many countries, the insolvency representative must be a natural person, but some countries do provide that a legal person may also be eligible for appointment, subject to certain requirements such as that the individuals to undertake the work on behalf of the legal person are appropriately qualified and that the legal person itself is subject to regulation. The complexity of many insolvency proceedings makes it highly desirable that the insolvency representative has knowledge of the law (not only insolvency law, but also relevant commercial and business law), as well as adequate experience in commercial and financial matters. If further or more specialized knowledge is required in a particular case, it can always be provided by hired experts. Some insolvency laws also require that a person to be appointed as an insolvency representative in a particular case have expertise and skills suited to that case.

235. [177] In addition to having the requisite knowledge and experience, it may also be desirable that the insolvency representative possess certain personal qualities, such as integrity, impartiality and independence from vested interests. [180] Conflicts of interest may arise from a number of prior or existing relationships with the debtor. Prior ownership of the debtor, a prior business relationship with the debtor, a relationship with a creditor of the debtor, prior engagement as a representative of the debtor, and a relationship with a competitor of the debtor may be sufficient in some countries to preclude the appointment of a person as an insolvency representative. In other countries, the person may still be appointed provided the conflict of interest is disclosed. In order to enhance the transparency, predictability and integrity of the insolvency system, it is desirable that the insolvency law specify the degree of relationship which may give rise to a conflict of interest and require a prospective insolvency representative to disclose circumstances that may lead to such a conflict or lack of independence. It is generally left to the court to determine whether or not a conflict of interest or a basis for demonstrating lack of independence exists in a particular case.

236. The qualifications required of a person who can be appointed as an insolvency representative may vary depending upon the design of the insolvency regime with regard to the role of the insolvency representative (including whether the proceedings are liquidation or reorganization) and the relative level of supervision of the insolvency representative (and of the insolvency proceedings generally) by the court. They may also vary depending upon the procedure for appointment (see below).

237. [178] Different approaches are taken to ensuring the appropriate qualification of the insolvency representative, including a requirement for certain professional qualifications and examinations; licensing where the licensing system is administered by a government authority or professional body; specialized training courses and certification examinations; requirements for certain levels of experience (generally specified in numbers of years) in relevant areas, for example, finance, commerce, accounting and law, as well as in the conduct of insolvency proceedings. Those systems which require some form of licensing or professional qualification and membership of professional associations often also address issues of supervision and discipline, and an insolvency representative may be subject to regulation by the court, a professional association, a corporate regulator or other body. A number of these systems are relatively complex and it is beyond the scope of the Guide to consider them in any detail.

238. [179] In determining the qualifications required for appointment as an insolvency representative, it is desirable that a balance be achieved between stringent requirements that lead to the appointment of a highly qualified person but which may significantly restrict the pool of professionals considered to be appropriately qualified and add to the costs of the proceedings, and requirements that are too low to guarantee the quality of the service required. Where there is a lack of appropriately qualified professionals, the role given to the court in appointment and supervision may be an important factor in achieving the required balance.

### 3. *Selection and appointment of the insolvency representative*

239. [174] Insolvency laws adopt a number of different approaches to selection and appointment of an insolvency representative. In some jurisdictions, the insolvency law provides that a particular public official (variously titled the Official Trustee, the Official Receiver, the Official Assignee and ...) automatically will be appointed to all insolvency cases or to certain types of insolvency cases. In many jurisdictions, it is the court that selects, appoints and supervises the insolvency representative. The selection may be made from a list of appropriately qualified professionals at the discretion of the court, it may be made by reference to a roster or rotation system or by some other means, such as the recommendation of the creditors or the debtor. While ensuring fair and impartial distribution of cases, [176] one possible disadvantage of a roster system is that it may not ensure the appointment of the person most qualified to conduct the particular case. That may depend, of course, upon the manner in which the roster list is compiled and upon the qualifications required of insol-

veny professionals in order to be included on that list. That disadvantage may not be perceived to be an important issue where the estate has no assets (see part two, chapter II.B.4(f)).

240. [174] In some jurisdictions, a separate office or institution which is charged with the general regulation of all insolvency representatives selects the insolvency representative after the court directs it to do so. A number of countries have adopted this approach, and it may have the advantage of it allowing the independent appointing authority to draw upon professionals that will have the expertise and knowledge to deal with the circumstances of a particular case, including the nature of the debtor's business or other activities; the type of assets; the market in which the debtor operates or has operated; the special knowledge required to understand the debtor's affairs; or some other special circumstance. The use of an independent appointing authority will depend upon the existence of an appropriate body or institution that has both the resources and infrastructure necessary to perform the required functions; otherwise it will require the establishment of an appropriate body or institution.

241. [174] Another approach allows creditors to play a role in recommending and selecting the insolvency representative to be appointed, provided that that person meets the qualifications for serving in the specific case. The approaches that rely upon the independent appointing authority and the creditor committee may serve to avoid perceptions of bias and assist in reducing the supervisory burden placed upon the courts. A different approach permits the debtor to appoint the insolvency representative in those cases where reorganization proceedings are commenced by the debtor. This approach allows discussions to take place between the debtor and other parties, such as secured creditors, before commencement of the proceedings to familiarize the prospective representative with the business and allows the debtor to select an insolvency representative that it considers will be best able to conduct the reorganization. Concerns may be raised, however, as to the independence of the insolvency representative. These may be addressed by permitting creditors, in appropriate circumstances, to replace the insolvency representative appointed by the debtor.

### 4. *Duties and functions of the insolvency representative*

242. [173] Insolvency laws often specify the functions that the insolvency representative will have to perform in the proceedings and it is important that the insolvency law provide the insolvency representative with the powers necessary to carry out these functions. Although some of those noted below may be more relevant to liquidation than to reorganization, the insolvency representative's duties and functions may generally include:

- (i) taking immediate control of the assets comprising the insolvency estate<sup>5</sup> and the debtor's business records;

<sup>5</sup>For a definition of the use of the word "estate" in the Guide, see part two, chapter III and the glossary in part one.



- (ii) representing the insolvency estate;
- (iii) generally administering the insolvency estate;
- (iv) exercising rights for the benefit of the insolvency estate in respect of court, arbitration or administration proceedings underway;
- (v) taking all steps necessary to protect and preserve the assets of the insolvency estate and the debtor's business, including preventing unauthorized disposal of those assets and exercising avoidance powers to pursue the recovery of assets disposed of improperly to defeat creditors;
- (vi) registering rights of the estate (where registration is necessary to perfect the rights of the estate against bona fide purchasers);
- (vii) appointing and remunerating accountants, attorneys and other professionals that may be necessary to assist the insolvency representative in performing its functions;
- (viii) obtaining information concerning the debtor, its assets, liabilities and past transactions (especially those taking place during the suspect period) including examining the debtor and any third person having had dealings with the debtor;
- (ix) examination of contracts that are not fully performed with a view to deciding to continue or reject;
- (x) dealing with employees and their rights and entitlements, including pension rights;
- (xi) in liquidation, selling the assets of the insolvency estate;
- (xii) verifying and admitting claims;
- (xiii) periodically providing information to the court and to creditors detailing the conduct of the proceedings. The information should include, for example, details of the assets sold during the period in question, the prices realized, the expenses of sale and such information as the court may require or the creditors' committee may reasonably require; receipts and disbursements; assets remaining to be administered; and preparation of the reorganization plan;
- (xiv) attending meetings of creditors;
- (xv) managing the business in reorganization and in liquidation where the business is to be sold as a going concern;
- (xvi) in reorganization, preparing a plan of reorganization or a report as to why reorganization is not possible (where this function is to be carried out by the insolvency representative);
- (xvii) supervising approval of the reorganization plan and, where required, the implementation of the plan;
- (xviii) closing the estate promptly, efficiently and in accordance with the best interests of the various constituencies in the case;
- (xix) submitting a final report and accounting of the insolvency estate's administration to the court or the creditors, as required;
- (xx) any other matters that may be referred to the insolvency representative by the creditors or determined by the court.

243. In addition to these specific duties and functions, insolvency laws often impose certain general obligations on the insolvency representative. These may include an obligation to maximize the value and protect the security of the insolvency estate, a duty to get the best price reasonably obtainable on the sale of assets of the estate; and [others?].

### 5. Confidentiality

244. The need to impose an obligation of confidentiality on the debtor has been noted above. It may also be appropriate for the insolvency law to impose a duty of confidentiality on the insolvency representative as much of the information that will be obtained concerning the debtor's affairs will be commercially sensitive (such as trade secrets, research and development information and customer information) and should not be disclosed to third parties who may be in a position to take unfair advantage of it. Observation of confidentiality may be particularly important where the insolvency representative has the power to compel disclosure of information and documents in the course of an examination of the debtor. Some of this information may come from third parties and be subject to privacy protection provisions and secrecy provisions, such as those applicable to banks. It is desirable that the insolvency representative be permitted to use that information only for the purposes of the insolvency procedure in the context of which the examination was permitted, unless the court decides otherwise. This issue may also be relevant to the provision and obtaining of information in the context of criminal proceedings against the debtor. A similar obligation of confidentiality should apply to agents of the insolvency representative (see below) and to other parties as ordered by the court.

### 6. Remuneration of the insolvency representative

#### (a) Determination of quantum

245. In addition to the reimbursement of the proper expenses incurred in the course of administration of the estate, the insolvency representative will be entitled to receive remuneration for its services. That remuneration should be commensurate with the qualifications of the insolvency representative and the tasks it is required to perform, and achieve a balance between risk and reward in order to attract appropriately qualified professionals. Several methods are adopted for calculating that remuneration. It could be fixed by reference to an approved scale of fees produced by a government agency or professional association; determined by the general body of creditors, the court or some other administrative body or tribunal in a particular case; based upon the time properly spent by the insolvency representative (and the various categories of person who are likely to work on the insolvency administration

from office staff through to the principal appointee) on administration of the estate; or it could be based upon a percentage of the quantum of the assets of the estate which are realized or distributed or a combination of both (calculated at the end of the procedure when the assets have been sold and the value determined). This may be a fixed percentage and include provision for increase or decrease depending upon the particular case.

(i) *Time-based systems*

246. An advantage of a time-based method is that often there will be a high level of uncertainty at the outset as to how complex and resource-intensive a particular administration may be, at least until some preliminary work has been carried out. A disadvantage is that although it may encourage a very thorough administration, a time-based system may also operate in some cases as an incentive to maximize the time spent on administration without necessarily achieving a proportional return of value to the estate.

(ii) *Commission-based systems*

247. An advantage of the commission system, at least from the creditors' perspective, is that at least some, if not a substantial proportion, of the assets recovered will be distributed to them. From the insolvency representative's point of view, however, it may be an uncertain method of calculation because the amount of work involved in an administration is not necessarily proportional to the value of assets available for distribution. It may also encourage an approach of "maximum return for minimum cost" and provides little incentive for undertaking functions which are not directly related to increasing returns to creditors, such as reporting obligations to both the court and to creditors, and assisting regulatory authorities with investigations into the debtor's affairs and possible misconduct.

(iii) *Involvement of creditors*

248. In some countries, the general body of creditors (or the creditors' committee on their behalf) may be required to play a role in fixing or approving the remuneration, having regard to factors such as the complexity of the case, the nature and degree of the responsibilities of the insolvency representative and the effectiveness with which these have been discharged, as well as the value and nature of the assets of the estate. The involvement of creditors may serve to overcome some of the difficulties discussed above as creditors would be more aware of the issues involved and have the opportunity to participate in fee setting and approval. Fees could also be reviewed periodically during the course of the proceedings, with any problems arising being addressed and resolved, perhaps by arbitration or some other form of dispute resolution between the insolvency representative and the creditors.

249. It is highly desirable that the insolvency law establish a mechanism for fixing the insolvency representative's remuneration that is clear and transparent to avoid disputes and to provide some level of certainty as to the costs of insolvency proceedings. However calculated, it is also desirable that the insolvency law recognize the importance of according priority to payment of the insolvency representative's remuneration.

(b) *Means of payment*

250. Payment of the remuneration of the insolvency representative is often a source of complaint from unsecured creditors as the most common source of available funds is often unsecured assets and may often leave nothing for distribution to those creditors. While it would be unfair to draw the conclusion that the costs of administration were excessive simply because they exceeded the unsecured assets available to pay them, the occurrence of unsecured creditors seeing most, if not all of the available assets being used to cover the costs of the administration, and perceptions of unfairness relating to the total cost of administration compared to the value of assets recovered, do point to the need to give this issue careful consideration. Different approaches can be taken to payment of the insolvency representative. For example, where the estate includes unsecured assets, remuneration could be paid from these; a surcharge could be levied against assets to pay for the administration or sale of those assets where the administration was of benefit to the creditors; a surcharge could be levied on creditors on the making of an involuntary application to cover at least initial costs and performance of basic functions (see part two, chapter II.B.5).

(c) *Review of remuneration*

251. Depending upon the manner in which the insolvency representative's remuneration is fixed, it may be desirable to provide for a review process to address dissatisfaction of the insolvency representative itself or creditor dissatisfaction. Where remuneration is fixed by a meeting of creditors, the court will generally have the power to review the amount on the application of the insolvency representative or of a specified percentage or number of creditors, for example creditors representing 10 per cent of the issued share capital or with at least 10 per cent or 25 per cent of the total debts. Where the remuneration is set by the court in the first instance, the insolvency representative may or may not have a right to appeal that decision; some insolvency laws provide that the debtor cannot make an application for review. Where the insolvency representative is required to be a member of a professional organization or to be licensed, the professional organization or the licensing authority may also have powers with respect to review of the fees charged by their members and may provide informal dispute resolution mechanisms.

## 7. *Duty of care [Liability]*

252. [181] The standard of care to be employed by the insolvency representative and its personal liability are important to the conduct of insolvency proceedings. Establishing a measure for the care, diligence and skill with which the insolvency representative is to carry out its duties and functions requires a standard that will take into account the difficult circumstances in which the insolvency representative finds itself when fulfilling its duties and a balance of that standard against an appropriate level of remuneration and the desirability of attracting qualified persons to act in that capacity. The liability of the insolvency representative may often involve the application of law outside of insolvency.

253. [182] Different approaches may be taken in an insolvency law to setting that measure, although the measure adopted will depend upon the how the insolvency representative is appointed and the nature of the appointment (e.g. a private practitioner as opposed to a government employee). One approach may be to require the insolvency representative to observe a standard no more stringent than would be expected to apply to the debtor in undertaking its normal business activities in a state of solvency, that of a prudent person in that position. Some countries, however, may require a higher standard of prudence in such a case because the insolvency representative is dealing with assets belonging to another person, not its own assets. A different formulation is one based upon an expectation that the insolvency representative acts in good faith for proper purposes. A further approach may be based upon the standard of care required in negligence. In determining the applicable standard, a balance is desirable between a standard that will ensure competent performance of the duties of the insolvency representative and one that is so stringent that it invites law suits against the insolvency representative and raises the costs of its services. Where the insolvency representative is a member of a professional organization, the professional standards of the organization may be relevant.

254. [183] One means of addressing the issue of liability for damages may be to require the insolvency representative to post a bond to cover loss of assets of the estate or provide insurance coverage against possible damages payable as a result of a breach of its duties. A number of insolvency laws require a bond and insurance, while others require only insurance. In some cases the level of the bond required relates to the book value of the assets, in others both the value of the bond and the amount of insurance cover required are established in the rules of the relevant professional association or regulatory body. These solutions, however, may not be available in all countries. In designing a solution to this issue, a balance may be desirable between controlling the costs of the service and distributing the risks of the insolvency process among the participants, rather than placing it entirely upon the insolvency representative on the basis of availability of personal indemnity insurance.

#### 8. *Agents of the insolvency representative*

255. [185] Some insolvency laws require court authorization for the insolvency representative to retain accountants, attorneys, appraisers and other professionals that may be necessary to assist the insolvency representative in carrying out its duties. Other laws do not require court authorization. It is desirable that an insolvency law establishes some criteria relating to the employment of such professionals in terms of their experience, knowledge and reputation, as well as the need for their services to be of benefit to the estate. In terms of remuneration of these professionals, some laws require an application to and approval by the court, while another approach may be to require approval of the creditor body. Professionals may be paid periodically during the proceedings, or may be required to wait until the proceedings are completed. The requirements for disclosure of conflict of interest that apply

to the insolvency representative may also apply to professionals employed by the insolvency representative. Obligations of confidentiality are also relevant.

256. [184] Where losses are sustained by the estate as a result of the actions of agents and employees of the insolvency representative, an insolvency law may need to address the liability of the insolvency representative for those actions. Some insolvency laws provide that the insolvency representative is not personally liable except where it fails to exercise the proper degree of supervision in the performance of its duties.

257. Different approaches may be adopted towards payment of the professionals employed by the insolvency representative. Under some insolvency laws, the insolvency representative will pay the professional and seek reimbursement from the estate. In others the professional will have an administrative claim against the estate.

#### 9. *Removal of the insolvency representative*

258. [186] Some insolvency laws permit the insolvency representative to be removed in certain circumstances which may include that the insolvency representative had violated or failed to comply with its legal duties under the insolvency law, that it had demonstrated gross incompetence or gross negligence, that it had not disclosed a conflict of interest, that it had engaged in illegal conduct, or for less serious reasons such as that the proceedings require a particular or different competency that the appointed representative does not possess. Different approaches provide that removal may occur on the basis of a decision of the court, acting on its own motion or at the request of an interested party, or a decision taken by an appropriate majority of unsecured creditors. In cases where the insolvency representative is subject to professional or regulatory supervision, they may be removed as the result of an investigation and review, which may also result in a licence or other authorization being taken away.

#### 10. *Replacement of the insolvency representative*

259. [186] In the event of the resignation or removal of the insolvency representative or the occurrence of any other event which might cause the insolvency representative to be unable to perform its duties, such as death or serious illness, disruption of the proceedings and the delay that may be occasioned by failure to provide for succession may be avoided by providing for the appointment of a successor insolvency representative, either by the court or by creditors. Where an insolvency law provides for replacement of the insolvency representative, it may also need to address issues relating to substitution and succession to either title or control (as appropriate) of the assets of the estate (see part two, chapter III.A) as well as handing over to the successor the books, records and other information relating to the debtor. An insolvency law may also need to consider the issue of the validity of the acts undertaken in the conduct of the proceedings by the insolvency representative that has been replaced.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions concerning the insolvency representative is to:

- (a) specify the qualifications required for appointment as an insolvency representative;
- (b) establish a mechanism for the appointment of insolvency representatives;
- (c) define the powers and functions of the insolvency representative;
- (d) provide for the remuneration, liability, removal and replacement of an insolvency representative.

### Content of legislative provisions

#### Qualifications

(96) [(75)] The insolvency law may specify the qualifications and personal qualities required for appointment as an insolvency representative. Relevant criteria include that the insolvency representative is independent and impartial, has the requisite knowledge of relevant commercial law and experience in commercial and business matters.

#### Appointment

(97) [(76)] The insolvency law should establish the mechanism for appointment of the insolvency representative on commencement of the proceedings. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of law, where the insolvency representative is a government or administrative agency or official.

(98) Where the insolvency law provides for appointment of an insolvency representative to administer an assetless estate, the insolvency law should also provide a mechanism for appointment and remuneration of that representative. That mechanism may include appointment of a government official or appointment by reference to a roster system, and remuneration by the State or [...].

#### Conflict of interest

(99) [(77)] The insolvency law should require a person proposed for appointment as an insolvency representative to disclose circumstances that may lead to a conflict of interest or lack of independence [from other interests]. The insolvency law should also require that persons employed by the insolvency representative are required to disclose circumstances that may lead to a conflict of interest or lack of independence [from other interests].

#### Powers and functions—Duties and functions of the insolvency representative

(100) [(78)] The insolvency law should provide that the insolvency representative has a general obligation to maxi-

mize the value and protect the security of the insolvency estate. The insolvency law should clearly identify the insolvency representative's specific powers and duties and functions. These should include:

- (a) taking control of the assets comprising the insolvency estate and the debtor's business records including those in the possession of third parties;
- (b) generally administering the estate;
- (c) controlling the collection, sale and distribution of assets;
- (d) obtaining information concerning the debtor, its assets, liabilities, past transactions (especially those taking place during the suspect periods), including conducting an examination of the debtor (whether under oath or some equivalent procedure);
- (e) ensuring the debtor's compliance with its obligations;
- (f) assisting the debtor to prepare a list of creditors and their claims and ensuring that the list is revised and amended as claims are admitted;
- (g) exercising avoidance powers;
- (h) exercising rights for the benefit of the insolvency estate in respect of court, arbitration or administration proceedings underway and to which the stay and suspension apply;
- (i) verifying and admitting claims;
- (j) managing the business in reorganization and in liquidation where the business is to be sold as a going concern;
- (k) providing information and reporting to creditors and the court on a regular basis on the conduct of the proceedings;
- (l) appointing and remunerating professionals to assist the insolvency representative;
- (m) in a reorganization, preparing (or cooperating in the preparation of) a plan of reorganization or a report as to why reorganization is not possible (where this is a function of the insolvency representative);
- (n) other matters as determined by the court or referred to the insolvency representative by creditors or the creditors' committee.

#### Liability

(101) [(79)] The insolvency law should address the consequences, including possible personal liability for, or arising from, the insolvency representative's failure to perform or the performance of its duties powers and functions [as set forth in recommendations (99) and (100)].<sup>6</sup> Issues of the insolvency representative's liability may also involve the application of non-insolvency law.

<sup>6</sup>At the twenty-sixth session of the Working Group (May 2002), some support was expressed in favour of including more detail in terms of the liability arising from the functions set forth in recommendations (99) and (100). The Working Group may wish to consider this issue further and make specific proposals as to what should be included in recommendation (101).

*Removal and replacement*

(102) [(80)] The insolvency law should establish the grounds for removal of the insolvency representative and the procedure for removal. These grounds may include:

(a) incompetence, negligence, failure to perform or failure to exercise the proper degree of care in the performance of its powers and functions;

(b) lack of a particular or specialized competency required by a specific case;

(c) engaging in illegal acts or conduct; or

(d) conflicts of interest or a demonstrated lack of independence arising in circumstances that would justify removal.

(103) [(81)] The procedure for removal of the insolvency representative will reflect the manner in which the insolvency representative was appointed, but may include removal by the court on an application by creditors or the creditors' committee; removal by the court on its own

motion; removal by the creditors where the creditors have appointed the insolvency representative and [...].

(104) [(82)] In the event of the death, resignation, inability to perform or removal of the insolvency representative, the insolvency law should provide for appointment of a successor.

*Remuneration*

(105) [(83)] The insolvency law should provide for the remuneration of the insolvency representative, specify a mechanism for fixing that remuneration and establish priority for payment of that remuneration.

*Judicial review*

~~(84) [A general provision for review of decision taken by the insolvency representative, e.g. on treatment of contracts, avoidance actions, admission of claims etc: see footnote 14].~~

**A/CN.9/WG.V/WP.63/Add.11**

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV.A-B appears in document A/CN.9/WG.V/WP.63/Add 10; chapters V-VII appear in subsequent addenda]*

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*Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide.*

*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)****IV. PARTICIPANTS AND INSTITUTIONS****C. Creditors****1. Classes of creditors**

260. [213] There are many diverse and competing interests in an insolvency proceeding. For the most part, credi-

tors are creditors by virtue of having entered into a legal and contractual relationship with the debtor prior to the insolvency. There are creditors, however, who have not entered into such an arrangement with the debtor, such as taxing authorities (who will often be involved in insolvency proceedings) and tort claimants (whose participation will generally be less common). Accordingly, [214] the rights of creditors will be governed by a number of different laws.

261. [214] While many creditors may be similarly situated with respect to the kinds of claims they hold based on similar legal or contractual rights, others may have superior claims or hold superior rights. Even within the same class of creditor, there will be competing rights such as secured creditors that have better security than others. For these reasons, insolvency laws generally rank creditors by reference to their claims, an approach not inconsistent with the objective of equitable treatment. In developing these categories, it is desirable that a balance be reached between the legal and commercial rights of creditors based upon fairness and the commercial reasonableness of their relative positions, at the same time observing the objective of equality of treatment, preserving legitimate commercial expectations and fostering predictability in commercial relationships. There is, however, a limit on the extent to which these goals can be achieved, given the balance that is desirable in an insolvency law between these competing objectives and other public policy considerations. To the extent that these broader public interests compete with private interests, they may lead to a distortion of normal commercial incentives. Where these public interests are given priority, and equality of treatment based upon the classification of claims is not observed, it is desirable that the policy reasons for establishing that priority be clearly stated in the insolvency law. In the absence of equality of treatment, this approach will at least provide an element of transparency and predictability in the area of claims (see part two, chapter VI.A) and distribution (see part two, chapter VI.C).

262. [216] Creditors of an insolvent debtor generally fall into categories of secured creditors, preferred or priority creditors, and unsecured or ordinary creditors. In some insolvency laws, employees are treated as a separate interest group.

*[Note to the Working Group: The Working Group may wish to consider whether the Guide should provide information on the different types of creditors and their interests. Would it be useful, for example, if this part of the Guide were to include a summary of the ways in which secured creditors may be affected by insolvency proceedings? A discussion of the ranking of claims appears in chapter VI.C]*

## **2. Participation of creditors in insolvency proceedings**

### *(a) Introduction*

263. [192] Creditors have a significant interest in the debtor's business once an insolvency proceeding is commenced. As a general proposition, these creditor interests are safeguarded by the appointment of an insolvency representative. In addition, many insolvency laws provide for creditors to be directly involved in the proceedings in different ways and for a number of reasons. As the party with the primary economic stake in the outcome of the proceedings they may lose confidence in a process where key decisions are made without consulting them by individuals who may be perceived by creditors as having limited experience or expertise in the debtor's type of business or a lack of independence, depending upon the manner in

which the representative is appointed. Creditors are often in a good position to provide advice and assistance with respect to the debtor's business and to monitor the actions of the insolvency representative, providing a check against possible abuse of the insolvency process and excessive administrative costs.

### *(b) Extent of involvement of creditors in the decision-making process*

264. [194] There are varying possible degrees of involvement of creditors in decision-making in insolvency proceedings and insolvency laws adopt a wide range of approaches and mechanisms for creditor participation. An approach which allows only a low level of participation is reflected in those insolvency laws which provide that the insolvency representative makes all key decisions on uncontested general matters of administration, with the creditors playing a marginal role and having little influence. Lack of creditor participation in this model may be balanced against the key obligations of the insolvency representative one of which is to protect the value and security of the insolvency estate, ultimately for the benefit of creditors generally. Such an approach may be effective where an experienced insolvency representative is appointed to the proceedings because it avoids potential delays and the costs involved in managing the participation of creditors, and where the insolvency system provides a high level of regulation of the process and its participants.

265. [195] Other approaches afford creditors greater participation in the proceedings. This participation may range from participation at an initial meeting where certain matters are considered, to an ongoing role which may require creditors to perform only an advisory function or to approve certain acts and decisions of the insolvency representative. These may include the sale of significant assets, verification of claims and approval of the insolvency representative's final report and accounting, or may even hold primary responsibility for some administrative functions. Creditors may also be able to seek the dismissal and replacement of the insolvency representative by the court for failure to perform its functions and duties or for negligence. Creditors may also have a role in requesting or recommending action from the court, for example, a recommendation that the reorganization be converted to liquidation or that an avoidance action be commenced by the insolvency estate or by creditors on behalf of the estate. In terms of costs, the creditors may also be given a role in monitoring the administrative expenditure and remuneration of the insolvency representative.

266. [196] Some insolvency laws draw a distinction between liquidation and reorganization in setting the level of creditor participation. In liquidation, although generally it may not be important for creditors to intervene in the process or participate in decision-making, they can provide a valuable source of expert advice and information on the debtor's business, particularly where it is to be sold as a going concern. It may be desirable for creditors to receive reports on the conduct of the liquidation to ensure their confidence in the process, as well as its transparency. In reorganization, however, the input of creditors is both

useful and necessary, as they will generally determine whether the reorganization plan will be supported and successful or not.

267. In terms of the mechanisms for participation, some insolvency laws allow creditors to participate as a general body of creditors. Other laws provide for the formation of a committee (on which creditors sometimes may share representation with shareholders and possibly other interested parties) to facilitate the participation in the administration of the estate. The committee will generally be a smaller number of creditors (in some laws, a specified number). A further approach is to provide for the appointment of a single person to represent certain groups of creditors (such as groups holding at least ten percent of the debt). In one law where this approach has been adopted the rationale is to facilitate more orderly and timely participation and avoid the delays and disputes previously encountered.

268. [198] An important issue that may need to be considered where an insolvency law allows creditors to participate actively in the process is how to overcome creditor apathy and encourage participation in the proceedings. It is not uncommon for creditors to adopt the view, even where the insolvency law provides for active participation, that nothing will be gained from such participation, especially where the return to creditors is unlikely to be significant and where participation may in fact require further expenditure of time and money. This common concern can be addressed to some extent by the overall balance that an insolvency law strikes between the different interests of the parties involved in the proceedings (see for example, part two, chapter IV.A.2) and by specific measures relating, for example, to selection of the creditors committee and the functions to be performed by that committee (or by creditors generally where there is no committee) (see below).

*(c) General body of creditors [assembly of creditors]*

269. Where the general body of creditors is required or permitted to participate in the insolvency proceedings, an insolvency law should clearly establish the powers and functions of that body and establish the manner in which meetings of creditors in general may be convened. It is also desirable that an insolvency law determine the extent to which secured creditors can or should participate at meetings of the general body of creditors; for example, some insolvency laws require secured creditors to surrender their security before they can participate in the proceedings and vote as a member of the creditor body.

*(i) Functions*

270. As noted above, the functions to be performed by creditors vary widely between insolvency laws. In some cases, they perform a general advisory function and the insolvency representative may refer matters to the creditors, but will not be bound by any decision they take. Under other laws, the creditors may have specific functions to perform with regard to the conduct of the proceedings, which may involve cooperation and coordination with the insolvency representative. The insolvency

representative may be required to consult with creditors on those matters before taking its decision or the decision-making power may reside with creditors. Other functions required the creditors to oversee the acts and decisions of the insolvency representative. Some of the issues in respect of which creditors may have an interest may include some or all of the following: continuation of the business in liquidation; post-commencement financing; verification of claims; compensation of professionals, including the insolvency representative; treatment of judicial proceedings to which the debtor was a party at the time of commencement; consideration and approval of a reorganization plan; appointing a committee or representatives of creditors; supervising the acts of the insolvency representative; distribution of assets; and consideration (and approval) of the insolvency representative's final report and accounting.

271. Where the insolvency representative is not bound to follow the decision of creditors, insolvency laws often provide that for certain acts the insolvency representative must seek the prior approval of the court, or that creditors may apply to the court to give binding instructions to the insolvency representative (or to seek replacement of the insolvency representative where the insolvency representative fails to meet its obligations or otherwise acts to the detriment of creditors). In the event of a dispute between the creditors and the insolvency representative, many laws give precedence to the decision at a meeting of creditors. A similar intention is found in the requirements for creditors to be consulted on any decisions that require court approval.

272. Whatever functions are to be performed by the creditors, it is desirable that an insolvency law clearly states whether the general body of creditors is required to undertake each of its specified functions, or whether certain functions are discretionary, and the manner in which creditors are to interact with the insolvency representative in the performance of those functions.

*(ii) Creditor meetings*

273. Many insolvency laws provide for the functions of creditors to be undertaken via general meetings of creditors (as opposed to meetings of a committee that might be appointed to undertake functions on behalf of the general body). As noted above (see part two, chapter II.B), an insolvency law should require creditors to be notified (whether by personal notice, advertisement or some other means) of the commencement of insolvency proceedings and for that notification to include advice on a number of matters, including details of an initial meeting of creditors, to be convened by the court or the insolvency representative within a prescribed period of time after commencement (examples of time limits range from five days to one month from the date of commencement).

274. Insolvency laws take different approaches to subsequent meetings of the general body of creditors. Under a number of insolvency laws, the initial meeting is the only meeting of creditors that will take place. Under other laws further meetings are to be convened by the court or the

insolvency representative for specific purposes, while yet other laws include provision for creditors or the insolvency representative, and in some limited cases the debtor, to convene meetings on an ad hoc basis, as required. Where the insolvency law allows creditors to convene a meeting, the law may include certain limitations on when a meeting can be called or conditions that must be fulfilled before a meeting can be called. These conditions may include the passing of a defined period of time after a certain step in the proceedings was to be taken, or upon the completion of defined acts or decisions of the insolvency representative or where the insolvency representative fails to act. Some laws also provide that only creditors holding a specified percentage of the total claims are entitled to call a meeting (examples include 10 per cent of creditors by value, creditors with no less than 25 per cent of total claims or at least 25 per cent of unsecured claims). A further approach allows any interested party the right to apply to the court to summon a meeting of creditors.

275. It is desirable that all creditors have the right to be heard on matters to be discussed at a creditor meeting. Where a vote of the general body of creditors is required, it is desirable that an insolvency law establishes the relevant voting requirements and mechanisms. It may also be desirable for an insolvency law to provide for creditors to establish rules governing the conduct of creditor meetings where this would facilitate creditor participation, and where it would be appropriate to the role to be played by creditors in the proceedings.

(d) *Creditor committee*

276. [193] In some insolvency proceedings the formation of a creditor committee or the election of a creditor representative can provide a mechanism to facilitate creditor participation in the proceedings, whether liquidation or reorganization. A creditor committee (or similar form of creditor representation) may not be required in all insolvency cases, but may be appropriate where there is a very large number of creditors, where creditors have very diverse interests, or where other features of the case indicate that such an approach is desirable or necessary (e.g. to limit time and monetary costs). Some insolvency laws provide for creditors to determine whether or not they will appoint a committee, while other laws provide for the court to appoint a committee to help supervise the acts of the insolvency representative. Where a creditor committee is formed, it will be necessary to consider the extent to which the insolvency estate will pay the costs of the committee; some insolvency laws allow creditors to form unofficial committees which are not formally recognized by the court or the insolvency representative and whose costs are not reimbursed by the insolvency estate, and other laws provide that creditors may appoint a representative, but must bear the associated costs. A number of laws provide that the costs of the creditor committee are to be borne by the estate. This question is closely linked to the role of the committee, the extent to which the functions specified under the insolvency law to be performed by the creditors can be performed by a committee and the factors determining whether a committee is to be formed in any particular proceeding.

(i) *Creditors that may be appointed to a committee*

277. [199] Different approaches are taken to the composition of creditor committees. As an initial issue, an insolvency law may need to consider which creditors will be entitled to be appointed to a creditor committee. Some insolvency laws provide, for example, that only creditors whose claims have been admitted (by the court or the insolvency representative, depending upon the admission procedure) can be appointed, while other laws provide for appointment of a provisional committee, for which all creditors are eligible, until all claims have been verified and admitted. Other insolvency laws impose restrictions on the location of creditors who may serve on a creditors committee. [205] To ensure equality of treatment of creditors, however, it may be desirable for creditors such as those whose claims have only been provisionally admitted and foreign creditors to be eligible for appointment to the committee.

278. A second issue relates to the types of creditors to be represented. [199] Although creditor committees generally represent only unsecured creditors, some laws recognize that there may be cases where a separate committee of secured creditors is justified. Those systems base this approach on the fact that the interests of the different types of creditors do not always converge and the ability of secured creditors to participate in, and potentially affect, the outcome of decisions by the committee may not always be appropriate or in the best interests of other creditors.

279. [200] Other insolvency laws provide for both types of creditors to be represented on the same committee. The rationale of this approach is that since the creditor committee is responsible for participating in the decision-making process and for making important decisions, secured creditors should participate otherwise they are excluded from the making of important decisions which may affect their interests. A further approach may be for an insolvency law not to specify which creditors should be represented in a given case, but to allow creditors to collectively choose their own representatives on the basis of willingness to serve (to address the problem of creditor apathy which is not uncommon) and to provide for enlargement or reduction of the size of the committee as required. Where the types of creditors requiring representation are too diverse to accommodate their interests within a single committee, such as may be the case for special interest groups such as tort claimants and shareholders, an insolvency law could provide for different committees to represent different interests. It is desirable, however, that this mechanism only be used in special cases, in order to avoid unnecessary costs and the possibility of the creditor representation mechanism becoming unwieldy.

280. [201] The participation of shareholders or owners of the debtor and creditors related to the debtor may be controversial, especially where the creditor committee has the power to affect the rights of secured creditors or where the shareholders or owners are involved with the management of the debtor. There will be cases, however, where the shareholders have no direct knowledge of, or involvement with, the management of the debtor, such as where the shareholders are investors with no direct association with



or access to management. In such cases, there may be compelling reasons for allowing the shareholders to participate through their own committee. Other creditors who may have a conflict of interest (such as competitors of the debtor who may have a personal interest with the potential to affect their impartiality in carrying out the functions of the committee) may also need to be excluded from participation in a committee in order to ensure that the committee is able to perform its functions on behalf of the general creditor body impartially and independently.

281. [202] A similar question of participation may arise in respect of parties who purchase the claims of creditors. Such purchasers may be related to the debtor or may be third parties who have no particular interest in the business of the debtor. Third party purchases may give rise to concerns about access to sensitive, confidential information that may be of value in the secondary debt market, while related party purchases raise the question of whether the related party should be entitled to claim the original face value of the claim or only the amount actually paid for it (where there is a difference between the two), which may affect the ability to vote where it is directly related to the value of claims.

282. [203] To address any potential problem, an insolvency law could adopt the approach of stipulating which parties are not entitled to participate in a creditor committee or vote on particular matters, such as selection of an insolvency representative or approval of a reorganization plan.

*(ii) Formation of a creditor committee*

283. [204] Where the law provides for the formation of creditor committees, details of the manner in which the committee is to be formed, the scope and extent of its duties, its governance and operation, including voting eligibility and powers, quorum and conduct of meetings, as well as replacement and substitution of members are often also addressed. It may be desirable to include such provisions in an insolvency law not only to avoid disputes and ensure confidentiality, but also to provide transparent and predictable procedures.

284. [206] A number of different approaches are taken to appointing the members of the committee, which depend to a large extent on the functions to be performed by the particular committee. In many cases, it is the general body of creditors that appoints the committee, normally at the initial meeting of creditors, or upon the provision by the insolvency representative of preliminary information regarding the debtor. Appointment of the committee by creditors may encourage both creditor confidence and participation in the insolvency process. Some jurisdictions allow the court to appoint a creditors committee, either at its own instigation or upon application by creditors or the insolvency representative. The disadvantages of this approach may include perceptions of bias, and a lack of equity and transparency; creditors may not have confidence in a system that does not encourage or allow them to play a role in selecting their own representatives and it may not serve to overcome the widespread problems of creditor apathy. On the other hand, such an approach may

serve to simplify the procedure for establishing a creditor committee and reduce the scope for disputes between creditors. The choice between these different approaches may depend upon the extent to which the court supervises the insolvency proceedings and is involved on a day-to-day basis, and the extent to which creditors are required to undertake an active role in performing functions that require more than the provision of advice to the insolvency representative.

285. [205] To facilitate administration and oversight of the committee, some insolvency laws specify the size of the committee—generally an odd number in order to ensure the achievement of a majority vote, and in some cases no more than three or five persons. Where the committee represents only unsecured creditors, membership of the committee is sometimes limited to the largest unsecured creditors. These creditors can be identified by a number of means, including requiring the debtor to prepare a listing of its largest creditors. [207] To ensure that it fulfils its duty to fairly represent creditors, oversight of the committee may be desirable where the insolvency law provides for the committee to undertake a significant role and could be undertaken by the insolvency representative, or by the court.

*(iii) Functions of a creditor committee*

286. As a general proposition, a creditor committee will perform its functions on behalf of the general body of creditors and those functions will therefore be related directly to the functions of the general body of creditors. The powers and functions given to a creditors committee should not impair the rights of the creditors as a whole to participate or otherwise act in the insolvency proceeding. In general, insolvency laws provide for a creditors committee to advise, consult with or possibly supervise the insolvency representative, and [208] undertake a number of specific tasks including monitoring the progress of the case (which may include requiring the provision of information by the insolvency representative); consulting with other principals in the proceeding, especially an insolvency representative and the existing management of the debtor; and advising the insolvency representative on the wishes of the creditor body on issues such as the sale of significant assets and formulation of the reorganization plan. To perform its functions, the committee may require administrative and expert assistance. This can be addressed by providing that the committee can seek permission from the insolvency representative or the general body of creditors to hire a secretary and, if circumstances warrant, consultants and professionals. Some insolvency laws provide that such costs will be paid by the insolvency estate, while other laws provide that creditors must meet their own costs of participation in the insolvency process.

*(iv) Liability of the creditor committee*

287. [209] The committee's duty would be to the general body of creditors. It would not have any liability or fiduciary duty to the owners of the insolvent business. It may be desirable to require the committee to act in good faith and to provide that members of the committee would be

immune from liability in respect of actions and decisions taken by them as members of the committee unless they were found to have acted improperly or to have breached a fiduciary duty to the creditors they represent. This might include, for example, deriving profit from the administration; or acquiring assets forming part of the estate without prior approval of the court. In considering the question of the liability of the committee, a balance may need to be struck between setting too high a level of responsibility which will promote creditor apathy and effectively discourage creditors from participating, and too low a level which may lead to abuse and prevent the committee from functioning efficiently as a representative body.

*(v) Removal and replacement of members of the committee*

288. An insolvency law may need to give some consideration to the grounds upon which removal of a member of the creditor committee might be justified and to establishing a mechanism for replacement. The procedure for such removal and replacement may be related to the procedure for appointment of a creditor committee in the first instance, whether by the court or election by the general body of creditors. A mechanism for replacement of members of the committee will also be relevant where members of the committee resign or are unable to continue performing the required functions, such as in cases of serious illness or death.

*(e) Voting of creditors*

289. An insolvency law may need to consider distinguishing between the matters on which a vote of the general body of creditors is required and those matters on which a creditor committee may make a decision, as well as establishing the applicable voting requirements in each case. It may also need to consider what will constitute a valid meeting of a creditor committee in terms of number of members (or quorum) required to attend, although the need for such a provision may depend upon the functions to be performed by the committee.

290. [210] Where actions to be taken in the course of the proceedings will have a significant impact on the creditor body, it is desirable that all creditors (as opposed to just the creditor committee) are entitled to receive notice of, and to vote on, those actions. These actions may include voting to select the insolvency representative where an insolvency law provides creditors with this role; on approval of the reorganization plan; on other significant events such as sale of substantial assets; and post-commencement finance.

291. A number of different approaches can be taken with respect to achieving that vote, depending upon the nature of the matter to be decided. Some laws provide that voting should occur in person at a meeting of creditors, while other laws provide that where a large number of creditors are involved or where creditors are not local residents, voting may take place by mail or by proxy. It may also be desirable to recognize that voting may take place using electronic means.

292. [211] Different approaches are taken to the type of voting result that is required to bind creditors to different decisions, [212] with some insolvency laws distinguishing between different types of decisions to be made. More important decisions, such as approval of a reorganization plan, may require a vote that includes both a proportion of value of claims as well as a number of creditors (see part two, chapter V). Some laws require a majority in value for most decisions and for decisions such as election or removal of the insolvency representative and hiring of particular professionals by the insolvency representative, a majority in value and number is required. Other laws provide that a simple majority is sufficient on issues such as election or removal of the insolvency representative. Some laws also distinguish between matters requiring the support of both secured and unsecured creditors; secured creditors will only participate in the vote on specified matters such as selection of the insolvency representative and matters affecting their security.

293. Jurisdictions also take a variety of approaches to establishing a voting mechanism for the committee. These approaches reflect those that are used for the general body of creditors. It is most important, however that some rules be established to govern the decision-making of the creditor committee, including rules relating to majorities and voting.

*(f) Resolution of disputes between the general body of creditors and the creditor committee*

294. As noted above with regard to disputes with the insolvency representative, many insolvency laws give precedence to decisions made in a meeting of the general body of creditors. As the primary decision-making organ for creditors, express decisions of the general body of creditors should over-ride decisions made on the same matter by a creditor committee.

*(g) Confidentiality*

295. As noted above (part two, chapter IV.A and B), it is desirable that an insolvency law imposes obligations of confidentiality on both the debtor and the insolvency representative. For similar reasons, it may be appropriate to also consider the circumstances in which creditors should be required to observe confidentiality. In the course of the administration of an insolvency proceeding, creditors generally will be in a position to obtain significant amounts of information concerning the debtor and its business, much of which may be commercially sensitive. While the consequences of liquidation suggest that there may not be much opportunity for creditors to take unfair advantage of that information (or that harm to the debtor will result), that may not be true of reorganization, and there may be circumstances where creditors can use that information to affect the successful implementation of an agreed plan. For these reasons, it may be appropriate to impose on creditors an obligation of confidentiality that permits the use of information obtained in the course of the proceedings only for the purposes of administration of the proceedings, unless the court decides otherwise.

## Recommendations

### Classes of creditors

#### Purpose of legislative provisions

The purpose of provisions on classes of creditors is to: [...].

#### Content of legislative provisions

(106) The insolvency law should clearly identify the different classes of creditors that will be affected by the insolvency law and the manner in which those classes will be treated under the law [in terms of claims, priority and distribution].

### Participation of creditors in insolvency proceedings

#### Purpose of legislative provisions

The purpose of provisions on participation of creditors in insolvency proceedings is to:

- (a) establish the functions and responsibilities of the general body of creditors;
- (b) provide for the participation in insolvency proceedings of the general body of creditors by the appointment of a creditor committee;
- (c) provide a mechanism for the appointment of a committee;
- (d) establish the functions and responsibilities of the creditor committee.

#### Content of legislative provisions

*General body of creditors [assembly of creditors]*

(107) [(85)] The insolvency law should establish the powers and functions of the general body of creditors. These should include:

- (a) approval or rejection of a reorganization plan;
- (b) [involvement in] [advising on] issues referred by the insolvency representative, including advising on continuation of the business in liquidation, post-commencement financing, verification of claims, compensation of professionals, treatment of judicial proceedings to which the debtor was a party at the time of commencement, distribution of assets and [...].

#### *— Voting of the general body of creditors*

(108) [(86)] The insolvency law should specify the matters on which a vote of the general body of creditors is required and establish the relevant voting requirements.

#### *— Right to be heard*

(109) [(87)] Creditors should have the individual right to be heard in the insolvency proceedings on matters relating to [...].

#### *— Participation of secured creditors*

(110) [(90)] The insolvency law should clearly indicate the extent to which secured creditors [may] [should] participate in both liquidation and reorganization proceedings. Where secured creditors rely on secured assets to pay part or all of their claims, the insolvency law [may][should] limit their participation in the proceedings to the extent that their claim is secured. Where secured creditors have surrendered their security to the insolvency representative, the insolvency law should enable them to participate in the proceedings to the same extent as ordinary unsecured creditors. Where a secured creditors claim is to be restructured under a reorganization plan, the secured creditor should be entitled to participate in the reorganization proceedings.

#### *— Convening meetings of the general body of creditors*

(111) Meetings of the general body of creditors may be convened [by the court] [by the insolvency representative] [at the request of creditors [holding (*specify a percentage of the total value of*) [unsecured] claims].

#### *Creditor committee*

(112) [(88)] The insolvency law should provide [a mechanism] for the general body of creditors to actively participate in the insolvency proceedings [such as] through a creditor committee. Where the interests and categories of creditors involved in the insolvency proceeding are diverse and participation will not be facilitated by the appointment of a single committee, the insolvency law may provide for the appointment of different creditor committees.

(113) Where the insolvency law provides for a creditor committee to be appointed the relationship between the general body of creditors and the creditor committee should be clearly stated. In particular, the insolvency law should specify: whether a committee is required in all insolvency cases, the distribution of functions and powers between the general body of creditors and the creditor committee, the mechanism for resolution of disputes between the general body of creditors and the creditor committee and [...].

#### *— Creditors that may be appointed to a creditor committee*

(114) [(89)] The insolvency law should specify the categories of creditors that may or may not be appointed to the committee, including whether or not a creditor's claim must be admitted [whether provisionally or otherwise] before it is entitled to be appointed to a committee. The creditors who [may] [should] not be appointed to the creditor committee would include related persons such as creditors related to the debtor (whether personally or as a director, manager or advisor of the debtor) and creditors with a personal interest in the affairs of the debtor where that interest has the potential to affect the creditor's impartiality in carrying out the functions of the committee (e.g. a competitor of the debtor).

— *Mechanism for appointment to a creditor committee*

(115) [(91)] The insolvency law should establish the mechanism for appointment of the creditor committee. Different approaches may include selection of the creditor committee by the general body of creditors or appointment by the court or other administrative body.

— *Functions of a creditor committee*

(116) [(92)] The insolvency law should establish the powers and functions of the creditor committee including:

(a) in both liquidation and reorganization proceedings, a general advisory function, providing advice and assistance to the insolvency representative;

(b) a supervisory function with respect to development of the reorganization plan, the sale of significant assets and in other matters as directed by the court or determined in cooperation with the insolvency representative;

(c) the right to be heard in insolvency proceedings.

— *Employment and remuneration of professionals by a creditor committee*

(117) [(93)] The insolvency law should permit the creditor committee, subject to approval by [the court] [the general body of creditors], to employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions.

— *Liability of members of a creditor committee*

(118) [(94)] The insolvency law should provide that members of the creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found, for example, to have acted fraudulently.

— *Removal and replacement of members of a creditor committee*

(119) [(95)] The insolvency law should provide for removal and replacement of members of the creditor committee and specify the grounds, including [gross] negligence, [lack of the necessary skills], [incompetence or inefficiency].

— *Procedural rules for a creditor committee*

(120) [(96)] The insolvency law may provide for the establishment of rules to govern the performance of the functions and decision-making of the creditor committee, including rules relating to majorities and voting.

## D. Institutional framework

296. An insolvency law is a part of an overall commercial legal system and is heavily reliant for its proper application not only on a developed commercial legal system, but also on a developed institutional framework for administration of the law. The choices made in developing or reforming an insolvency law will therefore need to be closely linked to the capacities of existing institutions. The insolvency system will only be effective if the courts and officials responsible for its implementation have the necessary capacity to provide the most efficient, timely and fair outcome to those for whose benefit an insolvency system exists. If that institutional capacity does not already exist, it is highly desirable that reform of the insolvency law is accompanied by institutional reform, where the costs of establishing and maintaining the necessary institutional framework are weighed against the benefits of providing a system that is efficient, effective and in which the public have confidence. Although a detailed discussion of the means by which this institutional capacity can be developed or enhanced is beyond the scope of this Guide, a number of general observations can be made.

297. In most jurisdictions, the insolvency process is administered by a judicial authority, often through commercial courts or courts of general jurisdiction or, in a few cases, through specialized bankruptcy courts. Sometimes judges have specialized knowledge and responsibility only for insolvency matters, while in other cases insolvency matters are just one of a number of wider judicial responsibilities. In a few jurisdictions non-judicial or quasi-judicial institutions fulfil the role that in other jurisdictions is played by the courts.

298. In designing the insolvency law it may be appropriate to consider the extent to which courts will be required to supervise the process and whether or not their role can be limited with respect to different parts of the process or balanced by the role of other participants in the process, such as the creditors and the insolvency representative. This is of particular importance where the insolvency law requires judges to deal quickly with difficult insolvency issues (which often involve commercial and business questions) and the capacity of the judiciary is limited, whether because of its size, a general lack of resources in the court system or a lack of specific knowledge and experience of the types of issues likely to be encountered in insolvency.

299. To limit the role to be played by the court, an insolvency law can provide that the representative, for example, is authorized to make decisions on a number of issues, such as verification and admission of claims, the need for post-commencement funding, surrender of secured assets of no value to the estate, sale of major assets, commencement of avoidance actions, and treatment of contracts, without the court being required to intervene, except in the case of a dispute. Creditors also can be authorized to provide advice to, or to approve certain decisions of, the insolvency representative, such as approving the sale of important assets or obtaining post-commencement finance, without requiring the court to intervene, except in the case of dispute. An insolvency law can specify those procedures that will require court approval, such as the provision of a priority

ranking above the rights of existing secured creditors to secure post-commencement finance.

300. The court's capacity to handle the often complex commercial issues involved in insolvency cases is often not only a question of knowledge and experience of specific law and business practices, but also a question of that knowledge and experience being current and regularly updated. To address the issue of judicial capacity, a special focus on the education and ongoing training of court personnel, not only of judges but also of clerks and other court administrators, will assist in supporting an insolvency regime that has the ability to respond effectively and efficiently to its insolvency caseload.

301. A further consideration related to the court's capacity to supervise insolvency cases is the balance in the insolvency law between mandatory and discretionary components. While mandatory elements, such as automatic commencement or automatic application of the stay, may provide a high degree of certainty and predictability for debtor and creditors as well as limiting the matters requiring consideration by the courts, it may also lead to rigidity if there are too many of these type of elements. A discretionary approach allows the court to weigh facts and circumstances, taking into account precedent, community interests, and those of persons affected by the decision and market conditions. It may also impose a burden on the court where it does not have the knowledge or experience required to weigh these considerations or the resources to respond in a timely manner. Where the insolvency law provides for confirmation of a reorganization plan by the court, for example, it is not desirable to ask the court to undertake complex economic assessments of the feasibility or desirability of the plan, but rather to limit its consideration to the conduct of the approval process and other specified issues. Where an insolvency law requires the exercise of discretion by a decision maker, such as a court, it is preferable that adequate guidance as to the proper exercise of that discretion is also included, particularly where economic or commercial issues are involved. This approach is consistent with a general objective of an insolvency regime of transparency and predictability.

302. The adequacy of the legal infrastructure and in particular, the resources available to courts dealing with

insolvency cases, may be a significant influence on the efficiency with which insolvency cases are handled and the length of time required for insolvency proceedings. This may be a relevant consideration in deciding whether the insolvency law should impose time limits for the conduct of certain parts of the process. If the court infrastructure is not able to respond to the demands placed upon it in a timely manner to ensure that time limits are observed by the parties and the insolvency process moves quickly along, the inclusion of such provisions in the law will not achieve the goal of an effective and efficient insolvency regime. Procedural rules will also be of importance to the conduct of cases and well-developed rules will assist courts and the professionals handling insolvency cases to provide an effective and orderly response to the economic situation of the debtor, minimizing the delays that can result in diminution in value of the debtor's assets and impair the prospects of a successful insolvency proceeding (whether liquidation or reorganization). Such rules will also assist in achieving a degree of predictability and uniformity of treatment from one case to the next.

303. Implementing an insolvency system depends not only on the court, but also on the professionals involved in the insolvency process, whether they are insolvency representatives, legal advisers, accountants, valuation specialists or other professional advisers. The adoption of professional standards and training may assist in developing capacity. It may be appropriate to assess which insolvency functions are truly public in nature and should be performed in the public sector in order to ensure the level of trust and confidence required to make the insolvency system effective, and those functions which can be performed by the creation of adequate incentives for private sector participants in the insolvency process. The insolvency representative might be one example.

### Recommendations

*[Note to the Working Group: The Working Group may wish to consider whether recommendations on the institutional framework required for an effective and efficient insolvency regime should be added to the Guide and if so, what those recommendations should include.]*

## A/CN.9/WG.V/WP.63/Add.12

### Draft legislative guide on insolvency law

#### Note by the Secretariat

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3-4; chapter III.A-F appears in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV.A-D appears in documents A/CN.9/WG.V/WP.63/Add.10-11; and chapters VI-VII appear in subsequent addenda]*

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*Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide.*

*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

## **Part two (continued)**

### **V. REORGANIZATION**

#### **A. The reorganization plan**

##### ***1. Introduction***

304. [261] Insolvency laws generally address a number of issues in relation to the reorganization plan, such as the nature or form of the plan; when the plan is to be prepared; who is able to prepare the plan; what is to be included in the plan; how the plan is to be approved and the effect of the plan.

305. [262] Reorganization plans perform different functions in different types of proceedings. In some, the plan may be the tailpiece of the reorganization proceedings, dealing

with the pay-out of a dividend in full and final settlement of all claims (also referred to as a composition or a scheme of arrangement) and the final structure of the business after the reorganization is complete or it may be proposed at the commencement of the proceedings and set out the way the debtor and the business should be dealt with during the reorganization period, much like a business plan, as well as expected dividends and dates of payment. There may also be circumstances where a plan, like a plan of reorganization, is prepared in liquidation where the business is to be sold as a going concern and may address the timing and mechanics for interim distributions. The following discussion focuses upon the issues that would be relevant to a plan proposed on commencement, addressing the conduct of the business in reorganization and the transformation of legal rights proposed to address the debtor's financial situation. These will also be relevant, although not necessarily in their entirety, to other types of plans.

## 2. *Nature or form of a plan*

306. [263] The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers. With different constituents involved in the reorganization process, each may have different views of how that objective can best be reached. Some creditors, such as major customers or suppliers, may prefer continued business with the debtor to rapid repayment of their debt. Some creditors may prefer an equity stake in the business, while others will not. Typically, therefore, there is a range of options from which to select in a given case and if an insolvency law adopts a prescriptive approach to the range of options available or to the choice to be made in a particular case, it is likely to circumvent achievement of the goal of maximizing value. It is desirable that the law does not, for example, permit only a plan that is designed to fully rehabilitate the debtor; nor provide that debt cannot be written off; nor provide that a minimum amount must eventually be paid to creditors; nor prohibit exchange of debt for equity. [264] Such a non-intrusive approach is likely to provide the flexibility sufficient to allow the most suitable (in terms of the particular entity) of a range of possibilities to be chosen. Some insolvency laws adopt an approach of listing some of the possibilities that may be adopted, but it is not intended that the list be exclusive of other approaches.

307. [263] These possibilities could include a choice of a simple composition (an agreement to pay creditors a percentage of their claims); the continued trading of the business and its eventual sale as a going concern (and for the debtor to then be liquidated); transfer of all or part of the assets of the estate to one or more existing businesses or to businesses that will be established; a merger or consolidation of the debtor with one or more other business entities; a sophisticated form of restructuring of debt and equity or some other solution. The determination of what is the most appropriate solution may best be left to the marketplace, where an effective one exists, or at least to negotiations among the debtor, the insolvency representative, creditors and other persons with economic interests.

308. [264] Even if it does not adopt a prescriptive approach to the form or nature of the plan, an insolvency law may establish some limits, such as that the priorities afforded to creditors in liquidation should be maintained in reorganization, that the effect of the plan should not be such that the debtor remains insolvent and is returned to the marketplace in that condition and that the reorganization plan comply with limitations set forth in other laws (where the insolvency law does not amend those limitations), for example foreign exchange controls.

## 3. *Preparation of a plan*

309. [265] Two important issues to be considered in relation to preparation of a reorganization plan are the stage of the proceedings at which it should be prepared and the party or parties that would be capable of preparing, or

could be authorized to prepare, a plan. A number of different approaches can be taken to each of these issues.

### (a) *Timing of preparation*

310. [266] As to the first issue, timing of preparation, the approach adopted may depend upon the purpose or objective of the particular reorganization, or relate to the manner in which the reorganization proceedings commenced. Some laws, for example, provide that the plan for reorganization should be filed with the application for reorganization proceedings (where the application may be called a "proposal" for reorganization) where those proceedings are voluntary proceedings commenced by the debtor. Potential difficulties with this approach may include delaying the debtor's ability to commence proceedings and obtain timely relief by way of the stay; the difficulty of knowing, at this early stage, exactly what the plan should accomplish; and if the plan has been prepared without consultation with creditors and other interested parties but is intended to be a final, definitive plan, it may not be a plan that could feasibly be implemented and could thus operate to pre-empt the proceedings and cause delay. Many other laws provide for the plan to be prepared after commencement of reorganization proceedings. This may be a more flexible option, allowing for consultation and negotiation of an acceptable reorganization plan while the debtor has the protection of the stay. These benefits may need to be balanced against possible misuse of the insolvency regime by debtors who have no intention of, or ability to, file a plan but are seeking to obtain only the benefits of the stay.

### (b) *Parties capable of preparing [permitted to prepare] a plan*

311. [267] With regard to the second issue, participants in the reorganization proceedings may have different capabilities and responsibilities with regard to preparation of the reorganization plan, depending upon the manner in which the insolvency law is designed and in particular the respective roles assigned to the insolvency representative, debtor and creditors. For example, in some insolvency laws, these parties have a positive obligation to cooperate in preparing the plan. In determining which party should be permitted to prepare, or which parties are capable of preparing, the plan, a balance may be desirable between the freedom accorded to the different parties to prepare the plan (e.g. should all parties be able to prepare a plan, should they be able to do so at the same time or should preparation by different parties be sequential and dependant upon the acceptability of a plan proposed), and the restraints necessarily attached to the process in terms of approval (voting) requirements (e.g. should all creditors play a role in formulating a plan they have to approve), time limits for preparation, provision in the insolvency law for amendment of the plan and other procedural considerations. A flexible approach, as opposed to a prescriptive approach, is likely to ensure that this balance is achieved, although in the interests of efficiency, certainty and predictability and the timely progress of the proceedings, it is desirable that an insolvency law provide sufficient guidance to ensure that a viable plan is prepared.

*(i) Preparation by the debtor*

312. [268] Some insolvency laws provide for the debtor to prepare the reorganization plan, sometimes specifying that it should do so in cooperation with other parties such as the insolvency representative, the creditors, an attorney, an accountant or other financial advisors. An approach which involves the debtor may have the advantages of encouraging debtors to commence reorganization proceedings at an early stage and of making the best use of the debtor's familiarity with its business and knowledge of the steps necessary to make the insolvent entity viable (although the freedom accorded to the debtor may need to be balanced against the need to ensure creditor confidence in the debtor and its proposal). The opportunity provided to the debtor could be made exclusive or exclusive only for a specified period, with the court having the power to extend the period if it will be of advantage to the reorganization proceedings, and with another party able to prepare a plan where the period expires without a plan being proposed. Where the plan is to be prepared before commencement, it would generally be prepared by the debtor, but may involve negotiation with one or more classes of creditors, not necessarily all, who may negotiate and agree on a plan, subject to its acceptance by other creditors or its imposition on remaining classes.

*(ii) Creditor participation*

313. [269] Where creditor approval of the plan is required, there is always a risk that reorganization will fail if the plan presented by the debtor is not acceptable. For example, creditors may only wish to approve a plan that deprives the debtor's shareholders of a controlling equity interest in the insolvent entity and may also deprive the incumbent management of any management responsibilities. If the debtor is given the exclusive opportunity to prepare the plan and refuses to consider such an arrangement, there is a danger that the reorganization will fail, to the detriment of the creditors, the employees, and the debtor. There are benefits to be derived from providing for debtor participation in preparation of the plan, even if it does not have principal responsibility. These benefits may be clear particularly where the plan envisages the ongoing operation of the debtor's business and key management personnel are necessary to the success of that business (such as for reasons of its complexity) or will be difficult to replace in the short term. To address these concerns, some insolvency laws provide that, if the debtor fails to provide an acceptable plan before the end of an exclusive period, the creditors are given the opportunity to propose a plan (which could be achieved through a creditor committee (see part two, chapter IV.C). This option may provide the leverage necessary to reach a compromise between the participating parties.

*(iii) Participation by the insolvency representative*

314. [270] Another approach adopted by many insolvency laws is to give the insolvency representative an opportunity to prepare the plan, either as an alternative to preparation by the debtor or the creditors or as a supplementary measure. Given that the insolvency representative will have had some opportunity to become knowledgeable

about the debtor's business after commencement of the proceedings, it may be well placed to determine what measures are necessary for the business to be viable. It may also be well placed to facilitate negotiations on the plan between the debtor and creditors. The importance of providing for participation by the insolvency representative or the creditors depends upon the design of the law. In circumstances where approval by the requisite majority of creditors is a necessary condition for effectiveness of the plan, a plan that takes account of proposals that will be acceptable to creditors has a greater likelihood of being approved than one which does not. This consideration will not apply where creditor approval is not necessary or can be overruled by the court. Where the plan is only to be approved by the court, substantial legal input may be required to ensure that the plan presented will be approved.

*(iv) Preparation by multiple parties*

315. [270] Some insolvency laws provide that a number of parties have the opportunity to prepare a plan. These may include management of the debtor, shareholders of the debtor, the insolvency representative, and creditors or the creditors committee. It may be desirable where such a provision is included that some procedure is adopted to ensure that a number of competing plans are not prepared simultaneously. Although in some cases this approach may promote the preparation of a mutually acceptable plan, it may also have the potential to complicate the process and lead to inefficiency and delay.

316. [271] Some laws provide for the court to consider the opinions of third parties on the plan, such as governmental agencies and labour unions. Although in particular cases this may assist in the preparation of an acceptable plan, it also has the potential to lengthen the duration of the process, and may be desirable only if it is likely to be beneficial in a particular case, where the process is carefully monitored and time limits are specified.

*(c) Time limits for preparation of a plan*

317. Some insolvency laws include a time limit within which the plan is to be prepared. This limit may specifically apply to preparation of the plan by the debtor or to preparation of the plan generally. One law, for example, provides a 120-day limit for preparation of the plan by the debtor; once that has expired any other party may submit a plan without any time limit being imposed. Examples of time limits generally applicable to preparation and submission of a plan include from 35 to 120 days from commencement, with some laws including provision for that time limit to be extended or shortened by the court in certain circumstances. Although the imposition of time limits may be helpful in ensuring that the reorganization proceedings proceed without delay, that advantage may need to be balanced against the risk that the deadlines may be too inflexible and impose an arbitrary restraint, particularly in large cases where preparation of the plan may take more than 12 months, or that the limits will not be observed, especially in the absence of appropriate sanctions, or that the insolvency infrastructure is unable to manage deadlines (for reasons such as lack of resources). An ad-



vantage of time limits which can be extended by the court is that they require the party seeking an extension to demonstrate to the court that the extension is warranted—that is, for example, that there is no improper reason for the delay, that the delay will not be harmful to the proceedings and that there is a prospect for a successful reorganization.

#### 4. *The plan*

318. [273] The question of what is to be included in the plan is closely related to the procedure for approval of the plan (for example, which creditors are required to approve the plan, the level of support required for approval and the procedure for court confirmation, if any) and the effect of the plan once approved (and confirmed by the court, where required) (for example, will it bind dissenting creditors and secured creditors, who will be responsible for implementation of the plan and for ongoing management of the debtor). The outcome of the plan rests on what is feasible, in other words whether, on the basis of known facts and circumstances and reasonable assumptions, the plan and the debtor are more likely than not to succeed. Determination of whether a plan is likely to succeed raises two related issues. The first is the content of the plan itself, or in other words what is proposed by the plan. The second is the manner in which those proposals are presented and explained to creditors in order to elicit their support.

##### (a) *Content of a plan*

319. [272] Many insolvency laws include provisions addressing the content of the reorganization plan. Some laws address the content of the plan by reference to general criteria, such as that the reorganization plan adequately and clearly disclose to all parties information regarding both the financial condition of the insolvent entity and the transformation of legal rights that is being proposed in the plan, or by reference to minimal requirements such as that the plan must make provision for payment of certain preferred claims.

320. Other laws set out more specific requirements as to what information is required in relation to the debtor's financial situation and the proposals included in the plan. [272] Information on the financial situation of the debtor may include asset and liability statements; cash flow statements; and information relating to the causes or reasons for the financial situation of the debtor.

321. [272] Information relating to what is proposed by the plan may include details of classes of claims; claims impaired under the plan and the treatment to be accorded to each class under the plan; the continuation or termination of contracts that are not fully executed; the treatment of unexpired leases; measures and arrangements for dealing with the debtor's assets (e.g. transfer, liquidation, retention); the sale of secured assets; the disclosure and acceptance procedure; the rights of disputed claims to take part in the voting process and provisions for disputed claims to be resolved; arrangements concerning personnel of the debtor; the role to be played by the debtor in implementation of the plan and identification of those to be respon-

sible for future management of the debtor's business; financing implementation of the plan; remuneration of management of the debtor for its services; the settlement of claims and how the amount that creditors will receive will be more than they would have received in liquidation; payment of interest on claims; possible changes to the form of the debtor (changes to by-laws, articles of association etc.); the basis upon which the business will be able to keep trading and can be successfully reorganized; supervision of the plan; and the period of implementation of the plan, including in some cases a statutory maximum period.

322. [274] The content of the plan also raises issues related to other laws. For example, to the extent that national company law precludes debt-for-equity conversions, a plan that provides for such a conversion could not be approved. Since debt-for-equity conversion can be an important feature of reorganization, it would be necessary to eliminate the prohibition, at least in the insolvency context, if such provisions were to be included in a plan and approved. Similarly, if a plan is limited by the operation of other law to debt forgiveness or the extension of maturity dates, it may not receive adequate support from creditors for it to be successful. Some insolvency cases raise similarly straightforward and uncontroversial issues of the relationship between the insolvency law and other laws. Other cases may raise more complicated questions. These may include limits on foreign investment and foreign exchange controls (especially in cases where many of the creditors are non-residents), or the treatment of employees under relevant employment laws where, for example, the reorganization may raise questions of modification of collective bargaining agreements, or questions related to taxation law. Some insolvency laws allow certain limitations contained in other laws, for example those relating to disposition of the debtor's assets and priority of distribution, to be overruled in specified circumstances, such as where creditors agree, and it is desirable, in order to ensure transparency and predictability, that an insolvency law specifically address the question of its relationship with other laws.

##### (b) *Information to accompany the plan*

323. [273] When voting on a plan, creditors need to be able to assure themselves that what is proposed by the plan is feasible and not based, for example, on faulty assumptions, and that implementation of the plan will not leave the debtor overburdened with debt. To facilitate that evaluation, creditors will need to be provided with information explaining what the plan proposes and the impact of those proposals on both the debtor and creditors. For these purposes, the plan can be accompanied by a report of a qualified professional who can be expected to provide a credible and unbiased assessment of the measures proposed by the plan or by a full disclosure of information from which creditors can evaluate the plan. Where creditors do not agree with the professional evaluation, or do not believe that the disclosed information is persuasive, those views could be taken into account either in voting on the plan, by a mechanism allowing for amendment of the plan, or by the court when it confirms the plan (where that is a required element of the process).

324. [272] A number of insolvency laws include provisions addressing the information that is to be provided to creditors to enable them to properly assess the plan, whether it is to be included in the plan itself or in a separate statement. Where the reorganization plan is to be accompanied by such a statement, the insolvency law may specify what information it should include. Provision of this information supports the key objective of transparency and can assist in ensuring creditor confidence in the insolvency process. It may need to be balanced, however, against confidentiality concerns arising from creditor access to potentially sensitive financial and commercial information relating to the debtor, even where that information may ultimately enter the public domain through approval or confirmation of the plan by a court. It may also need to be balanced against the provision of information that is irrelevant to the purpose of evaluating the plan; the focus should be upon the information required in a particular case to evaluate the specific proposals contained in the plan.

### 5. *Approval of a plan*

325. [275] Designing the provisions of an insolvency law with regard to the approval of the plan requires a balance to be achieved between a number of competing considerations, which will be particularly important where the plan does not receive the support of all creditors or classes of creditors. On the one hand, it will be essential to provide a way of imposing an agreed plan upon a minority of dissenting creditors within a class in order to increase the chances of success of the reorganization. It may also be necessary, depending upon the mechanism that is chosen for voting on the plan and whether creditors vote in classes, to consider whether the plan can be binding upon dissenting classes of creditors. To the extent that a plan can be approved and enforced upon dissenting creditors, there may be a need to ensure that the content of the plan provides appropriate protection for those dissenting creditors and, in particular, that their rights cannot be unfairly affected. On the other hand, to the extent that the approval procedure results in a significant impairment of creditors' claims without their consent (particularly secured creditors), there is a risk that the willingness of creditors to provide credit in the future may be undermined. The mechanism for approval of the plan, and the availability of appropriate safeguards, is therefore of considerable importance to the protection of these interests.

#### (a) *Procedures for approval*

326. [275] Many insolvency laws provide for a special meeting of creditors to be called for the purpose of voting on the reorganization plan, and require that the plan (and the information or disclosure statement where that document is also to be provided) be made available to the creditors within a certain period of time before that meeting is called. [210] Some laws provide that voting should occur in person at a meeting of creditors, while other laws provide that voting may take place by mail or by proxy. It may also be desirable to recognize that voting can take place using electronic means.

327. Other issues to be considered with regard to approval of the plan include the types of claims (in terms of admission or provisional admission of those claims) that will be considered in determining whether the requisite majority has been reached, whether secured creditors are required to vote; whether the votes of priority claims will be considered in determining the requisite majority, and the manner in which abstaining creditors will be treated. In some cases, for example, abstaining voters are treated as votes not to accept a plan, [280] while many countries adopt the approach of calculating the percentage of support on the basis of those actually participating in the voting and absentees and abstaining voters are considered to have little interest in the proceedings. The latter approach requires adequate notice provisions and their effective implementation, especially where creditors are non-residents.

328. Some insolvency laws also make use of presumptions regarding votes. Where, for example, a plan cancels a creditor's claim or owner's equity interest (and that party receives nothing under the plan), a vote against the plan can be presumed. In contrast, where a plan leaves a claim unimpaired or provides that it will be paid in full, a vote in favour of the plan can be presumed. Such presumptions may simplify the voting procedure, and lessen the need to provide notice and information to relevant creditors.

#### (b) *Approval by secured and priority creditors*

329. [276] In many cases, secured claims will represent a significant portion of the value of the debt owed by the debtor and different approaches may be taken to approval of the plan by secured and priority creditors. As a general principle, however, the extent to which a secured creditor is required to vote will depend upon the manner in which the insolvency regime treats secured creditors, the extent to which a reorganization plan can affect the secured interest of the secured creditor and the extent to which the value of secured asset will satisfy the claim of the secured creditor.

330. Under one approach, where the insolvency law ensures that an approved plan will not preclude secured creditors from exercising their rights against the secured assets, there is generally no need to give these creditors the right to vote since their security interests will not be impaired by the plan. Priority creditors are in a similar position under this approach—the plan cannot impair the value of their claims and they are entitled to receive full payment. The limitation of this approach, however, is that it may reduce the chances for a successful reorganization, especially where the secured assets are vital to the success of the plan. If the secured creditor is not bound by the plan, the election by the secured creditor to exercise its rights, such as by repossessing and selling the secured asset, may make the plan impossible to implement. Similarly, in certain circumstances, the only way in which the plan may succeed is to provide that priority creditors receive less than the full value of their claims upon approval of the plan. Thus, the prospects for reorganization may improve if priority creditors will accept payment over time and if secured creditors will acquiesce when the terms of the security are modified over time.

331. To the extent that the value of the secured asset will not satisfy the full amount of the secured creditor's claim, a number of insolvency laws provide for them to vote with ordinary unsecured creditors in respect of the unsatisfied portion of the claim. In some legal systems, this raises difficult questions of valuation in order to determine whether and the extent to which all secured creditors are in fact secured. For example, where three creditors hold security over the same asset, the value of that asset may only support the claim first in priority and part of the second in priority. The second creditor may therefore be required to vote in respect of the unsecured portion of its claim, while the third creditor will be totally unsecured. The valuation of the asset is therefore crucial to the determination of whether or not a creditor is secured and the extent of its security, a determination which becomes important where secured creditors are not required to vote on a plan (but where they do vote can be bound by the plan), but where unsecured creditors are required to vote.

332. [277] There are a variety of different approaches to secured creditor voting on a reorganization plan. Some insolvency laws provide for secured and priority creditors to vote as separate classes on a plan that would impair the value or terms of their claims or to otherwise consent to be bound by the plan. This approach recognizes that the respective rights and interests of these creditors differ from those of unsecured creditors, and from each other. Where secured creditors vote in classes, some insolvency laws provide that to the extent that the requisite majority votes to approve the plan, dissenting members of the class will be bound by the terms of the plan. The requisite majority would generally be the same as that required for approval by unsecured creditors, although there are examples of laws that require different majorities depending upon the manner in which secured creditors rights are affected (e.g. a three-quarter majority is required where the maturity date is extended and a four-fifths majority where the rights are otherwise impaired). Other insolvency laws provide that the plan cannot be imposed upon secured creditors unless they consent to such imposition.

333. A further approach is those insolvency laws which provide that dissenting secured creditors are entitled to receive at least as much as they would have received under liquidation and only where that occurs can they be bound by the plan. An alternative provides that they may be bound if the plan makes provision for them to be paid in full to the extent of the value of their security, with interest, within a certain period of time. Some insolvency laws also provide that secured creditors may be bound by the plan where the court has the power to order that they are bound, provided it is satisfied as to certain conditions. These may include that enforcement of the security by the secured creditor will have a material adverse effect on achieving the purposes of the plan and that the security interests of the secured creditor will be sufficiently protected under the plan and that the position of the secured creditor will not further deteriorate under or as a result of the plan (for example, payments of future interest will be made and the value of the secured interest will not be affected).

334. In determining which approach should be taken to this issue, it will be important to assess the effect of the desired approach upon the availability and cost of secured transaction financing and to provide as much certainty and predictability as possible.

(c) *Approval by ordinary unsecured creditors*

335. [278] Different mechanisms may be used to ensure that ordinary unsecured creditors have an effective means for voting on a plan. Whichever mechanism is chosen it is desirable that it be as simple as possible and be clearly set out in the insolvency law to ensure predictability and transparency.

(i) *Classes of unsecured creditors*

336. A number of insolvency laws do not provide for unsecured creditors to be divided into different classes, rather they vote together as a single group. Other insolvency laws do provide for division into classes where there is a large number of unsecured creditors or where unsecured creditors have different interests based upon the nature of their claims. Where there is a small number of unsecured creditors or where their interests are similar, there may be no need for creditors to vote on approval of the plan in different classes, thus simplifying the voting procedure.

337. [281] Countries that have established classes for secured and priority creditors often also provide for the division of ordinary unsecured creditors into different classes, based upon their varying economic interests. The creation of these classes is designed to enhance the prospects of reorganization in at least three respects by providing: a useful means of identifying the varying economic interests of unsecured creditors; a framework for structuring the terms of the plan; and a means for the court to utilize the requisite majority support of one class to make the plan binding on other classes which do not support the plan. Since the creation of different classes has the potential to complicate the voting procedure, it may be desirable only where there are compelling reasons for special treatment of some ordinary unsecured creditors, such as a lack of common economic interests. Criteria that may be relevant in determining commonality of interest may include: the nature of the debts giving rise to the claims; the remedies available to the creditors in the absence of the reorganization plan and the extent to which the creditors could recover their claims by exercising those remedies; the treatment of the claims under the reorganization plan; and the extent to which the claims would be paid under the plan.

(ii) *Determination of classes*

338. Some insolvency laws specify the manner in which classes of ordinary unsecured creditors or claims are determined for the purposes of approval of the reorganization plan. One approach is for the plan to place claims or interests into a particular class on the basis of common interest or substantial similarity or on the basis of the value of the claim. Where the test is commonality or similarity of interest, the person who prepares the plan may have

some flexibility in assigning claims to a particular group. Another approach provides for the insolvency representative to make recommendations to the court before the creditors vote on approval. A further approach provides that the classes are determined in the first instance by the debtor, who will have some limited flexibility as to the composition of each class; unsecured creditors who are unsatisfied by the composition of the class can seek to have the issue determined by the court.

*(d) Approval by shareholders*

339. [283] Some insolvency laws provide for the approval of reorganization plans by shareholders of the debtor, at least where the corporate form, the capital structure or the membership of the debtor will be affected by the plan. Shareholders may also be expected to vote where some shareholders will receive a distribution under the plan. Where the debtor's management proposes a plan, the terms of the plan may already have been approved by the shareholders (depending upon the structure of the debtor in question, this may be required under its constitutive instrument). This is often the case where the plan directly affects shareholders such as by providing for debt-for-equity conversions, either through the transfer of existing shares or the issuance of new shares.

340. [284] In circumstances where the insolvency law permits creditors or an insolvency representative to propose a plan, and the plan contemplates debt-for-equity conversion, some insolvency laws allow the plan to be approved over the objection of shareholders, irrespective of the terms of the constitutive instrument of the entity. Such plans may result in existing shareholders being entirely displaced without their consent, subject to some protections. Where, for example, the reorganization plan provides for some return to shareholders, they cannot be displaced.

*(e) Related person creditors*

341. [285] Some insolvency laws provide that related persons should not vote with other creditors on approval of the plan or that their votes will not count for certain purposes such as determining that an impaired class of creditors has accepted the plan (when that is a requirement of approval). Many insolvency laws, however, do not include provisions dealing specifically with this issue. Where the insolvency law makes no special provision, related persons should vote in the same manner as other creditors. They will generally be subject, however, to the provisions of non-insolvency law for their personal dealings with the debtor and its business.

*(f) Majorities required for approval of the plan*

342. [279] Many insolvency laws identify the minimum threshold of support required from creditors for the plan to be approved. The requisite majority can be calculated in a number of different ways, depending upon whether or not creditors vote in classes, and how those classes are treated in determining the majority. Where creditors do not vote in

classes, the majority may be fixed by reference to the support of a proportion or percentage of the value of claims or a number of creditors, or a combination of both. Some laws require, for example, that the plan be supported by at least two thirds or three quarters of the total value of the debt and more than one half or two thirds of the number of creditors. While these proportions generally apply to creditors voting on approval of the plan, there are laws which determine these proportions by reference to the total value of debt and total number of creditors, irrespective of whether or not they vote. Other combinations are also used.

343. [279] Where creditors do vote in classes, a wide variety of different approaches are taken to determining when a plan will be approved. Some insolvency laws require a majority of each class of creditors based upon a percentage or proportion of the value of claims or a number of creditors, or a combination of both. Other laws establish the requisite majority of creditors within a class, as well as what will constitute a majority of classes. For example, a simple majority of the classes may be required, or where less than a majority of classes support the plan, the plan may nevertheless be made binding on dissenting creditors, both within a class that otherwise supports the plan and where a class does not support the plan, provided the court is satisfied certain conditions are met (see Binding dissenting creditors and Court confirmation below). One law, for example divides claims into three classes and provides that the plan must be approved by at least two of those classes, and that at least one of the approving classes would not recover the full amount of their claims if the debtor were to be liquidated. Another variation requires that at least one of the classes approving the plan will have its rights impaired under the plan, to ensure that the plan is not only supported by those creditors whose rights are not impaired. Other laws provide that support by classes of unsecured creditors cannot force approval of the plan if secured creditors oppose the plan.

344. [279] Although increasing the difficulty of achieving approval, a procedure which includes both the value of claims and number of creditors may be justified on the basis that it protects the collective nature of the proceedings. For example, if a single creditor holds a majority of the value, such a rule prevents that creditor from imposing the plan on all other creditors against their will. Equally, such a provision may prevent a large creditor from imposing its lack of support for the plan on other creditors to their detriment, although there are examples of laws that do provide creditors holding more than a certain percentage of the total value of claims with a power to veto approval or to force an improvement of the terms of the plan for the benefit of all creditors. A voting procedure which combines the value of claims with a number of creditors will also prevent a large number of very small creditors from imposing their decision on a few creditors who hold very large claims. Some insolvency laws include provisions to the effect that even where a majority of the number of creditors support a plan, where those creditors represent less than a certain percentage of value of the total claims (e.g. around 25 or 30 per cent), the court will be reluctant to approve or confirm the plan. This procedure may also be justified on the basis that it helps to ensure the support for the plan is sufficient to enable it to be successfully implemented.

## 6. Where the plan is submitted to creditors for approval but is not approved

### (a) Modification of a plan

345. [291] Where a vote on a reorganization plan fails to achieve the level required for the plan to be approved, an insolvency law may adopt a mechanism that could lead to modification and reconsideration of the plan by creditors. One approach, for example, may be to allow a majority of creditors to vote to adjourn the decision meeting to enable further disclosure, if it appears that some further negotiation on a plan may produce a favourable result or to address unresolved disputes and issues. As with all areas of the insolvency process, however, it is desirable that that adjournment be available in limited circumstances or at least a limited number of times, with perhaps time limits being included to facilitate speedy resolution of the negotiations and avoid abuse.

### (b) Conversion of proceedings

346. [294] In cases where a reorganization plan is not approved and modification of the plan will not resolve the difficulties encountered, an insolvency law may adopt different approaches to the further conduct of the proceedings. Some insolvency laws provide that the failure by creditors to approve the plan should be taken as an indication that they favour liquidation and the reorganization proceedings can be converted to liquidation. This approach may operate to encourage debtors to propose an acceptable plan, safeguards to prevent abuse in cases where liquidation is not in the interests of all creditors may be appropriate. Where reorganization proceedings are converted to liquidation, an insolvency law will need to consider the status of any actions taken by the insolvency representative prior to approval of the plan, as well as the continued application of the stay, particularly to secured creditors when the insolvency law contains a time limit (see part two, chapter III.B.4(c) and recommendation (40)). Other insolvency laws provide that the reorganization proceedings should be dismissed. This approach has the disadvantage of leaving the debtor in a state of financial difficulty, where further debts may accrue and the value of the assets diminish, and postponing the commencement of the liquidation proceedings that may be inevitable.

## 7. Binding dissenting creditors

347. [282] A few countries that provide for voting by secured and priority creditors and for the creation of different classes of unsecured creditors also include a mechanism that will enable the support of one or more classes to make the plan binding on other classes (including, under some laws, classes of secured and priority creditors) which do not support the plan. This is sometimes referred to as a “cram-down” provision. Where such provisions are incorporated in the insolvency law, the law also generally includes conditions that are aimed at ensuring the protection of the interests of those dissenting classes of creditors. Since it is generally the court that is required to consider whether these conditions have been satisfied, they are discussed in the following section.

## 8. Court confirmation of a plan

348. [287] Not all countries require the court to confirm a plan that has been approved by creditors; approval by the requisite majority of creditors is all that is required for the plan to be effective and dissenting creditors will be bound by virtue of the operation of the insolvency law. In those systems, the court, however, may have a role to play with regard to review of the plan where minority creditors challenge the plan itself or the means by which it was procured.

### (a) Objections to approval of the plan

349. Many insolvency laws provide for objections to the approval of the plan to be made at the confirmation hearing, and a number establish the grounds for objection. [290] These may include that approval of the plan was obtained by fraud (e.g. false or misleading information was given or material information was withheld with respect to the reorganization plan); that there was some irregularity in the voting procedure (e.g. related persons participated where this is not permitted under the insolvency law or the resolution approving the plan was not consistent with the interests of creditors generally); that there was some irregularity in the conduct of the meeting at which the vote was taken; that the proposals contained in the plan were put forward for an improper purpose; that the plan is not feasible (e.g. secured assets are required for successful implementation of the plan, but secured creditors are not bound by the plan and no agreement has been reached with relevant secured creditors concerning enforcement of their security interests); that the plan does not satisfy the requirements for protection of dissenting creditors within a class (e.g. they will not receive as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment under the plan); or that the proposals unfairly prejudice the interests of the objector. Since all creditors are likely to be prejudiced to some degree by reorganization proceedings, a level of prejudice or harm that exceeds the prejudice or harm suffered by other creditors or classes of creditors would generally be required. Where the creditor challenging the plan voted in favour of the plan, the grounds for challenge may be limited, for example, to fraud and other impropriety. Where the challenge to the plan is successful, an insolvency law may provide that the plan can be reconsidered by creditors or set aside.

### (b) Steps required for court confirmation

350. [288] Where the insolvency law requires the court (or in some countries an administrative authority) to confirm a plan, it would normally be expected to confirm a plan that has been approved by the requisite majority of creditors (whether voting in classes or otherwise). Many countries enable the courts to play an active role in “binding in” creditors by making the plan enforceable upon a class of creditors that has not approved the plan. This may require the court to undertake a role that is in the nature of a legal formality; it does not require the court to examine the commercial basis upon which the plan was approved but to ensure that the decision of the creditors was properly obtained (i.e. there is no evidence of fraud in the approval process) and that certain conditions were satis-

fied. These conditions may include, for example, that those classes of creditors objecting to the plan will share in the economic benefits of the plan, that no creditor will receive more than the full value of their claim, that normal ranking of claims is recognized by the plan and that similarly situated creditors are treated equally (of course, some insolvency laws provide that creditors can agree to dispense with normal ranking and to different treatment of similarly situated creditors). Under some laws, the court may also be required to assess additional matters, such as that the plan is fair in respect of those classes which have accepted the plan, but whose interests are impaired by the plan, and that the interests of dissenting classes of creditors have been adequately protected (because, for example, they will receive as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment under the plan).

351. [289] Some insolvency laws also give the court the authority to reject a plan on the grounds that it is not feasible or impossible to implement. This may be justified, for example, where secured creditors are not bound by the plan but the plan does not provide for full satisfaction of the secured claims of these creditors. The court may reject the plan in such a case if it considers that secured creditors will exercise their rights against the secured assets, thus rendering the plan impossible to perform. The risk of this occurring can be addressed in provisions relating to preparation and approval of the plan.

352. The more complex the decisions the court is required to make in terms of approval or confirmation, the more relevant knowledge and expertise is required of the judges, and the greater the potential for judges to interfere in what are essentially commercial decisions of creditors to accept or reject a plan. [289] It is desirable, in particular, that the court not be asked to review the economic and commercial basis of the decision of creditors unless it has the competence and experience to do so, nor that it be asked to review particular aspects of the plan in terms of their economic feasibility, unless they have the competence to do so. For these reasons, it is desirable that the requirements for approval of the plan are carefully designed to minimize potential problems arising after these requirements have been satisfied.

### *9. Effect of a plan*

353. [286] Where the plan is approved by the requisite majority of creditors and, where required, confirmed or approved by the court, insolvency laws generally provide that it will be binding upon all affected ordinary unsecured creditors, including creditors who voted in support of the plan, dissenting creditors and creditors who did not vote on the plan. Some insolvency laws also provide that the plan will bind directors, shareholders and members of the debtor, and other parties as determined by the court. Some insolvency laws stipulate that the parties who are bound will be prevented from applying to the court to have the debtor liquidated (except where implementation fails or the debtor fails to perform as required under the plan), to start or continue legal proceedings against the debtor or to pursue enforcement without approval of the court. Some

laws also provide that once the plan is approved by creditors and approved or confirmed by the court (where that is required), the property of the insolvency estate returns to the control of the debtor for implementation of the plan and a debtor may obtain a discharge of debts and claims pursuant to the plan.

### *10. Challenges to a plan after confirmation*

354. [290] Many insolvency laws provide for the plan to be challenged subsequent to the confirmation hearing (in some cases within a specified time period). The grounds for challenge after confirmation may be narrower than the grounds for challenge at the time of confirmation and be limited, for example, to fraud. Where a challenge to a plan that has already been confirmed is successful, an insolvency law may adopt one of a number of possible options, for example that the plan be set aside and the proceedings converted to liquidation or that the debtor be left in its state of financial difficulty and the assets returned to its control. The latter approach does not resolve the debtor's financial difficulty and may simply delay commencement of liquidation proceedings and lead to further diminution of the value of the debtor's assets. In determining the most appropriate action to be taken in these circumstances, consideration will need to be given to the extent to which the plan has already been implemented and how steps taken in the implementation, such as payments to creditors, are to be treated.

### *11. Modification of a plan after approval by creditors (and confirmation by the court)*

355. [292] An insolvency law may include provision for a plan to be modified after it has been approved if its implementation breaks down or it is found to be incapable of performance. Of those insolvency laws that allow modification, some provide for the plan to be modified if the modifications proposed will be in the best interests of creditors. Other laws provide that the plan can be modified if circumstances warrant the modification and if the plan, as modified, continues to satisfy the requirements of the insolvency law concerning, for example, content, classes of creditors and notice to creditors.

356. Depending upon the nature of the modification it may not be necessary to obtain the approval of all classes of creditors but only those affected by the modification. Since in some cases obtaining this approval may prove difficult, an alternative approach may be appropriate. These alternatives may include providing that small modifications can be approved by the court or that creditors who supported approval of the plan should be notified of the proposed modification and can object to that modification within a specified time period or otherwise be deemed to have accepted the modification. The same approach may be taken to creditors who did not approve of the plan. Where the modification proposed is significant, the approval of all creditors may be required. [292] Where the court has confirmed the original plan, it may also be required to confirm the modification to the plan.

## 12. Implementation of a plan

357. [293] Many plans can be executed by the debtor without the need for further intervention by the court or the insolvency representative. But sometimes it may be necessary for the implementation to be supervised or controlled by an independent person. Several insolvency laws provide that the court has an ongoing role in supervision of the debtor after approval and confirmation of the plan, pending completion of implementation. This may be important where issues of interpretation of the performance or obligations of the debtor or others arise. Some countries permit the court to authorize continued supervision of the affairs of the debtor, to varying degrees, by a supervisor or insolvency representative after the confirmation of the plan.

## 13. Where implementation fails

358. Where the debtor defaults in performing the plan or implementation of the plan breaks down for some other reason, some insolvency laws provide that the plan will be terminated, and the debtor liquidated. In that liquidation, insolvency laws generally provide that creditors claims which might have been compromised in the reorganization will be reinstated to the full amount. Other laws provide that the plan will only be terminated in respect of the obligation breached (it otherwise remains valid). The creditor in question is not bound by the plan and will have its claim restored to the full amount. In some cases, this will only occur where the debtor has fallen significantly into arrears<sup>1</sup> in the performance of the plan. In some countries, the consequences of default may be set out in the plan itself.

359. [295] Conversion to liquidation will provide certainty as to the ultimate resolution of the proceedings, although it may lead to further delay and diminution of value if the liquidation proceedings are required to commence as if they were new proceedings. A further approach may be to regard the insolvency proceedings as at an end and allow creditors to take individual actions. This approach does not resolve the financial difficulties of the debtor and could lead to a race for assets that the commencement of collective proceedings was intended to avoid. A compromise approach may be to allow the proposal of a different plan by creditors within a specified deadline and only in situations where no plan can be prepared would liquidation follow. It must be recognized that at some point the balance between achieving the best outcome for all creditors and achieving what is feasible tips in favour of pursuing what is feasible, and it is desirable that an insolvency law be sufficiently flexible to allow this to occur.

## 14. Conversion to liquidation

360. [296] A number of circumstances may arise in the course of a reorganization proceeding where it may be desirable for an insolvency law to provide a mechanism to

<sup>1</sup>In one law, this requires a demand from the creditor for payment of the due liability and failure by the debtor to comply within a minimum period of time of at least two weeks.

convert the proceedings into liquidation. In addition to circumstances where the reorganization plan cannot be approved or where the debtor defaults in implementation of the plan, it may be appropriate to consider conversion where it is determined that there is no reasonable likelihood of the business being successfully reorganized; where it is apparent that the debtor is misusing the reorganization process either by not cooperating with the insolvency representative (e.g. withholding information) or otherwise acting in bad faith (e.g. making fraudulent transfers); where the business continues to incur losses or where administrative expenses are not paid. Because it is the party that, after the debtor or its management, has the greatest knowledge of the debtor's business, and so often learns at an early stage whether or not the debtor's business is viable, the insolvency representative can play a key role in the conversion process. In addition, it may be reasonable to allow creditors or the creditor committee (where one has been appointed), to request the court to convert the proceedings on similar grounds. The court could also be given the power to convert on its own motion where certain conditions are met, for example [...].

## Recommendations

### Purpose of legislative provisions

The purpose of provisions relating to the reorganization plan is to:

- (a) facilitate the rescue of ~~financially troubled~~ businesses subject to the insolvency law, thereby protecting investment and preserving employment;
- (b) facilitate maximization of the value of the insolvency estate;
- (c) facilitate the negotiation and approval of a reorganization plan and establish the effect of approval, including a mechanism to make an approved plan binding on all creditors and other interested parties;
- (d) address the consequences of a failure to propose an acceptable reorganization plan or inability to have the plan approved by creditors, including conversion of the proceedings to liquidation in certain circumstances;
- (e) provide for the implementation of the reorganization plan, including discharge of debts and claims, and the consequences of failure of implementation.

### Content of legislative provisions

#### Preparation of the plan—timing

(121) [(125)] The insolvency law should provide that the reorganization plan is [prepared] [filed] on or after the making of an application to commence insolvency proceedings, or within ~~but no later than the end of~~ a specified time period after commencement of the insolvency proceeding.

- (a) The time period should ~~may be set by the court or alternatively~~ fixed by the insolvency law.
- (b) The court should be authorized to extend the time period in appropriate circumstances.

*Preparation of the plan—  
parties [permitted] [capable]*

(122) [(126)] The insolvency law should ~~specify~~identify the parties ~~responsible~~[permitted to propose] [capable of proposing] for the ~~preparation of the~~ a reorganization plan for approval by creditors.

(123) [(127)] In providing for the preparation of the reorganization plan, the insolvency law should adopt a flexible approach that potentially involves all parties central to the insolvency proceedings, i.e. the debtor, the creditors [although a plan need not impair or alter the rights of every class of creditor] and the insolvency representative. The insolvency law may combine different elements:

(a) An exclusive period may be given to one party to propose a plan. To encourage debtors to apply for commencement of proceedings at an early stage of financial difficulty, it [may] [should] be the debtor that is given that opportunity. The party provided with the exclusive period may be required to consult with other parties in order to ensure that the most acceptable plan will be proposed;

(b) Where no acceptable plan is forthcoming within the exclusive period, other parties, such as the insolvency representative, creditors or the creditors committee in collaboration with the insolvency representative may be given the opportunity to propose a plan, or the court may extend the exclusive period if the party which has the exclusive period can show that an extension is warranted [such as by showing that the delay is justified and that there is a real prospect for reorganization].

*Content of the plan*

(124) [(128)] The insolvency law should specify the minimum contents of a reorganization plan, which should include:

(a) Detail as to the classes of creditors and the treatment provided for each class by the plan (e.g. how much they will receive and the timing of payment);

(b) the terms and conditions of the plan, including;

(i) treatment of contracts, including ~~employment~~labour contracts;

(ii) the debtor's role in implementation of the plan, including control over assets;

(c) means for the implementation of the plan which may include:

(i) the possibility of sale of all or any part of the debtor's business;

(ii) proposed changes in the capital structure of the debtor's business;

(iii) amendment of the debtor's charter;

(iv) merger or consolidation of the debtor with one or more persons;

(v) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(vi) distribution of all or any part of the assets of the insolvency estate among those having an interest in those assets;

(vii) identification of those responsible for future management of the entity;

(viii) supervision of the implementation of the plan.

*[Explanatory] [disclosure] statement*

(125) [(129)] The insolvency law should require a reorganization plan submitted for the approval of creditors to be accompanied by a [explanatory] [disclosure] statement that will enable creditors to make an informed decision about the plan. The statement should be prepared by the same party as prepares the reorganization plan, be submitted to creditors at the same time as submission of the reorganization plan and include:

(a) information relating to the financial situation of the debtor including asset and liability and cash flow statements;

(b) a comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;

(c) the basis upon which the business would be able to keep trading and could be successfully reorganized; and

(d) information showing that, having regard to the effect of the plan, the assets of the debtor will exceed its liabilities and the debtor will have the cash flow to pay its [matured debts] [its debts as provided in the plan].

*Submission of the plan and [explanatory] [disclosure] statement*

(126) The insolvency law should provide a mechanism for submission of the reorganization plan and [explanatory] [disclosure] statement to creditors.

*Voting mechanisms*

(127) [(130)] The insolvency law should establish a mechanism for voting on approval of the reorganization plan. This mechanism should address the creditors who are required to vote on the plan; the manner in which the vote can be conducted, either at a meeting of creditors convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether or not creditors should vote in classes according to their respective rights or as a general body of creditors.

*Approval of the plan by creditors of a particular class*

(128) [(131)] The insolvency law should establish the majority required for approval of the reorganization plan by a particular class of creditors. Where the required majority of creditors in that class supports the plan, that class of creditors will be regarded as supporting the plan. The majority should be limited to those creditors actually vot-



ing, whether in person or by proxy. A majority based on unanimity or a simple majority of the number of creditors voting is not recommended. Alternative approaches may include a combination of the number of creditors voting and the amount of claims, in proportions such as a simple majority of the number of creditors voting combined with a simple or greater (for example, two-thirds) majority in amount of the claims of those voting.

#### *Approval by majority of classes of creditors*

(129) Where creditors vote on approval of the reorganization plan in classes, the insolvency law may require approval by a specified majority of classes.

(130) [(132)] The insolvency law should address the treatment of those classes of creditors which do not vote in support of the reorganization plan in those cases where the plan satisfies the requirements for approval and is approved by the requisite majority.

#### *Objections to approval*

(131) [(135)] The insolvency law should allow interested parties, including the debtor, to object to the approval of the reorganization plan before it is confirmed or otherwise becomes binding on creditors and specify the time at which that challenge may be made. The law may include criteria against which the challenge can be assessed, including that:

- (a) the approval process was improperly conducted;
- (b) creditors will not receive at least as much under the plan as they would have received in liquidation, unless they agree to receive lesser treatment; or
- (c) the plan contains provisions forbidden by law.

#### *Effect of the plan*

(132) The insolvency law should provide that an approved reorganization plan will bind the debtor, creditors, stakeholders and any other person [specified in the plan], either by operation of the insolvency law or through confirmation of the plan by the court.

#### *Confirmation of the plan*

(133) [(133)] Where the insolvency law provides for the court to confirm the reorganization plan, the court should ~~refuse to~~ confirm the plan if:

- (a) requirements of the insolvency law for notice of commencement of proceedings; preparation and submission of the plan and disclosure statement; and approval of the plan process was improperly conducted are met;
- (b) the plan does not contain provisions forbidden by law;
- (c) creditors will receive at least as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment.

#### *Post-approval [post-confirmation] amendment of the plan*

(134) [(136)] The insolvency law should include limited provision for amendment of the reorganization plan, specifying the parties that may propose amendments and the time at which the plan may be amended. The limited circumstances in which the plan may be amended may include where, after approval [and confirmation], implementation of the plan breaks down or the plan is found to be incapable of implementation in whole or in part, and the matter can be ~~easy~~ remedied.

#### *Approval of amendments*

(135) [(136)] The insolvency law should address the mechanism for approval of amendments to the plan. ~~The amended plan should be subject to~~ That mechanism may require notice to and approval by the creditors and satisfaction of the rules for confirmation, or [other requirements?].

#### *Challenges to the plan after confirmation [during implementation]*

(136) The insolvency law may provide for the plan to be challenged once it has been confirmed on the basis of improper conduct of the approval process, obtaining of the approval by fraud or [other grounds?].

#### *Supervision of implementation*

(137) [(137)] The insolvency law may establish a mechanism for supervising implementation of the plan, including supervision by the court, or by a court appointed supervisor, by the insolvency representative, or by a creditor-appointed supervisor.

#### *Failure of implementation*

(138) [(138)] The insolvency law should provide that where implementation of the reorganization plan fails and the plan cannot be amended, the proceedings should be converted to liquidation. Payments made in the course of the implementation of the plan should be protected from the operation of avoidance powers in any subsequent liquidation.

~~(a) the plan can be terminated; and~~

~~(b) if the reorganization proceedings have not closed, the proceedings can be converted to liquidation.~~

#### *Closing [and reopening] of proceedings*

~~(139) After an insolvency estate is fully administered [and the insolvency representative discharged] the court should close the proceedings.~~

~~(140) [reopening]~~

**B. (Expedited) reorganization proceedings  
[Recognition of a reorganization plan negotiated and  
agreed prior to commencement of reorganization  
proceedings]**

**1. Introduction**

361. As discussed above in part one of the Guide, reorganization can take one of several forms including, principally, reorganization conducted under the formal supervision of a court or administrative body (the main form of reorganization discussed in this Guide) and informal or out-of-court reorganization (sometimes referred to as voluntary reorganization) which requires little or no court involvement and essentially depends upon the agreement of the parties involved. Because many of the costs, delays and procedural and legal requirements of a formal reorganization proceedings can be avoided where out-of-court reorganization procedures are used, they often can be the most cost efficient means of resolving a debtor's financial difficulties. [A/CN.9/507, para. 244] As such these types of procedures can be valuable tools in the range of insolvency procedures available to a country's commercial and business sector.

362. [507/para. 244] Encouraging the use of out-of-court reorganization need not stem from the fact that a country's formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such reorganizations can offer as an adjunct to a formal insolvency system which delivers fairness and certainty.

**2. Out-of-court reorganization**

*(a) Creditors typically involved*

363. [507/para. 244] An out-of-court reorganization typically involves negotiations between the debtor and one or more classes of creditors, such as lenders, bondholders and shareholders. It also frequently involves major non-institutional creditors, typically where such creditors' involvement is so considerable that an effective restructuring is not possible without their participation. These types of creditors often find it advantageous to participate in out-of-court reorganization because there is a potential to reduce the loss that they would otherwise suffer under full court-supervised insolvency proceedings.

364. The limited classes of creditors that would normally participate in out-of-court proceedings makes them easier to accomplish than full court supervised reorganization, which typically affects all claims, including trade, employee and governmental claims. [507/para. 244] It is usual in out-of-court reorganization for these types of non-institutional creditors to continue to be paid in the ordinary course of business. On that basis, these creditors are not likely to have any objection to the proposed restructuring and therefore do not need a voice in the process. Where, however, such creditors were not, or ceased to be, paid in the ordinary course of business, they would have the right to commence full proceedings under the insolvency law.

*(b) Impediments to achieving consensus*

365. Out-of-court reorganization is often impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of certain existing classes of debt. These problems are magnified in the context of complex, multinational businesses, where it is especially difficult to obtain consents from all relevant parties. To assist the conduct of out-of-court reorganization, the International Federation of Insolvency Professionals (INSOL) developed the *Principles for a global approach to multi-creditor workouts*. [A/CN.9/WG.V/WP.55, para. 10] The Principles are designed to expedite out-of-court processes and increase the prospects of success by providing guidance to diverse creditor groups about how to proceed on the basis of some common agreed rules (for the text of the Principles see ...).

366. Out-of-court reorganization can also be impeded by a minority of affected creditors who may refuse to agree to a reorganization that is in the best interests of most creditors in order to take advantage of their position to extract better terms for themselves at the expense of other parties (often referred to as "holding out"). Where these hold-outs occur, the negotiated agreement can only go ahead if by some means the contractual rights of these dissenting creditors can be modified without their consent. [507/para. 244] Under most existing legal systems, such a modification of contractual rights requires the out-of-court reorganization to be converted to a full court-supervised reorganization proceeding under the insolvency law, involving all creditors and including standards of treatment that appropriately protect the interests of dissenting creditors. Timing is typically critical in business reorganization and delay (usually inherent in full court-supervised insolvency proceedings) can frequently be costly or even fatal to an effective reorganization. It is therefore important that the court be able to take advantage of any negotiations and work done prior to the commencement of reorganization proceedings under the insolvency law and that the insolvency law permits the court to expedite those reorganization proceedings.

**3. Proceedings to recognize a reorganization plan negotiated and agreed out-of-court**

367. Where an insolvency law provides for recognition of a plan negotiated and agreed before commencement of a reorganization proceeding under the insolvency law and also provides for expedition of that reorganization proceeding, consideration may need to be given to defining the debtors to whom it might apply and the parties that can be affected by such a proceeding.

*(a) Eligible debtors*

368. This type of proceeding may be available, for example, on the application of any debtor which is in a position of imminent insolvency but has not generally ceased making payments, in a position of temporary insolvency, or in a position where it can continue paying trade creditors in the ordinary course of business but has a moratorium agreed to allow for a reorganization of financial debt.

Where the insolvency law establishes an obligation to commence insolvency proceedings where the debtor meets specified criteria concerning its financial position (e.g. that it has generally ceased making payments), it may be necessary to consider providing an exception for the type of proceeding described in this section or to provide a temporary moratorium which will enable the debtor to avoid meeting those criteria (and thus avoid the sanctions for failure to meet the obligation to apply for commencement). [Where there is a pre-petition plan negotiated and accepted between the debtor and creditors, there is no need to consider providing for a creditor application for commencement of such proceedings.]

*(b) Obligations affected*

369. As noted above, the types of obligations typically involved in out-of-court reorganization relate to borrowed money indebtedness, both institutional and public whether secured or unsecured, and other similar financial obligations. Secured debt would be included in such reorganizations with the agreement of the secured creditors. Indebtedness held by other creditors, such as trade creditors and employees would not generally be affected unless they individually agreed to adjustment of their claims. The specific obligations to be affected in any given case would be those identified in the plan which is to be enforced under this type of proceeding.

*(c) Application of the insolvency law*

370. In addition to identifying eligible debtors and determining who may apply for commencement of this type of proceeding, a regime providing for this type of proceeding will need to identify those provisions of the insolvency law applicable to full court-supervised proceedings that will apply to these proceedings, particularly if any changes are to be made in the manner in which they apply. So, for example, the provisions which would generally apply to this type of proceedings in the same manner as for full court-supervised proceedings (unless specifically modified) might include provisions on: application procedures; commencement; application of the stay; requirements for preparation of a list of all creditors (in order to inform the court, and provide notice and certainty as to who is affected by the plan and who is not); requirements for approval of the plan (including notice to affected creditors, determination of classes of creditors, creditor committees, criteria and majorities required for approval); effect and confirmation of the plan; and discharge of claims.

371. Provisions of the insolvency law that might not apply to this type of proceeding would include those relating to: the requirement for general cessation of payments or insolvency; appointment of the insolvency representative, unless there is provision for such an appointment in the plan; making of claims; requirements for notice and time periods for plan approval (where included in the insolvency law); and voting on the plan. A further and important exception to the application of the insolvency law would be that creditors not affected by the plan could continue during the proceedings to be paid in the ordinary course of business.

372. The application for commencement of this type of proceeding may need to be somewhat different to an application for full court-supervised proceedings to take account of the different background considerations. The application could include, for example, additional information concerning the negotiations that have already been conducted and the voting of affected classes of creditors, and the protections afforded to dissenting creditors within accepting classes. An insolvency law may also need to address the question of whether the application will function as an automatic commencement of the proceedings or whether the court will be required to consider the application; if court consideration is required it is desirable that the time for such consideration be as brief as possible.

*(d) Expedition of the proceedings*

373. In order to take full advantage of the agreement negotiated out-of-court and avoid the delays that may make that agreement impossible to implement, an insolvency law may need to consider how this type of proceeding can be handled more quickly than full court-supervised reorganization proceedings. [507/para. 244(a)] For example, if a plan and other documentation that complies with the formal requirements of the insolvency law has been negotiated informally and is supported by a substantial majority, it may be possible for the court to order an immediate meeting or hearing as applicable, saving time and expense. [507/para. 244(b)] It may also be possible for an exemption to be granted from part of the formal process. For example, if an informally negotiated plan has been agreed by a sufficient majority of creditors of a particular class to approve a reorganization plan under the voting requirements of the insolvency law—typically the institutional creditors—and the rights of other creditors will not be impaired by the implementation of the plan, it might be possible for the court to order a meeting or hearing of that particular approving class of creditors only.

374. [507/para.244] Even though the insolvency law may provide for eligible cases to be treated expeditiously, it is highly desirable that it does not afford less protection for dissenting [non-assenting] creditors and other parties under such a procedures than the insolvency law provides for such dissenting creditors in full court-supervised reorganization proceedings. The procedural requirements for such (expedited) reorganization proceedings would therefore include substantially the same safeguards and protections as provided in full court-supervised reorganization proceedings.

375. [507/para. 244] Other laws may need to be modified to encourage or accommodate both out-of-court reorganization and this type of (expedited) reorganization proceedings. Examples of those laws might include those that require unanimous consent to adjust indebtedness outside of insolvency proceedings, that expose directors to liability for trading during the period when an out-of-court reorganization is being negotiated, that do not recognize obligations for credit extended during such a period or subject those obligations to avoidance provisions, and that restrict conversion of debt to equity.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions relating to insolvency procedures which combine out-of-court negotiation and acceptance of a reorganization plan with an expedited procedure conducted under the insolvency law for court approval of that plan is to:

(a) recognize that out-of-court reorganization, which typically involves restructuring of the debt due to lenders and other institutional creditors, and major non-institutional creditors where their participation is crucial to the restructuring, but not involving all categories of creditors, is a cost-effective, efficient tool for the rescue of financially troubled businesses;

(b) encourage and facilitate the use of out-of-court reorganization;

(c) develop a procedure under the insolvency law that will:

- (i) preserve the benefits of out-of-court reorganization negotiations where a majority of each affected class of creditors [and equity holders] agree to a reorganization plan;
- (ii) minimize time delays and expense and ensure that the agreement reached in out-of-court negotiations is not lost;
- (iii) bind those minority members of each affected class of creditors [and equity holders] who do not accept the reorganization plan negotiated out-of-court;
- (iv) be based upon the same procedural requirements, but shortened time periods, as full reorganization proceedings under the insolvency law, including essentially the same safeguards for dissenting affected creditors;

(d) recognize that requirements in other laws may prevent or inhibit the use of procedures which do not invoke the insolvency law, such as requirements for unanimous consent for adjustment of indebtedness outside of insolvency proceedings, liability for directors where the debtor continues to trade during the period when the out-of-court reorganization is being negotiated, that do not recognize obligations for credit extended during such a period, and that restrict conversion of debt to equity.

### Content of legislative provisions

#### *Commencement of (expedited) reorganization proceedings*

(139) [(141)] A debtor [which is eligible under the insolvency law] may file an application to commence expedited reorganization proceedings [to implement] The insolvency law should provide that this type of proceeding is available on the application of any debtor [which is not a natural person] that will be unable to pay its debts as they mature (but has not generally ceased making payments) where a plan of reorganization has been negotiated and accepted by the vote of a majority of each affected class of creditors [and equity holders] and by each affected creditor not part of a voting class prior to the application to commence reorganization proceedings.

#### *Application requirements*

(140) [(142)] The insolvency law should provide that where the debtor can satisfy the requirements of recommendation (139) and the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law, the application for commencement of this type of proceeding should be accompanied by the following additional materials:

(a) the reorganization plan and [explanatory] [disclosure] statement;

(b) a description of the out-of-court reorganization activity that preceded the making of the application for commencement, including [evidence] that appropriate notice was given to all members of affected classes of creditors and that adequate information was provided to affected creditors [and equity holders] to enable them to make an informed decision about the plan [or a summary of that information];

(c) certification that unaffected creditors are being paid in the ordinary course of business and that the plan does not modify or impair the rights or claims of [fiscal][tax] authorities or employees;

(d) a report of the votes of affected classes of creditors [and equity holders] demonstrating that those classes have accepted the reorganization plan by the majorities specified in the reorganization law;

(e) a report of the acceptance of any individual creditors which are not members of an affected class;

(f) a financial analysis prepared by [the debtor] [an independent expert] [or other evidence acceptable to the court] which demonstrates that the reorganization plan is feasible [and that dissenting creditors will receive at least as much as they would have received in a liquidation proceeding under the insolvency law]; and

(g) a list of the members of any creditor committees formed during the course of the out-of-court reorganization.

#### *Effect of commencement*

(141) [(143)] The insolvency law should provide that the application for commencement will [function as automatic commencement of proceedings] [be acted upon by the court as expeditiously as possible] and that:

(a) the effects of commencement should be limited to the debtor, individual creditors and classes of creditors [and equity holders] [those parties] whose rights are modified or who are affected by the plan;

(b) any creditor committee formed during the course of the out-of-court reorganization should be treated as a creditor committee appointed under the insolvency law;

(c) provisions of the insolvency law that apply to full reorganization proceedings shall also apply to this type of expedited reorganization proceeding unless identified as not being applicable<sup>2</sup>; and

<sup>2</sup>Provisions of the insolvency law that would not be applicable would include: the requirement for insolvency of the debtor; full claim filing; notice and time periods for plan approval; mechanics of voting; no insolvency representative would be appointed unless required by the plan; provisions on amendment of the plan after confirmation; and [...].

An exception to the insolvency law would be that creditors not affected by the reorganization plan would be paid in the ordinary course of business during the implementation of the plan.

(d) a hearing on the confirmation of the reorganization plan should be held as expeditiously as possible.

#### *Notice of commencement*

(142) [(144)] The insolvency law should provide that notice of the commencement of this type of reorganization proceeding should promptly be provided to all known creditors [and equity holders] and should indicate:

(a) the amount of each affected creditor's claim according to the debtor;

(b) the time period for submitting a claim in a different amount if the affected creditor disagrees with the debtor's statement of claim, and specify the place where the claim can be submitted; and

(c) the time and place for the hearing on confirmation of the reorganization plan, and for the submission of any objection to confirmation.

#### *Confirmation of the plan*

(143) [(145)] The insolvency law should provide that the court ~~should~~ will confirm the reorganization plan where it determines that:

(a) the plan satisfies the requirements for confirmation of a plan in a full court-supervised non-expedited reorganization proceeding, in so far as those requirements apply to affected creditors [and equity holders];

(b) the notice given and the information provided to affected creditors [and equity holders] during the out-of-

court reorganization was sufficient to enable them to make an informed decision about the plan [and any pre-commencement solicitation of acceptances to the plan complied with applicable non-insolvency law];

(c) the financial analysis submitted with the application is satisfactory and demonstrates that the reorganization plan is feasible [and that dissenting creditors [and equity holders] will receive as much under the reorganization plan as they would in a liquidation proceeding under the insolvency law];

(d) unaffected creditors are being paid in the ordinary course of business and the plan does not modify or impair [rights] [claims] of [fiscal][tax] authorities or employees.

#### *Effect of a confirmed plan*

(144) The insolvency law should provide that the effect of a plan confirmed by the court under this type of reorganization proceeding should be limited to those creditors who took part in the negotiation and approval process.

#### *Failure of implementation of the plan*

(145) The insolvency law should provide that where the debtor fails to meet the obligations of the plan confirmed in accordance with recommendation (143), the plan should be terminated and creditors may exercise their rights at law, as modified by the plan.

## A/CN.9/WG.V/WP.63/Add.13

### Draft legislative guide on insolvency law

#### Note by the secretariat

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV.A-D appear in documents A/CN.9/WG.V/WP.63/Add.10-11, chapter V appears in document A/CN.9/WG.V/WP.63/Add.12; chapter VI.B-E and chapter VII appear in subsequent addenda]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

**VI. MANAGEMENT OF PROCEEDINGS**

**A. Treatment of creditor claims**

**1. Introduction**

376. [215] Claims by creditors operate at two levels in insolvency proceedings—firstly, for purposes of determining which creditors may vote in the proceedings and how they may vote (according to the class of creditor into which they fall) and secondly, for purposes of distribution (see part two, chapter VI.C). The procedure for submission of claims and their admission or non-admission is therefore a key part of the insolvency procedure and consideration should be given to determining which creditors should be required to submit claims, the procedures applicable to the submission of claims, the procedure for verification and admission (or non-admission) of claims, the consequences of failure to make a claim, and review of decision concerning the admission or non-admission of claims. An insolvency law should also address the effect of submission and admission of claims, as this will be key to creditor participation. For example, submission of a claim may entitle a creditor to participate at the first meeting of creditors, while admission, or at least provisional admission, may be essential to enable a creditor to vote on various matters in the proceedings.

**2. Submission of creditor claims**

*(a) Creditors who may be required to submit claims*

377. The principal issue with regard to deciding which creditors will be required to submit a claim relates to the treatment of secured creditors, since unsecured creditors (irrespective of whether the debt is contingent or liquidated) are generally required to submit a claim (unless of course, the claims procedure provides that not all creditors are required to file claims).

378. Under those insolvency laws that do not include secured assets in the insolvency estate and allow secured creditors to freely enforce their secured interest against the secured assets, secured creditors may be excluded from the requirements to submit a claim to the extent that their claim will be met from the value of the sale of the secured asset. To the extent that the value of the secured asset is less than amount of the secured creditor's claim, the creditor may be required to submit a claim as an ordinary unsecured creditor. The value of the unsecured claim depends upon the value of the secured asset and the time at which that value is determined and the method of valuation used, and unless clear rules apply to valuation, there is the potential for some uncertainty, particularly in terms of deciding voting rights.

379. Other insolvency laws allow secured creditors to surrender the security to the insolvency representative and to submit a claim for the total value of the secured interest. A further approach requires secured creditors to submit a claim for the total value of the secured interest (ir-

respective of the surrender of the security), a requirement which in some laws is limited to the holders of certain types of security, such as floating charges, bills of sale, or security over chattels. Where secured creditors are required to submit a claim, the procedures for submission and verification are generally the same as for unsecured creditors. The approach of requiring secured creditors to submit claims has the advantage of providing information to the insolvency representative as to existence of all claims and the amount of the outstanding debt. Whichever approach is chosen, it is desirable that an insolvency law includes clear rules on the treatment of secured creditors for the purposes of submission of claims.

*(b) Limitations on claims that can be submitted*

*(i) Post-commencement debt*

380. [234] As a general principle, claims can only be submitted in respect of debt incurred prior to commencement. How debt incurred after commencement is treated will depend on the nature of the proceedings and what is provided in the insolvency law—many laws provide that they are payable in full as costs of the proceedings (see part two, chapter VI.C.1(b)).

*(ii) Types of excluded claims*

381. [246] For a variety of public policy reasons, an insolvency law may seek to exclude certain types of claims. Examples include foreign tax claims, fines and penalties, claims relating to personal injury, claims relating to negligence and gambling debts. Other insolvency laws provide that such claims can be submitted but they may be subject to special treatment, such as subordination to other unsecured claims. It is highly desirable that an insolvency law identifies those claims that are to be excluded from the insolvency process (or subjected to special treatment—see part two, chapter VI.C).

382. [247] Foreign tax claims are currently excluded by many countries, and it is generally recognized that such an exclusion does not violate the objective of equal treatment of foreign and domestic creditors. Despite this general view, however, there are no compelling reasons why such claims cannot be admitted if a country wishes to do so. Where foreign tax claims are admitted, they can be treated in the same manner as domestic tax claims or as ordinary unsecured claims. Article 13(2) of the UNCITRAL Model Law on Cross-Border Insolvency recognizes these different approaches, providing that the requirement of equal treatment of foreign and domestic creditors is not affected by the exclusion of foreign tax and social security claims or by their ranking on the same level as general non-preference claims or lower if equivalent local claims have that lower ranking.

383. [248] Where gambling debts are treated as excluded claims it is generally on the basis that they arise from an activity that is itself illegal. Rather than focusing upon the specific types of claims that may be excluded as illegal, an insolvency law may exclude, as a general category, those claims that arise from illegal activity and are thus unenforceable.

384. [249] With respect to fines and penalties, an insolvency law may distinguish between those that are of a strictly administrative or punitive nature (such as a fine imposed as the result of an administrative or criminal violation) and those of a compensatory nature. It may be argued that the first category should be excluded on the basis that they arise from some wrongdoing on the part of the debtor and unsecured creditors should not be made to bear the burden of that wrongdoing by seeing a reduction in the assets available for distribution. In comparison, there would seem to be no compelling reason for excluding the second category, particularly where it relates to recompense for damage suffered by another party, except to the extent that exclusion may also be justified as a means of increasing the assets available to unsecured creditors. An alternative approach would be to admit claims based on fines and penalties because otherwise they will remain uncollected [*other reasons?*].

(c) *Procedure for submission of claims*

(i) *Timing of submission of claims*

385. [236] To ensure that claims are submitted in a timely fashion and that the insolvency proceedings are not unnecessarily prolonged, deadlines for submission of claims can be included in an insolvency law, or be determined by the court or by the insolvency representative. Some insolvency laws provide, for example, that the court, when deciding to commence proceedings, will establish a deadline for the making of claims; in some cases that deadline is to be within a range established by the insolvency law, and examples range from 10 days to three months. Other insolvency laws do not establish any deadlines for submission, and may provide for the insolvency representative to determine the timing of submission of claims, or provide for claims to be filed at any time up until the final report and accounting by the insolvency representative. Some insolvency laws provide for different time limits depending upon the method of notification of commencement; where the creditor is a known creditor and receives personal notification of the commencement of proceedings the time limit may be shorter than where the creditor has to rely on public notification of commencement.

386. While these deadlines may assist in ensuring that the claims process does not impose unnecessary delay on the proceedings, they [236] may operate to disadvantage foreign creditors who in many cases may not be able to meet the same deadlines as domestic creditors. To ensure the equal treatment of domestic and foreign creditors, and to take account of the international trend of abolishing discrimination based upon the nationality of the creditor, it may be possible to adopt an approach that either allows claims to be submitted at any time prior to distribution, or sets a time limit which can be extended or waived where a creditor has good reason for not complying with the deadline, or where the deadline operates as a serious impediment to a creditor. Where the claim is submitted late and causes costs to be incurred, those costs could be borne by the creditor.

(ii) *Burden of submitting and proving claims*

387. [235] Many insolvency laws place the burden of submitting and proving their claim upon creditors. Generally they will be required to produce evidence as to the amount of the claim, the basis of the debt and any preferences or security claimed. In some cases this information is to be provided by way of a standard claim form, but in any event the claim generally is to be accompanied by supporting documentation. Many laws provide that the insolvency representative is entitled to request the creditor to provide more information or documentation to prove their claim. Some insolvency laws provide that creditors do not have to prove their claim in all cases, such as where the insolvency representative is able to ascertain, from the debtor's books and records, which creditors are entitled to payment. Those creditors may be required, however, to notify the insolvency representative of their claim.

388. [253] An approach which does not require creditors to submit a claim in all cases may be facilitated where the insolvency law requires, as an initial step in the proceedings, that a list of creditors and claims is prepared, either by the court or by the debtor, with the assistance of the insolvency representative. Preparation of such a list by the debtor takes advantage of the debtor's knowledge about its creditors and their claims and gives the insolvency representative an early indication of the state of the business. An alternative would be to require the insolvency representative to prepare that list, an approach that may serve to reduce the formalities associated with the process of verification of claims, but may add to expense and delay, as it would rely upon the insolvency representative obtaining accurate and relevant information from the debtor. Once the list is prepared, it could be used to assess which creditors should be invited to make their claims to the insolvency representative for purposes of verification or for the purposes of ensuring that all relevant creditors have submitted claims. The list can also be revised and updated over time to provide an accurate indication of the level of the debtor's indebtedness.

(iii) *Formalities for submission of foreign claims*

389. [238] An issue of particular importance to foreign creditors is whether the claim must be submitted in the language of the jurisdiction in which the insolvency proceedings have commenced, and whether the claim is subject to certain formalities, such as notarization and translation. To facilitate the access of foreign creditors, consideration may be given to whether these requirements are essential or may be relaxed as in the case of other procedural formalities discussed in respect of article 14 of the UNCITRAL Model Law on Cross-Border Insolvency (see part two, chapter VIII).

(iv) *Conversion of foreign currency claims*

390. [250] The valuation of claims is of particular relevance to foreign creditors who will generally make their claims in currencies other than that of the country of the insolvency proceedings. For verification and distribution

purposes, these claims are normally converted into the domestic currency. The date of conversion may have been agreed in the contract between the debtor and creditor, or it may be set by reference to the stages of the proceedings, such as commencement or some later time. If the date of conversion is set at the date of commencement of the insolvency proceedings, and the currency depreciates or appreciates in the period before distribution (which could occur at a significantly later time), the amount of the claim will also fluctuate. An alternative approach is to make a provisional conversion at the time of commencement for the purposes of voting, but if the exchange rate fluctuates more than a given percentage (which may be stipulated in the insolvency law) in the period before distribution, then the conversion can be made at the time of distribution or an appropriate adjustment made to the earlier calculation.

(v) *Party authorized to receive claims*

391. Insolvency laws generally adopt one of two approaches to this question. Some laws require the claim to be submitted to the court, while others provide for claims to be submitted to the insolvency representative. The reason for the difference generally relates to the process of verification and whether it is conducted by the court or the insolvency representative.

(d) *Failure to submit claims*

(i) *Failure to submit within a stipulated time period*

392. Different approaches are taken in respect of those claims not submitted within the specified time limit (where the insolvency law, the court or the insolvency representative imposes such a limit). Some insolvency laws adopt a flexible approach providing that notwithstanding the application of a deadline, claims still can be filed at any time up to the insolvency representative's final report and accounting in liquidation, but the creditor must bear any additional costs associated with submitting a claim at such a late stage. One consequence of late submission may be that the creditor cannot participate in interim distributions occurring before submission (or admission) of the claim, although there are examples of laws which provide for the creditor to receive previous interim dividends once the claim has been admitted. A further consequence is the loss of the right to vote at meetings of creditors.

393. Another approach is to adhere strictly to submission deadlines, and some laws provide that failure to file a claim may result in the debt being extinguished or security rights being waived or forfeited. It should be noted, however, that in the case of one law which follows this approach, the law requires creditors protected by registered security rights and leasing agreements to be personally notified of commencement of proceedings and of the need to submit a claim. Other laws require the creditor who has failed to submit its claim to petition the court to admit its claim. Where admitted, the creditor will only share in future dividends.

(ii) *Failure to submit a claim before conclusion of the proceedings*

394. The failure of a creditor to submit a claim before the final report and accounting may lead to different results depending upon other provisions of the insolvency law. Where the insolvency law provides for a discharge of the debtor upon conclusion of the insolvency proceedings, some of those laws provide that unsubmitted claims are forfeited [*are there other approaches?*]

### 3. *Procedure for verification and admission*

(a) *List of submitted claims*

395. Many insolvency laws require the court or the insolvency representative, depending upon requirements for submission, to prepare a list of submitted claims, either after expiry of the deadline for submission of claims or on a continuing basis in cases where there is no deadline. Where the insolvency law requires preparation of a list of creditors (see para. 388), the list of claims would update that earlier list of creditors. The list of claims can be used as the basis of verification and admission of claims and for notification as to the receipt, admission or non-admission of claims, depending upon the applicable admission procedure. [239] Many insolvency laws provide that all identified and identifiable creditors are entitled to receive notice of claims that have been made. This will enable creditors to see what claims have been submitted and to object to the claims of other creditors (where this is permitted under the insolvency law). The notification may be given personally, by publishing notices in appropriate commercial publications or by filing the list with the court.

(b) *Procedures for verification and admission*

396. [241] Verification involves not only an assessment of the underlying legitimacy and amount of the claim, but also classification of a claim for purposes of voting and distribution (e.g. secured or unsecured claims; pre-commencement or post-commencement claims, priority and so on).

(i) *Deadline for verification and admission*

397. A number of insolvency laws impose time limits for verification and admission of claims, requiring that a decision be provided to creditors within a short period such as 30 days after the expiry of the deadline for submission. Other laws make no provision for time limits.

(ii) *Admission procedure*

398. Where claims are submitted to the insolvency representative, insolvency laws provide that those claims will be admitted by the insolvency representative, or the insolvency representative will be required to convene a meeting of creditors to scrutinize those claims. Where claims are submitted to the court, the court will convene that meeting or hearing. One issue that may be of concern to foreign creditors is the requirement in some insolvency laws for



them to attend such meetings in person in order for their claims to be admitted. Such a requirement has the potential to frustrate the goal of equal treatment of similarly situated creditors, and it is desirable that claims of foreign creditors can be admitted on the basis of documentary evidence without the additional formality of personal appearance.

399. [242] Many insolvency laws provide that where the claim is to be submitted to the insolvency representative, it is for the insolvency representative to verify the claims and decide whether or not the claims should be admitted, whether in whole or in part. The creditor will be notified of the insolvency representative's decision and where the claim is not admitted, or admitted only in part, the insolvency representative is generally required to provide reasons for that decision (often required to be given in writing). Such a requirement is likely to enhance the transparency of the procedure and potentially its predictability for creditors. Some insolvency laws provide that the insolvency representative's decisions on admission of claims are to be updated on the list of claims that is filed with the court or made public in some other way in order to facilitate consideration by other creditors and the debtor. Where following appropriate notification the insolvency representative does not receive any objections to claims proposed to be admitted, a number of insolvency laws provide that the claim is deemed to be admitted.

400. Under some insolvency laws the insolvency representative is required to convene a meeting of creditors to consider submitted claims on the basis of the list prepared by the insolvency representative. That list may be required to include recommendations as to admission, value and priority of individual claims. Where no objections to admission of claims are made at that meeting, the insolvency representative's recommendations may be deemed under the insolvency law to be approved or the claims admitted. A similar procedure is followed where claims are submitted to the court.

401. [243] With a view to minimizing the formalities required for verification and admission of claims, an alternative approach to those outlined above may be to provide that claims outstanding at the time of commencement do not require verification and can be admitted on an automatic basis unless the claim is challenged. This approach will require some mechanism for determining the existence of claims, and it may not be sufficient to rely upon the books and records of the debtor to identify all claims as these may not provide a sufficiently reliable or complete source of information. If an approach of automatic admission is adopted, it may be desirable to combine it with a mechanism aimed at ensuring that adequate information as to the claims admitted on that basis is available to all interested parties. Automatic admission of claims may avoid many of the difficulties associated with the insolvency representative having to make a precise assessment of the situation at the outset of the proceedings to enable creditors to participate in and vote at meetings held at an early stage of the proceedings. Automatic admission of claims may be assisted by requiring claims to be submitted in the form of a declaration, such as an affidavit, to which sanctions would attach in the event of fraud. It could also be assisted by admitting claims that are supported by prop-

erly maintained accounting records or allowing creditors to accept as correct the amount of their claim as shown in the records of the debtor that are kept in the ordinary course of business. It may be desirable for an insolvency law to address the question of false claims and the applicable sanctions.

(iii) *Provisional admission of claims*

402. [240] Creditors claims may be of two types: those that involve a determined amount and those where the amount owed by the debtor has not been or cannot presently be determined. Such claims may be either contractual or non-contractual in nature and may arise in respect of both secured and unsecured claims. Claims may also be conditional, contingent and not mature at the time of commencement (the latter would generally be subject to a deduction for the unexpired period of time before maturity).

403. [240] Where the amount of the claim cannot be or has not been determined at the time the claim is to be submitted, many insolvency laws provide for a claim to be admitted provisionally or to be given a provisional value. Admission of provisional claims raises a number of issues. These concern valuation of the claim and the party to undertake that valuation (the insolvency representative, the court or some other appointed person); voting of provisional creditors on important issues such as determining whether the case is one of liquidation or reorganization or approval of the reorganization plan; and whether, as minority creditors, they can be bound by a plan to which they have not agreed (see part two, chapter V). Where an insolvency law provides for provisional admission of claims, it may be necessary to consider whether such claims will be subject, in the first instance, to the same procedure as other claims. For example, where admission involves a hearing before the court or a meeting of creditors to be called, claims that might be provisionally admitted could be subject to that procedure, or they could first be admitted by the insolvency representative, without prejudice to the right of a dissenting party to dispute that claim, and be subject to some procedure for approval at a later stage.

(c) *Disputed claims*

404. [245] Where an insolvency law allows a claim submitted in the insolvency proceedings to be disputed, whether as to its value, priority, or basis, it may also indicate which parties are entitled to initiate such a challenge. Some laws allow claims to be disputed only by the insolvency representative, while other laws permit other interested parties, including creditors and the debtor, to dispute a claim. Depending upon the procedures for submission and admission of claims, the dispute may be raised with the insolvency representative, or before or at the court hearing or creditors meeting held to examine claims. Where such a meeting or hearing is held, the preparation of a provisional list of admissions, either by the court or by the insolvency representative and the provision of that list to all creditors before the hearing or meeting will facilitate the consideration of claims. Where claims are the subject of a dispute outside of the insolvency proceedings, they may generally fall into one or other of the categories of

claims that may be provisionally admitted in the insolvency proceedings, depending upon the nature of the claim.

405. [245] Where claims are disputed, whether by a creditor, the insolvency representative or the debtor, a mechanism for quick resolution of the dispute is essential to ensure efficient and orderly progress of the proceedings. If disputed claims cannot be quickly and efficiently resolved, the ability to dispute a claim may be used to frustrate the proceedings and create unnecessary delay. Most insolvency laws provide for disputes to be resolved by the court to ensure finality of the decision.

(d) *Effect of admission of a claim*

406. [244] Admission of a claim of a creditor will establish the right of the creditor to attend a meeting of creditors, and the amount for which the creditor is entitled to vote at such a meeting, whether on the election of an insolvency representative or approval of a reorganization plan. It will also fix the amount that the insolvency representative must take into account in making a distribution to creditors. Provisional admission of a claim will generally entitle the creditor to participate in the proceedings to the same extent as other creditors, except that they may not be entitled to participate in distributions until the value of the claim is finally fixed and the claim admitted. Where, however, the claim is not ultimately fully admitted, any previous votes by the creditor in the proceedings may be discounted.

(e) *Setoff of mutual claims*

[to be coordinated with chapter III.F]

407. As noted above in chapter III.F, a number of insolvency laws make provision for mutual money obligations between the debtor and creditors to be setoff in insolvency proceedings, provided certain conditions are met. These may include, for example, requirements that the claims existed and were due and payable at the time of commencement of the proceedings; that the creditor acquired the claim without fraud or was not aware of the financial situation of its debtor; that the creditor did not acquire the claim during the suspect period; that the creditor has declared its intention to seek a setoff to the insolvency representative; and that the claims were related. A very few insolvency laws provide for mandatory setoff in insolvency, while a number of other laws do not permit setoff on the basis that it violates the *pari passu* principle.

(f) *Claims requiring special treatment*

(i) *Administrative claims*

408. [220] Insolvency proceedings often require the assistance of professionals, such as the insolvency representative and advisors to the debtor or insolvency representative. Expenses may be incurred by creditor committees and also for the purposes of operating the business and carrying out the proceedings, including many or all post-commencement debts, such as claims of employees, lease costs and similar claims.

409. [221] Notwithstanding the importance of providing appropriate remuneration to those involved in the conduct of the insolvency proceedings, administrative expenses have the potential for a significant impact on the value of the insolvency estate. While to some extent that impact will depend upon the design of an insolvency law and its supporting infrastructure, consideration of how that impact can be minimized may be desirable. An insolvency law can provide, for example, precise but flexible criteria relating to the allowance of those expenses. These criteria may include providing that allowance of the expenses is conditional upon the utility of the expense to increasing the value of the estate for the general benefit of all constituents, or that the expenses be not only reasonable and necessary, but also consistent with the key objectives of the process. Reasonableness of the expense may be assessed by reference to the amount of resources available to the proceedings and to the possible effect of the expense on the proceedings. [Note to the Working Group: Are there examples of laws which include such criteria?]

410. [222] Different approaches may be taken to conducting that assessment. One approach may be to require authorization by the court prior to the cost being incurred, or authorization by the court of all costs falling outside the scope of the ordinary course of business. A second approach may be to provide that the assessment be made by creditors, to facilitate the transparency of the proceedings, subject to recourse to the court in the event that the assessment of the creditors is disputed.

(ii) *Related persons*

411. [233] A category of creditors that may require special consideration is those persons related to the debtor, whether in a familial or business capacity (discussed above, see part two, chapter III.E.3(e)). Special treatment of the claims of these persons is often justified on the basis that they are more likely to have been favoured and tend to have had early knowledge of the financial difficulties of the debtor and [other?]. While they do not properly fall within classes of excluded claims, it may be appropriate to consider whether they should be admitted and treated in the same way as other creditors or be admitted subject to special treatment. The mere fact of a special relationship with the debtor, however, may not be sufficient in all cases to justify special treatment of a creditor's claim. In some cases these claims will be entirely transparent and should be treated in the same manner as similar claims made by creditors who are not related persons, in other cases they may give rise to suspicion and will deserve special attention. An insolvency law may need to include a mechanism to identify those types of conduct or situations in which claims will deserve additional attention, such as where the debtor is under-capitalized or where there has been self-dealing. In those cases, the claim may be restricted in the amount allowed or the claim may be subordinated, or the voting rights of the related creditor restricted (such as in selection of the insolvency representative).

(iii) *Claims for interest* (see part two, chapter VI.C.1(g))

### Recommendations

#### Purpose of legislative provisions

The purpose of provisions on treatment of creditor claims is to:

- (a) define the claims that can be submitted and the treatment to be accorded to those claims;
- (b) enable persons who have a claim against a debtor to make claims against the insolvency estate;
- (c) establish a mechanism for verification and admission or non-admission (in full or in part) of claims;
- (d) provide for review of disputed claims.
- (e) ~~establish the treatment of particular claims, including those of secured creditors, foreign creditors, creditors whose claims are in a foreign currency, conditional or non-monetary claims, claims for interest, and claims in respect of non-mature liabilities.~~

#### Content of legislative provisions

(146) The insolvency law should establish a mechanism for creditors to file claims, for the admission or non-admission of claims and for the treatment of claims.<sup>1</sup> The insolvency law may also provide a mechanism by which undisputed claims can be automatically admitted, by reference to for example [the books and records of the debtor...]. The insolvency law should minimize the formalities associated with submitting a claim.

(147) [(99)] The insolvency law should provide that claims that may be submitted should include all rights to payment which arise from acts or omissions of the debtor prior to commencement of the insolvency proceedings, whether mature or not, whether of a determined [liquidated] or undetermined [unliquidated] amount, whether fixed or contingent. The insolvency law should identify claims, if any, that will not be affected by the insolvency proceedings.<sup>2</sup>

#### *Secured claims*

(148) The insolvency law should clearly indicate the treatment of secured claims—whether all secured creditors are required to make claims or only where they are under-secured—and specify the consequences of making or failing to make a claim.<sup>3</sup>

<sup>1</sup>The insolvency law should address claims that may require special treatment, for example claims of foreign and other creditors where they are denoted in foreign currency, conditional or non-monetary claims, claims for interest, and claims in respect of immature liabilities.

<sup>2</sup>Some insolvency laws provide, for example, that claims such as [government] fines and penalties and taxes will not be affected by the insolvency proceedings. Where a claim was to be unaffected by the insolvency proceedings it would continue to exist and would not be included in any discharge.

<sup>3</sup>See UNCITRAL Model Law on Cross-Border Insolvency, art. 14(3) and para. 111 of the Guide to Enactment. See also recommendation (24), chapter II.B

#### *Equal treatment of similarly situated creditors*

(149) [(100)] The insolvency law should provide that all similarly situated creditors, including foreign creditors, are treated equally with respect to the submission and treatment of claims.

#### *Timing of claims*

(150) [(101)] The insolvency law should establish the time in which claims can be submitted, either:

- (a) within a specified time after [the commencement of proceedings] [notice of commencement of proceedings]; or
- (b) at any time prior to final distribution or at a specified time prior to the consideration of a reorganization plan.<sup>4</sup>

#### *Consequences of failure to claim*

(151) [(102)] The insolvency law should address the consequences that apply where a claim is not submitted within the specified time, or is not submitted before a final distribution is made and the proceedings concluded.

#### *Foreign currency claims*

(152) [(103)] In respect of foreign currency claims, the insolvency law should indicate the time at which the claim will be converted into local currency. This time may be determined by reference to any agreement in a contract between the debtor and the claiming creditor as to the date of conversion or by reference to the time of the application for, or the commencement of, insolvency proceedings [or some other time in the insolvency proceedings].

#### *Evidence of claims*

(153) [(104)] The insolvency law should provide that a creditor may be required to provide evidence of its claim to the court or alternatively, to the insolvency representative without having to personally appear.

#### *Admission or non-admission of claims*

(154) [(105)] The insolvency law should provide for admission or [non-admission] of any claim, in full or in part, by the insolvency representative. Where the insolvency representative does not admit a claim it should be required to give reasons.

(155) [(105)] The insolvency law should provide that creditors whose claims have not been admitted or which are disputed in the insolvency proceedings should have a right to review of their claim by the court. The insolvency law should also provide that an interested party may seek review by the court of the admission of any claim.

<sup>4</sup>Where the insolvency law adopts option (b), and a claim is not filed until late in the proceedings, the creditor may be required to accept that it may not participate in any distributions made prior to the filing of the claim.

(156) The insolvency law should permit the insolvency representative, in verifying claims, to decide on the question of setoff.

#### *Provisional admission*

(157) [(106)] The insolvency law should provide that, to facilitate the conduct of the proceedings and in particular the voting of creditors, claims of undetermined value, secured claims and claims disputed in the insolvency proceedings can be provisionally admitted by the insolvency representative pending valuation of the claim, or resolution of the dispute by the court.

(158) [(107)] The insolvency law should provide that the valuation of a claim may be undertaken by the insolvency representative or by the court. Where the valuation is made by the insolvency representative, it should be subject to review by the court where disputed by an interested party.

#### *Effects of admission*

(159) [(108)] The insolvency law should establish the effect of admission, including provisional admission, of a claim. These effects may include:

- (a) permitting the creditor to vote at a meeting of the general body of creditors, including on approval or disapproval of a reorganization plan;

(b) determining the ~~class in which the creditor is entitled to vote~~ the priority to which the creditor's claim is entitled;

(c) determining the amount for which the creditor is entitled to vote;

(d) except in the case of provisional admission of a claim, permitting the creditor to participate in a distribution.<sup>5</sup>

#### *Claims by related parties*

(160) [(109)] The insolvency law should specify that claims by related parties should be subject to scrutiny and where justified by reference, for example, to undercapitalization of the debtor or self-dealing, then:

(a) ~~subjection of the claim to careful scrutiny;~~

(b) the voting rights of the related party may be restricted;

(c) ~~subordination of the claim;~~

(d) the amount of the claim of the related party may be restricted.

<sup>5</sup>However, when making a distribution, the insolvency representative may be required to take account of claims which have been personally admitted, or submitted but not yet admitted: see recommendation (171).

## A/CN.9/WG.V/WP.63/Add.14

### Draft Legislative Guide on Insolvency Law

#### Note by the secretariat

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-F appears in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV. A-D appear in Adds. 10-11, chapter V appears in Add.12, chapter VI. A appears in Add.13, chapter VII.A-B appear in Add.15, and chapter VI.D-E will appear in Add.16]*

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*Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide.*

*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

## **Part two (continued)**

### **VI. MANAGEMENT OF PROCEEDINGS**

#### **B. Post-commencement finance**

##### **1. Need for post-commencement finance**

412. [187] The continued operation of the debtor's business after the commencement of insolvency proceedings is critical for reorganization and, to a lesser extent, in liquidation where the business is to be sold as a going concern. To maintain its business activities, the debtor must have access to funds to enable it to continue to pay for crucial supplies of goods and services, including labour costs, insurance, rent, maintenance of contracts and other operating expenses, as well as costs associated with maintaining the value of assets. It may also be relevant in those cases of liquidation where funds are required to continue the business for a short period to facilitate sale of the assets. In some insolvency cases, the debtor may already have sufficient liquid assets to fund the ongoing business expenses in the form of cash or other assets that can be converted to cash (such as anticipated proceeds of receivables). Alternatively, those expenses can be funded out of the debtor's existing cash flow through operation of the stay and cessation of payments on pre-commencement liabilities. Where the debtor has no available funds to meet its immediate cash flow needs, it will have to seek financing from third parties. This financing may take the form of trade credit extended to the debtor by vendors of goods and services, or loans or other forms of finance extended by lenders.

413. To ensure the continuity of the business where this is the object of the proceedings, it is highly desirable that a determination on the need for new finance is made at an early stage, in some cases even in the period between the making of the application and commencement of proceedings. In many jurisdictions, however, the provision of finance in the period before commencement raises difficult questions relating to avoidance powers, and the liability of the lender and of the debtor. Some insolvency laws provide, for example, that where a lender advances funds to an insolvent debtor it may be responsible for any increase in the liabilities of other creditors that arise from what is simply a postponement of the commencement of liquidation. Beyond that initial period, particularly in reorganization proceedings, the availability of new finance will also be important in the period between commencement of the proceedings and consideration of the plan; obtaining finance in the period after approval of the plan generally should be addressed in the plan, especially in those jurisdictions which prohibit new borrowing unless the need for it is identified in the plan.

414. [187] An insolvency law can recognize the need for such post-commencement finance, provide authorization for it and create priority for repayment of the lender. The central issue is the scope of the power, and in particular, the inducements that can be offered to a potential creditor as a means of obtaining finance from that creditor. To the extent that the solution adopted impacts the rights of existing secured creditors or those holding an interest in assets that was established prior in time, it is desirable that provisions addressing post-commencement financing are balanced against the general need to uphold commercial bargains, protect the pre-existing rights and priorities of creditors and minimize any negative impact on the availability of credit, in particular secured finance, that may result from interfering with those pre-existing security rights and priorities. As a general rule, the economic value of the rights of pre-existing secured creditors should be protected so that they will not be unreasonably harmed. If necessary (and as already discussed in relation to protection of the insolvency estate: see part two, chapter III.B.5), pre-existing secured creditors should receive additional protection to preserve the economic value of their security rights, such as periodic payments or security rights in additional assets in substitution for any assets that may be used by the debtor or encumbered in favour of new lending. In addition to issues of availability and security or priority for new lending, an insolvency law may need to consider the treatment of funds that may have been advanced before the reorganization fails and where the debtor subsequently is to be liquidated. Some insolvency laws provide that any security provided in respect of new lending can be set aside in a subsequent liquidation, while other laws provide that creditors obtaining priority for new funding will retain that priority in any subsequent liquidation.

##### **2. Sources of post-commencement finance**

415. [188] Post-commencement lending is likely to come from a limited number of sources. The first is pre-insolvency lenders or vendors of goods who have an ongoing relationship with the debtor and its business and may advance new funds or provide trade credit in order to enhance the likelihood of recovering their existing claims and perhaps gaining additional value through the higher rates charged for the new lending. A second type of lender has no pre-insolvency connection with the business of the debtor and is likely to be motivated only by the possibility of high returns. The inducement for both types of lender is the certainty that special treatment will be accorded to post-commencement lending and credit. For existing lenders there are the additional inducements of the ongoing relationship with the debtor and its business, the assurance that the terms of their pre-commencement lending will not be altered and under some laws, the possibility that, if they do not provide post-commencement finance, their priority may be displaced by the lender who does provide that finance.

### 3. *Attracting post-commencement finance—providing security or priority*

416. [189] A number of different approaches can be taken to attracting post-commencement finance and providing for repayment. [190] Many insolvency laws provide that the insolvency representative can obtain unsecured credit without approval by the court or by creditors, while other laws require approval by the court or creditors in certain circumstances. Where the lender requires security, it can be provided on unencumbered property, or as a junior or lower security interest on already encumbered property where the value of the encumbered asset is significantly in excess of the amount of the secured obligation. In that case, no special protections will generally be required for the pre-existing secured creditor, unless circumstances change at a later time.

417. [189] Where these approaches are either insufficient or not available, for example because there are no unencumbered assets or there is no excess value in those assets already encumbered, insolvency laws adopt a variety of approaches to obtaining new finance. A number of insolvency laws do not specifically address the issue of new finance and do not provide for any priority to be given for its repayment. In those cases where there are no unencumbered assets that the debtor can offer as security or the lender is prepared to take the risk of lending without security, no new money will be available.

418. [189] Some insolvency laws provide that new lending will be afforded some level of priority over other creditors, in some cases including existing secured creditors. One level of priority is classed as an administrative priority (see part two, chapter VI.C), which will rank ahead of ordinary unsecured creditors, but not ahead of a secured creditor with respect to its security. In some cases, this priority is afforded on the basis that the new lending is extended to the insolvency representative, rather than to the debtor, and becomes an expense of the insolvency estate. Some insolvency laws require such borrowing to be approved by the court or by creditors, while other laws provide that the insolvency representative may obtain the necessary finance without approval, although this may involve an element of personal liability for the insolvency representative. Such a requirement is likely to result in reluctance to seek new finance.

419. [189] Other insolvency laws provide for a “super” administrative priority, which ranks ahead of administrative creditors or a priority that ranks ahead of all creditors, including secured creditors (sometimes referred to as a “priming lien”). In countries where this latter type of priority is permitted, insolvency courts recognize the risk to the existing secured lenders and authorize these types of priority reluctantly and as a last resort. The granting of such a priority may be subject to certain conditions such as the provision of notice to affected secured creditors and the opportunity for them to be heard by the court; proof by the debtor that it is unable to obtain the necessary finance without the priority; and the provision of adequate protection for any diminution of the economic value of the security interests of the affected secured creditor. In some legal systems, all of these options for attracting post-commencement finance are available.

420. It may be desirable in considering the issue of authorization to link it to the damage that may occur or the benefit that is likely to be provided as a result of the provision of new finance. Although many insolvency laws require authorization by the court, and court involvement may assist in promoting transparency and provide additional assurance to lenders, in many instances the insolvency representative may be in a better position to assess the need for new finance. In any event, the court generally will not have expertise or information additional to that provided by the insolvency representative on which to base its decision. Alternative approaches may include establishing a threshold above which approval of the court is required or requiring court approval only where affected creditors object to what is proposed by the insolvency representative.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on post-commencement finance and credit is to:

- (a) Permit finance and credit to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor;
- (b) Provide appropriate protection for the providers of post-commencement finance and credit;
- (c) Provide appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance and credit.

### Content of legislative provisions

(161) [(110)] The insolvency law should permit the insolvency representative to obtain post-commencement finance and credit where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor. The insolvency law may provide that authorization by the court or creditors is required.

~~[(111)] The insolvency law should permit the insolvency representative to obtain post-commencement credit where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor.~~

### *Security for post-commencement finance*

(162) [(112)] The insolvency law should enable security to be provided for repayment of post-commencement finance, including security on unencumbered assets [including after-acquired assets] and a junior or lower priority security on already encumbered assets of the debtor.

(163) [(113)] The insolvency law should provide that a security over the assets of the debtor to secure post-commencement finance does not have priority ahead of any existing security over the same assets unless the insolvency representative notifies the existing security holder and obtains their agreement or follows the procedure in recommendation [(114)].

(164) [(114)] The insolvency law should provide that where the holder of the existing security does not agree, the court may authorize the [granting] [creation] of that security provided specified conditions are satisfied, including:

~~(a) That the existing secured creditor has sufficient security in the assets that it will not [be harmed] [suffer unreasonable harm] by a priority given to the post-commencement finance;~~

(a) The existing [secured creditor] [security holder] was given notice and the opportunity to be heard by the court;

(b) The debtor can prove that it cannot obtain the finance in any other way; and

(c) The interests of the existing [secured creditor] [security holder] will be adequately protected, including through a sufficient excess in the value of the secured asset so that the existing secured creditor will not suffer unreasonable harm by a priority given to the post-commencement finance.

#### Priority for post-commencement finance

(165) [(115)] The insolvency law should establish the priority that may be provided for post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of payment of ordinary unsecured creditors ~~(an administrative priority)~~ [including those unsecured creditors with administrative priority]. Where reorganization proceedings are converted to liquidation, any priority provided to post-commencement finance in the reorganization should continue to be recognized in the liquidation.

### C. Priorities and distribution [of proceeds of liquidation]

#### 1. Priorities

421. [253] Distribution of the proceeds of the estate will generally be made according to the ranking of creditor's claims by class. To the extent that different creditors have struck different commercial bargains with the debtor, the ranking of creditors may be justified by the desirability of the insolvency system recognizing and respecting those commercial bargains and promoting the equal treatment of similarly situated creditors. Establishing a clear and predictable ranking system for distribution can help to ensure that creditors are certain of their rights at the time of entering into commercial arrangements with the debtor and, in the case of secured credit, facilitate its provision. [215] In addition to relying upon these categories based upon commercial and legal relationships between the debtor and

its creditors, distribution policies also very often reflect choices that recognize important public interests (such as the protection of employment), the desirability of ensuring the orderly and effective conduct of the insolvency proceedings (providing priority for the remuneration of insolvency professionals and the expenses of the insolvency administration), and promoting the continuation of the business and its reorganization (by providing a priority for post-commencement finance).

422. Insolvency laws adopt a wide variety of different approaches to the ranking of creditors, both in terms of priorities between different classes and in terms of the treatment of creditors within a particular class, for example those creditors broadly defined as unsecured.

#### (a) Secured creditors

423. [218] Many insolvency laws recognize the rights of secured creditors to have a first priority for satisfaction of their claims, either from the proceeds of sale of the specific assets secured or from general funds. The method of distribution to secured creditors depends on the method used to protect the secured creditor during the proceedings. If the security interest was protected by preserving the value of the secured asset, the secured creditor generally will have a priority claim on the proceeds of the sale of that asset to the extent of the value of its secured claim (provided this does not exceed the value of the asset). Alternatively, if the security interests of the secured creditor were protected by fixing the value of the secured portion of the claim at the time of the commencement of the proceedings, the creditor generally will have a priority claim to the general proceeds of the estate with respect to that value. Where the secured creditor's claim is in excess of the value of the secured asset, or the value of the secured claim as determined at commencement (where that approach is followed), the unsecured portion of the claim will generally be treated as an ordinary unsecured claim for purposes of distribution.

424. [219] In insolvency laws that do not afford secured creditors a first priority, payment of secured creditors may be ranked after costs of administration and other claims which are afforded the protection of priority, such as unpaid wage claims, tax claims, environmental claims and personal injury claims. Another approach is reflected in those laws which provide that the amount that can be recovered (in priority) by secured creditors from the assets securing their claim is limited to a certain percentage of that claim. The carved-out portion of the claim is generally used to serve the claims of other creditors, whether lower ranking priority creditors or ordinary unsecured creditors, or to pay the remuneration and expenses of the insolvency representative and costs in connection with the preservation and administration of the estate where the value of assets of the estate is insufficient to meet these costs. One of the rationales of this approach is that the secured creditor should share, in some equitable manner, some of the losses of other creditors in liquidation and, in reorganization, some of the costs. It is desirable, however, that these types of exceptions to the rule of first priority of secured creditors are limited to provide certainty with respect to the recovery of secured credit, thus encouraging the provision of secured credit and lowering the associated costs.

425. [219] Where the secured claim is satisfied directly from the net realization proceeds of the asset concerned, the secured creditor, unlike unsecured creditors, generally will not contribute (either directly or indirectly) to the general costs of the insolvency proceeding, unless there are provisions such as noted above. However, the secured creditor still may be required in those cases to contribute to other costs directly related to its interests, such as the administrative expenses related to the maintenance of the secured asset. If the insolvency representative has expended resources in maintaining the value of the secured asset, it may be reasonable to recover those expenses as administrative expenses from the amount that would otherwise be paid in priority to the secured creditor from the proceeds of the sale of the asset. A further exception to the first priority rule may also relate to priorities provided in respect of post-commencement finance, where the effect on the interests of secured creditors of any priority granted should be clear at the time the finance is obtained, particularly since it may have been approved by the secured creditors (see part two, chapter VI.B).

(b) *Administrative claims*

426. [220] The administrative expenses of the insolvency proceeding often have priority over unsecured claims, and generally are accorded that priority to ensure proper payment for the parties acting on behalf of the insolvency estate. These expenses would generally include remuneration of the insolvency representative and any professionals employed by the insolvency representative; debts arising from the proper exercise of the insolvency representative's (or in some cases the debtor's) functions and powers (see part two, chapter IV.A and B); costs arising from continuing contract obligations (e.g. labour and lease agreements); costs of the proceedings (e.g. court fees) and, under some insolvency laws, the remuneration of any professionals employed by a committee of creditors.

(c) *Priority or privileged claims*

427. [223] Insolvency laws often attribute priority rights to certain (mainly unsecured) claims which in consequence will be paid in priority to other, unsecured and non-privileged (or less privileged) claims. These priority rights, which are often based upon social, and sometimes political, considerations, militate against the principle of *pari passu* distribution and generally operate to the detriment of ordinary unsecured debts by reducing the value of the assets available for distribution to ordinary unsecured creditors. The provision of priority rights has the potential to foster unproductive debate on the assessment of which classes of creditors should be afforded priority and the justifications for doing so. The provision of these rights in an insolvency law also has an impact on the cost of credit, which will increase as the amount of funds available for distribution to other creditors decreases.

428. [226] Some priorities are based on social concerns that may more readily be addressed by non-insolvency law

such as social welfare legislation than by designing an insolvency law to achieve social objectives that are only indirectly related to questions of debt and insolvency. Providing a priority in the insolvency law may at best afford an incomplete and inadequate remedy for the social problem, while at the same time rendering the insolvency process less effective. Where priorities are to be included in an insolvency law or priorities exist in other laws which will affect the operation of the insolvency law, it is desirable that these priorities be clearly stated or referred to in the insolvency law (and if necessary ranked with other claims). This will ensure that the insolvency regime is at least certain, transparent and predictable as to its impact on creditors and will enable lenders to more accurately assess the risks associated with lending.

429. [225] In some recent insolvency laws there has been a significant reduction in the number of these types of priority rights, reflecting a change in the public acceptability of such treatment. A few countries, for example, have recently removed the priority traditionally provided to tax claims. In other countries, however, there is a tendency to increase the categories of debt that enjoy priority. Maintaining a number of different priority positions for many types of claims has the potential to complicate the basic goals of the insolvency process and to make the achievement of an efficient and effective process difficult. It may create inequities and, in reorganization, complicates preparation of the plan. In addition, it should be remembered that adjusting the order of distribution to create these priorities will not increase the total amount of funds available for creditors. It will only result in a benefit to one group of creditors at the expense of another group. The larger the number of categories of priority creditors, the greater the scope for other groups to claim that they also deserve priority treatment. The greater the number of creditors receiving priority treatment, the less beneficial that treatment becomes.

430. Some of the factors that may be relevant in determining whether compelling reasons exist to grant privileged status to any particular type of debt may include the need to give effect to international obligations; the need to strike a balance between private rights and public interests and the alternative means available to address those public interests; the desirability of creating incentives for creditors to manage credit efficiently and to fix the price of credit as low as possible; the impact of creating certain preferences on transaction and compliance costs; and the desirability of drawing fine distinctions between creditors that result in one class of creditor having to bear a greater burden of unpaid debt.

431. [224] Many different approaches are taken to the types of claims that will be afforded priority and what that priority will be. The types of priorities afforded by countries vary, but two categories are particularly prevalent. The first is a priority for employee salaries and benefits (social security and pension claims), and a second is for tax claims. Consideration of the priority of tax claims may be of particular concern in transnational cases. One approach might be to disallow priority for all foreign tax claims. An alternative might be to recognize some type of priority for such tax claims, perhaps limited in scope, either where



there is reciprocity with respect to the recognition of such claims or where insolvency proceedings in respect of a single debtor are being jointly administered in more than one State. Article 13 of the UNCITRAL Model Law on Cross-Border Insolvency recognizes the importance of the non-discrimination principle with respect to the ranking of foreign claims, but also provides that countries which do not recognize foreign tax and social security claims can continue to discriminate against them.<sup>1</sup>

(i) *Employee claims*

432. In a majority of countries, workers' claims (including claims for wages, leave or holiday pay, allowances for other paid absence, and severance pay) constitute a class of priority claims, which in a number of cases ranks above tax and social security claims. [224] This approach is generally consistent with the special protection that is afforded to employees in other areas of insolvency law (see part two, chapter III.D.6), as well as with the approach of some international conventions.<sup>2</sup> In some insolvency laws, the importance of maintaining continuity of employment in priority to other objectives of the insolvency process, such as maximization of value of the estate for the benefit of all creditors, is 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 these obligations may be altered or terminated.

433. In some countries, employee claims are afforded priority but will rank equally with taxes and social security claims in a single class of priority claims and may be satisfied proportionately in the event of insufficient funds. In other countries, no priority is provided for employee claims and they are ranked as ordinary unsecured claims, although in some cases payment of certain obligations accrued over specified periods of time (for example, for wages and remuneration arising within three months before commencement of insolvency proceedings) may be guaranteed by the State through a wage guarantee fund. The fund guaranteeing the payment of such claims may itself have a claim against the estate and may or may not have the same priority vis-à-vis the insolvency estate as the employee claims, depending upon policy considerations such as the use of public monies (as opposed to the assets of the insolvent debtor) for funding the provision of wage compensation. [230] Usual practice would be for the fund to enjoy the same rights as the employee, at least in respect of a certain specified amount which may be denoted in terms of an amount of wages or a number of weeks of pay.

(ii) *Tax claims*

434. [224] Priority is often accorded to government tax claims on the basis of protecting public revenue. Accord-

ing a priority to such claims has been justified on a number of other grounds. These grounds include that it can be beneficial to the reorganization process because tax authorities will be encouraged to delay the collection of taxes from a troubled business entity on the basis that eventually they will be afforded a priority for payment under insolvency, and that because the Government is a non-commercial and unwilling creditor, it may be precluded from some commercial debt recovery options. Providing a priority to such claims, however, can be counterproductive because failure to collect taxes can compromise the uniform enforcement of tax laws and may constitute a form of State subsidy which undermines the discipline that an effective insolvency regime is designed to support. It may also encourage tax authorities to be complacent about monitoring debtors and collecting debts in a commercial manner that would assist to prevent insolvency and the depletion of assets.

(d) *Ordinary unsecured creditors*

435. [227] Once all secured and priority creditors have had their claims satisfied the balance of the insolvency estate generally would be distributed pro rata to ordinary unsecured creditors. There may be subdivisions within the class, with some claims being treated as subordinate or with a priority as noted above. Some claims that generally are subordinated are discussed below.

(e) *Owners and shareholders*

436. [232] Owners and shareholders may have claims arising from loans extended to the debtor and claims arising from their equity or ownership interest in the debtor. Many insolvency laws distinguish between these different claims. With respect to claims arising from equity interests, many insolvency laws adopt the general rule that the owners and shareholders of the business are not entitled to a distribution of the proceeds of assets until all other claims which are senior in priority have been fully repaid (including claims of interest accruing after commencement). As such, shareholders and owners will rarely receive any distribution in respect of their equity interest in the debtor. Where a distribution is made, it would generally be made in accordance with the ranking of shares specified in the company law and the corporate charter. Debt claims, such as those relating to loans, however, are not always subordinated.

(f) *Related persons*

437. [233] A category of creditors that may require special consideration is those persons related to the debtor, whether in a familial or business capacity (discussed above, see part two, chapter III.E.3(e) and chapter VI.A). Under some insolvency laws, these claims are always subordinated, and under other laws they are subordinated only on the basis of inequitable conduct or fraudulent or quasi-fraudulent conduct. Where they are subordinated, the claims may rank after ordinary unsecured claims. Other approaches for treatment of these claims do not relate to

<sup>1</sup>UNCITRAL Model Law on Cross-Border Insolvency, article 13(2) and footnote 2.

<sup>2</sup>For example, the ILO Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173). Article 8(1) provides that "national laws or regulations shall give workers' claims a higher rank of privilege than most other privileged claims, and in particular those of the State and social security system". The Convention entered into force in 1995.

ranking, but to restrictions on voting rights or to the amount of the claim that will be admitted in the proceedings.

(g) *Fines, penalties and post-commencement interest*

438. [227] Some countries treat claims such as gratuities, fines and penalties (whether administrative, criminal or some other type) as ordinary unsecured claims, and subordinate them to other unsecured claims. In some insolvency laws these types of claims are treated as excluded claims.

439. Different approaches are taken to the accrual and payment of interest on claims. Some insolvency laws provide that interest on claims ceases to accrue on all unsecured debts once liquidation proceedings have commenced, but that payment in reorganization will depend upon what is agreed in the plan. In other cases where provision is made for interest to accrue after commencement of proceedings, payment may be subordinated and it will be paid only after all other unsecured claims have been paid.

## 2. Distribution

440. [254] Where there are a number of different categories of claims with different priorities, each level of priority generally will be paid in full before the next level is paid. Once a level of priority is reached where there are insufficient funds to pay all the creditors in full, the creditors of that priority share pro rata. In some laws which do not establish different levels of priority, all the creditors share pro rata if there are insufficient funds to pay them in full.

441. [255] It may be desirable to provide in reorganization proceedings that priority claims must be paid in full as a predicate to confirmation of a plan unless the affected priority creditors agree otherwise [*reasons?*] A plan of reorganization may propose distribution priorities that are different to those provided by the insolvency law in a liquidation, provided that creditors voting on the plan approve such a modification.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on distribution is to:

(a) Establish the order in which claims should be paid from the estate of the debtor following realization of the assets in liquidation or upon confirmation of the reorganization plan;

(b) Ensure that creditors of the same class are treated equally and are paid proportionately out of the assets of the estate;

[(c) Specify limited circumstances in which priority in distribution is permitted.]

### Content of legislative provisions

(166) [(116)] The insolvency law should establish the order in which claims, other than secured claims, are to be paid from the estate of the debtor following sale of the assets in liquidation.

(167) [(117)] The insolvency law should minimize the priorities accorded to categories of unsecured claims. Where priorities are granted by operation of law other than the insolvency law, they should be clearly set forth in the insolvency law.

(168) [(118)] Secured claims should be paid from the proceeds of the realization of the security, subject to claims that are superior in priority to the secured claim, if any.<sup>3</sup>

(169) [(119)] With respect to the payment of classes of claims other than secured claims, the insolvency law should provide that the amount available for distribution to creditors be paid in the following order:

(a) Administrative costs and expenses, including those in connection with the appointment, performance of the powers and functions and remuneration of the insolvency representative and the creditor committee;

(b) Pre-commencement claims with priority;

(c) Ordinary pre-commencement claims;

(d) Deferred or subordinated pre-commencement claims;

(e) The debtor (i.e. equity interests or owners of the debtor).

(170) [(120)] With respect to the payment of claims of the same class, the insolvency law should provide, as a general principle, that claims in each class are ranked equally as between themselves unless the holders of the affected claims agree otherwise. All the claims in a particular class should be paid in full before the next class is paid. If there are insufficient funds to pay them in full they should be paid in proportion.

(171) [(121)] The insolvency law should provide that distributions be made promptly and that they may be paid as far as possible on an interim or regular basis. In making a distribution an insolvency representative is required to make provision for provisionally admitted claims, and submitted claims that are not yet admitted.

<sup>3</sup>Note to the Working Group: The European Bank for Reconstruction and Development has suggested that the Guide consider the proposition that a secured creditor should share some of the burden of a financial failure, at least with respect to involuntary creditors, such as tort claimants and employees and in particular where the secured creditor holds an "enterprise mortgage" over every asset of the debtor entity. To this end, the following drafting for the protection of employees rights is proposed to be added at the end of this recommendation: "... provided, however, that if a secured creditor holds a lien or mortgage over substantially all the assets of the debtor, the proceeds from the realization of the security should be paid first to satisfy all accrued and unpaid employee wage claims (if not otherwise guaranteed by a State agency) and then to satisfy all personal injury claims (not covered by insurance) and then to the secured creditor in accordance with the first clause of this recommendation."

## A/CN.9/WG.V/WP.63/Add.15

**Draft legislative guide on insolvency law**  
**Note by the Secretariat**

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*[The introduction and part one of the draft Guide appear in document A/CN.9/WG.V/WP.63; part two, chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Add.5-9; chapter IV.A-D appear in Adds. 10-11, chapter V appears in Add. 12, chapter VI. A-C appear in Adds. 13-14, and chapter VI.D-E will appear in Add.16]*

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*Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text and deletions are indicated by strike through.*

**Part two (continued)**

**VII. RESOLUTION OF PROCEEDINGS**

**A. Discharge**

*1. Discharge of the debtor in liquidation<sup>1</sup>*

442. [256] Following distribution in the liquidation of the estate of an individual debtor, it is likely that a number of creditors will not have been paid in full. An insolvency law will need to consider whether these creditors will still have an outstanding claim against that individual debtor or, alternatively, whether the debtor will be released or “discharged” from those residual claims.

443. [257] When the debtor is a limited liability company, the question of discharge following liquidation does not arise; either the law provides for the disappearance of the legal entity or, alternatively, that it will continue to exist as a shell with no assets. The shareholders will not be liable for the residual claims and the issue of their dis-

charge does not arise. If the debtor’s business takes a different form, such as an individual (sole proprietorship), a group of individuals (a partnership), or an entity whose owners have unlimited liability, the question arises as to whether these individuals will still be personally liable for unsatisfied claims following liquidation.

444. There is an increasing awareness in some circles of the need to recognize business failure as a natural feature of the economy and to accept that both weak and good businesses can fail, albeit for different reasons, without necessarily involving irresponsible, reckless or dishonest behaviour on the part of the management of the business. A person who has failed in one business may have learned from that experience and some studies suggest that they are often very successful in later business ventures. For these reasons, a number of countries have taken the view that their insolvency regime needs to focus not only on addressing the administration of failure, but also upon facilitating a fresh start for insolvent debtors by clearing their financial situation and taking other steps to reduce the stigma associated with business failure, rather than upon punishment of the debtor. In addition to adapting the insolvency law to remove unnecessary conditions and restrictions on discharge, there is a need to encourage banks and the wider community to

<sup>1</sup>These paragraphs relate to discharge of a debtor who is an individual or natural person.

take a different view of business failure, and to provide assistance and support to those involved in business failure. At the same time, the insolvency regime needs to protect the public and the commercial community from those debtors whose conduct of their financial affairs has been irresponsible, reckless or dishonest.

445. [258] Insolvency laws adopt different approaches to the question of discharge. In some, the debtor remains liable for unsatisfied claims, subject to any applicable limitation periods (which in some cases might be quite long, for example, 10 years) and may also be subject to a number of conditions and restrictions relating to professional, commercial and personal activities. This type of rule emphasizes the value of a debtor-creditor relationship: the continued responsibility of the debtor following liquidation is intended to both moderate a debtor's financial behaviour and encourage a creditor to provide financing. At the same time, it may work to inhibit opportunity, innovation and entrepreneurial activity because the sanctions for failure are severe.

446. [258] Other insolvency laws provide for a complete discharge of an honest, non-fraudulent debtor immediately following liquidation. This approach emphasizes the benefit of the "fresh start" that discharge brings and is often designed to encourage the development of an entrepreneurial class. It is also a recognition that over-indebtedness is a current economic reality and should be addressed in an insolvency law. A third approach attempts to strike a compromise: discharge is granted after a period following distribution, during which the debtor is expected to make a good faith effort to satisfy its obligations.

447. [259] In some circumstances, it may be appropriate to limit the availability of discharge. These may include those cases where, for example, the debtor has acted fraudulently; engaged in criminal activity; violated employment or environmental laws; failed to keep appropriate records; failed to participate in the insolvency proceedings in good faith or to cooperate with the insolvency representative; failed to provide or has concealed information; continued trading at a time when it knew it was insolvent; incurred debts with no reasonable expectation of being able to pay them; and concealed or destroyed assets or records after the application for commencement.

448. [259] Different approaches are taken to the conditions that will apply to discharge in these types of circumstances. In some countries, the period before a discharge is given may be quite long or conditions and restrictions will apply to the discharge, or a combination of both. In some of the countries where a discharge is given, certain debts may be excluded from the discharge, such as those arising from maintenance agreements (payments to a divorced spouse or to support children of the debtor); fraud; court fines; and taxes. Conditions may also be imposed upon the debtor, both during the proceedings or as a condition for a discharge, either by way of recommendation by the insolvency representative or by the court. These conditions may include restrictions on the ability of the debtor to obtain new credit, to leave the country, to carry on business for a certain period of time or a ban, where relevant, on practising its profession for a period of time. They may also

include a discharge that is provided on the condition that the debtor does not subsequently acquire a substantial new fortune from which previous debts may be paid. The length of the application of these provisions will vary, depending upon the situation of the debtor. Other limitations relate to the number of times a debtor can be discharged. In some jurisdictions, a discharge is a once in a lifetime opportunity; in others there is a minimum waiting period, for example, 10 years, before a debtor will qualify for a new discharge, or even be able to enter insolvency proceedings which may lead to a new discharge. A further approach restricts discharge where, for example, the debtor has been given a discharge within a certain period of time before commencement of the current proceedings and where the payments made in those proceedings were less than a fixed percentage.

449. Some insolvency laws also provide for a discharge to be suspended where the debtor fails to comply with an obligation, or revoked in certain circumstances such as where it was obtained by fraud, where the debtor fraudulently withheld information concerning property that should be property of the estate, or failed to comply with orders of the court.

450. [260] One issue that may need to be taken into account in considering discharge of individuals engaged in a business undertaking is the intersection of business indebtedness with consumer indebtedness. Recognizing that different approaches are taken to the insolvency of natural persons (in some countries a natural person cannot be declared bankrupt at all, in others there is a requirement for the individual to have acted in the capacity of a "merchant") and that many countries do not have a developed consumer insolvency system, a number of countries do have insolvency laws that seek to distinguish between those who are simply consumer debtors and those whose liabilities arise from small businesses. Since consumer credit often is used to finance small business either as start-up capital or for operating funds, it may not always be possible to separate the debts into clear categories. For that reason, where a legal system recognizes individual consumer and business debt, it may not be feasible to have rules on the business debts of individuals that differ from the rules applicable to consumer debts.

## *2. Discharge of debts and claims in reorganization*

451. [298] To ensure that the reorganized debtor has the best chance of succeeding, an insolvency law can provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan. This approach supports the goal of commercial certainty by giving binding effect to the forgiveness, cancellation or alteration of debts in accordance with the approved plan. The principle is particularly important to ensure that the plan provisions will be complied with by creditors that rejected the plan and by creditors that did not participate in the process. It also gives certainty to other lenders and investors that they will not be involved in unanticipated liquidation or have to compete with hidden or undisclosed claims. Thus the discharge establishes unequivocally that the plan fully addresses the legal rights of creditors.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on discharge is to:

- (a) enable an individual debtor to be finally discharged from liabilities for pre-commencement debts, thus providing the debtor with a fresh start;
- (b) establish the circumstances under which discharge will be granted and the terms of that discharge.

### Content of legislative provisions

#### Liquidation

(172) [(122)] Where the insolvency law allows the insolvency of individuals engaged in business activity, the issue of discharge of the debtor from liability for pre-commencement debts following [liquidation of the assets of the estate] [termination of the liquidation proceedings] should be addressed. Different approaches may be taken:

- (a) the debtor may be discharged completely and immediately where the debtor [is honest] [and] has not acted fraudulently] [acts in good faith];
- (b) the discharge may not apply until after the expiration of a specified period of time following [distribution] [commencement], during which period the debtor is expected to make a good faith attempt to satisfy its obligations;
- (c) certain debts may be excluded from the discharge, such as those that were not disclosed by the debtor;<sup>2</sup>
- (d) the discharge may be subject to certain conditions, such as restricting access to new credit or preventing the carrying on of business for a certain period of time.

#### Reorganization

(173) (138) Once the plan has been fully implemented, the debtor should be discharged from all debts that have been provided for in the plan.

## B. Conclusion of proceedings

452. Insolvency laws adopt different approaches to the manner in which a proceeding is to be concluded or closed, the prerequisites for closure and the procedures to be followed.

### 1. Liquidation

453. A number of insolvency laws adopt an approach that generally requires, following realization of assets and dis-

<sup>2</sup>Where the insolvency law provides that certain claims will not be affected by the insolvency proceedings, those claims will be excluded from the discharge, but do not need to be specifically referred to in this section: see recommendations on treatment of creditor claims: see part two, chapter VI.A.

tribution, that the insolvency representative call a meeting of creditors and present a final accounting. Provided that creditors agree to the accounting, all that is then required under some laws (where the debtor is a corporate entity) is that the final accounts and a report of the final meeting be filed with the administrative body responsible for registration of corporate entities and the debtor entity will be dissolved, while other laws require a formal application to the court for an order for dissolution. Some variations on this general approach include slightly different procedures for voluntary and involuntary proceedings.

## 2. Reorganization

454. [299] In general, insolvency laws adopt one of two or three approaches to the conclusion of reorganization proceedings. Reorganization proceedings may be treated as concluded where the reorganization plan is not approved (whether by creditors or the court) (see part two, chapter V.A.6); where the liabilities have been discharged in accordance with the plan and the plan has otherwise been fully implemented (with or without the need for a formal court order, although some laws make provision for the insolvency representative to be discharged from its duties by a formal order of the court); and where the court orders the proceedings to be terminated because of a failure of implementation (because the plan cannot be implemented or because there is a continuing deterioration in the debtor's financial condition). Proceedings may also be terminated in accordance with the terms of the plan or some other contractual agreement with creditors. Where the proceedings are terminated without implementation of the reorganization plan, the insolvency law may provide, and the court may also make an order, for the proceedings to be converted to liquidation, in order to avoid the debtor being left in an insolvent state with its financial situation unresolved. A number of insolvency laws adopt a different approach, providing that the reorganization proceedings will conclude once creditors have approved the plan. In this situation, the enforcement of rights and obligations provided for in the plan will be under non-insolvency law.

## Recommendations

### Purpose of legislative provisions

The purpose of provisions on conclusion is to:

- (a) ensure that the insolvency law includes a procedure for ending the proceedings once the goal of those proceedings has been achieved or addressing the situation where the goal of those proceedings cannot be achieved;
- (b) provide for the dissolution of the debtor, where relevant.

### Content of legislative provisions

#### Liquidation

(174) [(123)] After an insolvency estate is fully administered [and the insolvency representative discharged] provi-



sion should be made for the insolvency proceedings to be closed.

(124) *[reopening]*

#### Reorganization

(175) (139) The insolvency law should make provision for reorganization proceedings to be concluded when the reorganization plan is fully implemented. The court may

order the proceedings to be terminated where implementation of the plan fails, where the plan cannot be implemented or because there is a continuing deterioration in the debtor's financial condition. [Where the proceedings are terminated without implementation of the plan, the insolvency law should make provision for conversion of the proceedings to liquidation.] After an insolvency estate is fully administered [and the insolvency representative discharged] the court should close the proceedings.

(140) *[reopening]*

### C. Working paper submitted to the Working Group on Insolvency Law at its twenty-seventh session: Draft legislative guide on Insolvency Law

(A/CN.9/WG.V/WP.64)

1. At its thirty-fourth session (2002), the Commission noted with particular satisfaction the efforts undertaken by Working Group VI (Security Interests) and Working Group V (Insolvency Law) towards coordinating their work on a subject of common interest such as the treatment of security interests in the case of insolvency proceedings. Strong support was expressed for such coordination, which was generally thought to be of crucial importance for providing States with comprehensive and consistent guidance with respect to the treatment of security interests in insolvency proceedings. The Commission endorsed a suggestion made to revise chapter X of the draft legislative guide on secured transactions in light of the core principles agreed by Working Groups V and VI (see A/CN.9/511, paras. 126-127 and A/CN.9/512, para. 88). The Commission also endorsed a suggestion for closer coordination of the work of the two working groups at their upcoming sessions.<sup>1</sup>

2. To facilitate the discussion at the joint session of Working Groups V and VI on 16 December 2002, this note set forth a list of those parts of the draft legislative guide on insolvency law (set forth in documents A/CN.9/WG.V/WP.63/Add.3-16) that discuss the manner in which secured creditors may be affected by insolvency law. Unlike the draft legislative guide on secured transactions, the draft insolvency guide does not include a separate chapter addressing those issues, but rather deals with secured creditors in the context of each topic. In respect of some issues, the Guide makes specific reference to secured creditors and the manner in which they may be affected. In respect of other issues, secured creditors will be affected in the same manner as all other creditors, for example, with respect to commencement criteria and therefore no particular reference is made to secured creditors. The references set forth below (which include both relevant paragraphs of the commentary and recommendations) relate both to sections specifically addressing secured creditors and to references to secured creditors in the text of paragraphs dealing with other issues.

<sup>1</sup>Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17), para. 203.

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twenty-eighth session (New York, 24-28 February 2003) (A/CN.9/530)  
[Original: English]**

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**I. INTRODUCTION: SUMMARY OF THE PREVIOUS  
DELIBERATIONS OF THE WORKING GROUP**

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in

the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime



that a country had adopted had become a “front-line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session in 2000, the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.<sup>1</sup>

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the Secretariat, in cooperation with INSOL and IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December 2000.

6. At its thirty-fourth session in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished so far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the

form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.<sup>2</sup>

8. The twenty-fourth session of the Working Group on Insolvency Law (New York, 23 July to 3 August 2001) commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504. Work continued at the twenty-fifth (Vienna, 3-14 December 2001), twenty-sixth (New York, 13-17 May 2002) and twenty-seventh (Vienna, 9-13 December 2003) sessions of the Working Group. The reports of those meetings are contained in documents A/CN.9/507, A/CN.9/511 and A/CN.9/529 respectively.

9. At its twenty-seventh session, in response to a request by the Commission at its thirty-fifth session in 2002 that the Working Group make a recommendation as to the completion of its work,<sup>3</sup> the Working Group stressed the need to finalize the Guide as soon as possible and recommended that while the draft Guide may not be ready for final adoption by the Commission in 2003, nevertheless a draft should be presented to the Commission in 2003 for preliminary consideration and assessment of the policies on which the legislative guide is based. Such an approach would facilitate the use of the legislative guide as a reference tool before final adoption in 2004 and would allow those countries that have not participated in the Working Group an opportunity to consider the development of the guide. It was noted that the Working Group might require a further session in the second half of 2003 and possibly even the first half of 2004 to refine the text for final adoption.

## II. ORGANIZATION OF THE SESSION

10. Working Group V (Insolvency Law) which was composed of all States members of the Commission, held its twenty-eighth session in New York, from 24-28 February 2003. The session was attended by representatives of the following States members of the Working Group: Austria, Cameroon, Canada, China, Colombia, Fiji, France, Germany, Italy, Japan, Kenya, Lithuania, Mexico, Morocco, Paraguay, Russian Federation, Singapore, Spain, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

<sup>1</sup>Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 400-409.

<sup>2</sup>Ibid., Fifty-sixth Session, Supplement No. 17 (A/56/17), paras. 296-308.

<sup>3</sup>Ibid., Fifty-seventh Session, Supplement No. 17 (A/57/17), para. 194.

11. The session was attended by observers from the following States: Australia, Belarus, Bulgaria, Denmark, Ireland, Jordan, the Libyan Arab Jamahiriya, Marshall Islands, Philippines, Republic of Korea, Switzerland, Turkey, United Republic of Tanzania, Venezuela and Viet Nam.

12. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: International Labour Office (ILO), International Monetary Fund (IMF), the World Bank; (b) non-governmental organizations invited by the Commission: American Bar Association (ABA), American Bar Foundation, Center for International Legal Studies, Groupe de Réflexion sur l'Insolvabilité et sa Prévention (GRIP 21), International Bar Association, Committee J (IBA), International Federation of Insolvency Professionals (INSOL), International Insolvency Institute (III).

13. The Working Group elected the following officers:

<i>Chairman:</i>	Mr. Wisit WISITSORA-AT (Thailand)
<i>Rapporteur:</i>	Mr. Luis Humberto USTARIZ GONZÁLEZ (Colombia)

14. The Working Group had before it a Note by the Secretariat: Draft legislative guide on insolvency law (A/CN.9/WG.V/WP.63 and addenda 1-17). Those documents, which set forth the text of the commentary of the Guide together with recommendations, had been revised in the light of the discussion of the Working Group at its twenty-fifth and twenty-sixth sessions. At its twenty-seventh session, the Working Group completed consideration of A/CN.9/WG.V/WP.63, addenda 3-9 (up to and including recommendation (77)).

15. The following background materials were also made available: Possible future work on insolvency law: Note by the Secretariat A/CN.9/WG.V/WP.50; Reports of the Secretary-General A/CN.9/WG.V/WP.54, A/CN.9/WG.V/WP.54/Add.1-2; A/CN.9/WG.V/WP.55; A/CN.9/WG.V/WP.57; A/CN.9/WG.V/WP.58; A/CN.9/WG.V/WP.59; A/CN.9/WG.V/WP.61 and Add.1; Report on the UNCITRAL/INSOL/IBA Global Insolvency Colloquium (2000) A/CN.9/495; Report of UNCITRAL on the work of its thirty-fourth session (2001) A/56/17 and thirty-fifth session (2002) A/57/17; Report of Working Group V (Insolvency Law) on the work of its twenty-second session (December 1999) A/CN.9/469; twenty-fourth session (July/August 2001) A/CN.9/504; twenty-fifth session (December 2001) A/CN.9/507; twenty-sixth session (May 2002) A/CN.9/511 and twenty-seventh session (December 2002) A/CN.9/529.

16. The Working Group adopted the following agenda:

1. Scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of a legislative guide on insolvency law.
5. Other business.
6. Adoption of the report.

### III. SUMMARY OF DELIBERATIONS AND DECISIONS

17. The Working Group reviewed the draft legislative guide on insolvency law commencing with document A/CN.9/WG.V/WP.63/Add.9, recommendation (77) and continuing through Addenda 10 to 14 (recommendation (165)). For lack of time, the Working Group was not able to complete its consideration of the remaining part of A/CN.9/WG.V/WP.63/Add.14, and Adds.15, 16, 17, 1 and 2. The deliberations and decisions of the Working Group with respect to the various addenda considered are set forth below.

18. The Working Group reviewed its progress with consideration of the draft legislative guide in the light of the decision taken at its twenty-seventh session that a draft of the legislative guide should be presented to the Commission in 2003 for preliminary consideration and assessment of the policies on which it is based,<sup>4</sup> and adopted the following recommendation to the Commission:

“After five sessions (between July 2001 and February 2003) of extensive study, analysis and deliberation, the Working Group advises the Commission that it has completed its review of the core substance of the draft legislative guide on insolvency law (as set forth in document A/CN.9/WG.V/WP.63 and Addenda 1-17) and recommends that the Commission:

1. Approve the scope of the work undertaken by the Working Group as being responsive to the mandate given to the Working Group to prepare “a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches”;

2. Give preliminary approval to the key objectives, general features and structure of insolvency regimes as set forth in the introductory chapters of Part One of the legislative guide;

3. Direct the Secretariat to make the current draft of the legislative guide available to all United Nations member States, relevant intergovernmental and non-governmental international organizations, as well as the private sector and regional organizations for comment;

4. Continue to work collaboratively with the World Bank and other organizations working in the field of insolvency law reform to ensure complementarity and avoid duplication and take into consideration the work of the Working Group VI on secured transactions; and

5. Direct the Working Group to complete its work on the legislative guide and present it to the Commission in 2004 for approval and adoption.

19. The Working Group noted that it would require further sessions in the second half 2003 and potentially in the first half of 2004 to complete its consideration of the legislative guide. Reservations were expressed as to the ability of

<sup>4</sup>Document A/CN.9/529, para. 17.

the Working Group to reach a satisfactory conclusion on A/CN.9/WG.V/WP.63/Add.17 on conflicts of laws without an appropriate opportunity for discussion and deliberation and as to the time that may be needed to undertake that discussion and deliberation without taking away from the time currently available for completion of the legislative guide or requiring an extension of the completion date of the legislative guide. It was suggested that the Working Group could examine those issues at a future session in order to assess the likelihood of being able to reach agreement on the text proposed in A/CN.9/WG.V/WP.63/Add.17. To facilitate its consideration of the draft legislative guide, it was proposed that the Commission should be apprised of the work on the legislative guide that had been completed and the work that was still to be undertaken.

#### IV. PREPARATION OF DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

##### Part Two. Chapter III. Treatment of assets on commencement of insolvency proceedings

###### *E. Avoidance proceedings* (A/CN.9/WG.V/WP.63/Add.9)

###### *Recommendations*

20. Having concluded its discussion on recommendation (76) at its twenty-seventh session in December 2002, the Working Group resumed its deliberations on the draft Guide at recommendation (77).

21. The Working Group agreed that the word, “may”, in the second last line of recommendation (77) be replaced by words to the effect that the law should specify a time period for commencement of avoidance actions, although some difference of opinion was expressed as to whether such a time limitation should be included in the insolvency law or in general procedural law. A further suggestion was that the phrase, “of which the insolvency representative is aware”, was superfluous and could be removed from the recommendation.

22. The Working Group discussed two key points regarding recommendation (78). Firstly, the Working Group agreed that of the two bracketed terms, “excessive” should be removed from the brackets and retained, and “unjustifiable” deleted. It was also agreed that a footnote should be added to explain that “excessive” costs referred to an appraisal of the costs and benefits of an avoidance action, and an implicit rule that if the costs of a proceeding would exceed the benefits to the estate, that proceeding should not go ahead. Secondly, the prevailing view was that, of the proposed options in the second sentence of the recommendation, paragraphs (a) and (c) should be deleted. In support of the agreed change, it was noted that avoidance actions could be highly detrimental to the success of rehabilitation proposals, warranting a balanced consideration of the merits of an action by a non-creditor party before it be allowed to proceed. A different view, which received some support, was that paragraph (a) provided a necessary incentive in those situations where an insolvency representative had a strong case for taking an avoidance action

but lacked the necessary funding, and that, in any event, recommendation (78) was discretionary and simply indicated different approaches that might be taken. It was also pointed out that the Guide should make a clear distinction between the funding of proceedings and the party that may commence an action (which was addressed in recommendation (76)). As a matter of drafting, it was suggested that the requirement for a justification of the insolvency representative’s decision not to pursue an avoidance action be removed and the word, “either”, in the first sentence of the paragraph be replaced with the words, “for example”.

23. After discussion, the Working Group agreed to retain recommendation (79) with the word, “possible” in relation to defences, to be replaced by the word “specific”. Although some concern was expressed that the provision was not necessarily a component of insolvency law and could be left to the general law, it was pointed out that it was closely linked to recommendation (70) and for reasons of clarity and certainty should be included in the insolvency law. That approach received some support.

24. The Working Group agreed to retain recommendation (80) with some drafting changes. It was proposed that the reference to “classes of person” should be deleted as all that was required was the reference to certain specified persons and the example of related persons. It was noted that that issue was discussed in paragraph 172 of the commentary. It was suggested that a useful addition to the recommendation might be words to the effect that whatever evidentiary presumptions might apply should be clearly stated in the law. A drafting suggestion which received some support was to replace the phrase, “the avoidance of certain transactions occurring within”, with the word, “clearly”. In response to a suggestion that the recommendation might usefully refer to suspect periods in respect of related persons, it was pointed out that that issue was addressed in recommendation (72).

25. In the course of discussion, it was noted that recommendation (81) contained at least two distinct propositions which, it was suggested, could be separated into different recommendations, that is, the effect of avoidance of a transaction in terms of orders against the counterparty and the sanction for failure of the counterparty to comply with those orders. It was observed that the usual consequence of avoidance of a transaction would be setting aside of the transaction and execution of the court order against the counterparty, not the consequence suggested in the second sentence of the recommendation. It was recognized however that the insolvency law may provide an additional consequence that the counterparty could not participate in any distributions. After discussion, a suggestion to delete the second sentence of the recommendation received some support. A different view was that the sentence should be retained and redrafted to provide for those circumstances where the counterparty has acted in good faith but was unable to return the preference received. With regard to the first sentence of recommendation (81), the Working Group agreed that the term, “material benefits”, was too wide and should be replaced with the wording used in paragraph 188 of the commentary, that the counterparty be required to return “the assets obtained or make a cash payment for the value of the transaction to the insolvency estate”.

## F. *Set-off, netting and financial contracts*

### *Recommendations*

26. A number of different views were expressed with respect to the scope and drafting of recommendations (82) to (88). It was suggested that the recommendations needed to clarify a number of points including: the existence of rights of set-off at commencement of insolvency proceedings as opposed to the exercise of those rights by reference to the time of commencement of insolvency proceedings; whether the rights arose under separate contracts or under a single contract and the distinctions to be made between those rights, including in terms of the application of the stay and the consequent treatment of those rights; the netting of non-financial obligations; and any exceptions that might be required, in respect of certain types of contracts, from the operation of the insolvency law (e.g. automatic stay, avoidance provisions and automatic contract termination clauses).

27. In respect of recommendation (82) it was observed that as drafted it simply preserved a right of set-off that arose under general law and could be exercised irrespective of the commencement of insolvency. On that basis it could be supported.

28. In respect of recommendation (83), it was noted that while some laws did not permit post-commencement set-off unless the conditions for set-off were present before the commencement of insolvency proceedings, other laws did permit post-commencement set-off. It was suggested that what was required was specification of those conditions in addition to the requirement that the mutual claims arose under the same agreement. Those conditions should include that the debtor seeking to invoke the set-off had the right to do so and that the exercise of the set-off be subject to a decision by the insolvency representative or the court.

29. With respect to recommendation (84), it was suggested that the definition of "financial contracts" needed careful consideration. One view was that it should be limited to transactions which formed part of a master agreement providing for settlement between transactions. Another view was that the definition based upon article 5 (k) of the UNCITRAL Convention on the Assignment of Receivables in International Trade was too narrow and did not include, for example, transactions occurring both through an exchange or outside of an exchange.

30. It was suggested that what the Guide should make clear was the volatility of the financial markets in question, the problems of systemic risk and the consequent need to provide exceptions to the normal rules of insolvency, as proposed in recommendations (85) to (88). On that basis, one proposal was that the Guide should not attempt to address the very complex and difficult issues raised by such contracts, but rather focus on the ordinary on issues of set-off. A different view was that the Guide should focus on the need to preserve financial markets and the special rules required to do that. In respect of the exceptions proposed in recommendations (86) to (88), one view was that all were required for financial transactions and should specifically be included in section F and aligned with

recommendations on exceptions already agreed to be included in previous chapters on the stay, treatment of contracts and avoidance. With reference to avoidance, one view was that avoidance would only be relevant in the case of actual fraud. A different view was that financial transactions should be subject to avoidance provisions in the same way as other transactions.

31. The Working Group considered a proposed revision of the recommendations concerning rights of set-off as follows:

“(82) The insolvency law should protect a right of set-off existing under general law that was validly exercised prior to the commencement of insolvency proceedings [except as set forth in (82 A)].

(82 A) The exercise of set-off rights prior to commencement of insolvency proceedings should be voidable under the following circumstances:

[add any exceptions to (82)]

(83) The insolvency law should permit, without stay, the post-commencement exercise of valid set-off rights existing, but not exercised, at the time of commencement of insolvency proceedings where the mutual obligation arose in respect of the same transaction.

(83 A) The insolvency law should stay the exercise of set-off rights arising out of obligations in respect of separate transactions, subject to exceptions for certain financial contracts as set forth in Paragraph (84).

[(83 B) A creditor whose claim is subject to valid set-off rights existing at the time of commencement of insolvency proceedings, the exercise of which have been stayed pursuant to Paragraph (83 A), should be treated as having a secured claim to the extent of such valid but unexercised set-off rights, including the ability to obtain relief from the stay.]

(84) The insolvency law should permit the termination, close-out and set-off or netting of obligations under financial contracts, whether exercised pursuant to the respective contracts, related agreements or otherwise applicable law, and the exercise of the non-debtor party's rights in respect thereof (including the realization upon security in respect thereof) should not be stayed under the insolvency law.

(85) Obligations in respect of financial contracts and transfers of property in respect thereof should not be voidable under the insolvency law [except in the case of transfers intended to delay, hinder or defraud creditors].

(86) [add definition of financial contracts]”.

32. The revised recommendations sought to separate the subject matter into three key issues. Different opinions were expressed on the approach that the recommendations should take to those three issues.

33. On the first issue, regarding rights of set-off existing prior to insolvency as set forth in recommendations (82) and (82 A), strong support was expressed for a formulation to the effect that the insolvency law should protect a right of set-off under general law that was validly exercised prior to the commencement of insolvency proceedings, subject to the application of the avoidance provisions.

34. On the second issue, regarding rights of set-off following commencement of insolvency proceedings as set forth in recommendations (83) to (83 B), there was some support for providing for the right to set-off to be stayed subject to exceptions, but the Working Group was not able to reach agreement relating to further detail. In particular, some concern was expressed as to the treatment of the creditor referred to in recommendation (83 B) as a secured creditor, and it was noted that a number of approaches to that issue were adopted by different laws.

35. On the third issue, regarding rights of set-off concerning financial obligations as set forth in recommendations (84) to (86), there was some support for adapting the draft proposal to recommend a statement along the lines of, “In order to protect the integrity of the financial markets, the insolvency law should address how the commencement of insolvency proceedings will affect [existing] mutual financial obligations between the debtor and the creditor”.

36. It was agreed that the definition of financial contracts was central to recommendations (84) and (85). It was observed that a number of different definitions were used in different laws and although that might make it difficult to reach a single definition, those definitions might nevertheless inform the discussion in the Working Group.

37. It was proposed that because the subject matter required further discussion by the Working Group before an agreed position could be reached and because the time for that discussion might not be available at its current session, the revised text should be placed in square brackets for consideration by the Working Group at a future session. It was observed that, because of the importance of the issue of set-off in insolvency practice, it was of key importance to the usefulness of the Guide and should be addressed in as detailed a set of recommendations as possible.

## Part Two. Chapter IV. Participants and institutions

### A. *The debtor (A/CN.9/WG.V/WP.63/Add.10)*

#### *Recommendations*

38. The Working Group agreed that with the deletion of the text in square brackets the purpose clause was generally acceptable.

39. The Working Group agreed generally that recommendation (89) was acceptable. It was suggested that to ensure consistent use of terminology in the Guide either the phrase “insolvency proceedings” or a reference to “both liquidation and reorganization proceedings” should be used. It was noted that since under some insolvency laws the right to be heard could be modified in cases where the

debtor was not operational and could not be heard, or where shareholders and owners of the debtor could not expect to participate in distributions, that approach should be reflected in the commentary, but that the recommendation should not include any qualifications. That view was supported.

40. With respect to recommendation (90), the Working Group agreed that although the second sentence should be deleted, the content of the sentence should be reflected in the commentary. A concern was expressed that the right to request information should not be used to delay or frustrate proceedings and should therefore be restricted to information specified by the insolvency law or to information relating to the proceedings and to rights and obligations of the debtor. Those suggestions to include a limitation received support.

41. The view was expressed that recommendation (91) needed to be aligned more closely with recommendation (29), to ensure that the right to retain assets related only to the assets excluded by the insolvency law.

42. A number of suggestions were made with respect to recommendation (92) including: the addition of an obligation to prepare a list of debtors as well as of creditors; deletion of the words in square brackets in paragraph (a) together with the addition of that idea to the commentary; and addition of references to information on transactions in general, not just those occurring in the suspect period, to information on assets, liabilities, income and disbursements, as well as a reference to the need to provide the information at the commencement of proceedings, subject to allowing the debtor the time necessary to collect the relevant information. It was proposed that paragraph (e) should be amended to a provision requiring the debtor to provide notice if it should propose, or was forced, to leave its habitual place of residence. That proposal was supported. A further suggestion was that the recommendation should also address the movement of the headquarters of a legal person, which should require consent of the court or the insolvency representative. That suggestion was also supported.

43. In respect of paragraph (c) of recommendation (92), the Working Group agreed that it was not appropriate to refer to the debtor surrendering control of foreign assets to the insolvency representative, since in many cases the debtor may not be able to satisfy this obligation because of the law applicable in the foreign jurisdiction. Rather, the debtor should be required to facilitate, or cooperate in, the recovery by the insolvency representative of assets located abroad. It was recalled that, in previous deliberations, the Working Group had agreed that any definition of the property of the estate should be consistent with the Model Law on Cross Border Insolvency so as to include property of the debtor wherever located.

44. The Working Group agreed with the objective of recommendation (93), but noted that the obligation applied equally to the insolvency representative and creditors, and therefore might be more appropriately included elsewhere in the Guide. It was noted that there was a potential inconsistency between the obligation of confidentiality and the

obligation to provide information contained in recommendation (92) which should be taken into account in revising the recommendation. As a matter of drafting it was suggested that the words, “commercially sensitive”, were not clear and could be replaced by the phrase, “subject to obligations”.

45. After discussion, the Working Group agreed to retain the current text and all three approaches outlined in recommendation (94), with some minor amendments. It was observed, with some support, that the bracketed language in the chapeau was not necessary and might be deleted. Alternatively it was suggested that the text might be replaced with the words “during insolvency proceedings”. It was observed that the recommendation might be improved if the clauses were reordered with (c) and (b) appearing first in order to address reorganization, followed by (a) which was relevant in the liquidation context. Other drafting suggestions included changing the title of the recommendation to refer to the right of the debtor to continue its business, and deleting from (c) the words, “with no insolvency representative appointed”.

46. In discussing recommendation (95), the Working Group agreed that a distinction needed to be drawn between the level of liability of the debtor and the consequences of its failure to comply with its obligation, which should be fully discussed and cross-referenced in the commentary. It was noted that the issue of the invalidity of transactions entered into by the debtor was addressed by the recommendations on avoidance (specifically recommendation (68)) and could be deleted from (95). In discussing who the sanctions might apply to, wide support was expressed in favour of including in any definition of the debtor any responsible person who might generally be described to be in control of the debtor and should include any directors or management where the debtor was a corporation. Drafting suggestions included deleting the words, “whether a natural person or commercial entity”, and replacing the word, “invalid” with the phrase, “no legal effect”.

### ***B. The insolvency representative (A/CN.9/WG.V/WP.63/Add.10)***

#### *Recommendations*

47. The Working Group agreed that the substance of the purpose provision was acceptable.

48. With regard to recommendation (96), the Working Group agreed that the word, “may”, be replaced by “should”, and that the grounds that might exclude a person from being appointed as an insolvency representative should be discussed in the commentary. Suggested grounds included that the individual had been bankrupt, removed from a position of public administration or convicted of fraud. It was also suggested that the commentary could discuss positive qualities such as integrity and good management. It was noted that a law other than the insolvency law might provide the occupational regulation of insolvency representatives.

49. After some discussion, the Working Group agreed that recommendations (97), (98) and (105) might be redrafted to better explain the relationship between appointment and remuneration of the insolvency representative. In reaching that decision, the Working Group noted that the substance of recommendation (97) as currently drafted was acceptable, although it was suggested that the opening words might be amended to, “where an insolvency representative is to be appointed, the insolvency law should establish ...”, to ensure consistency with recommendation (94) (c). A general drafting suggestion was that the term, “assetless insolvency estate”, should be used instead of “assetless estate” and should be defined in the Glossary.

50. While the Working Group agreed substantively on the need to disclose any information regarding a conflict of interest, as currently required by recommendation (99), it was recalled that the Working Group had not reached a view on the extent to which a conflict should disqualify an individual from being appointed as an insolvency representative, as insolvency laws adopted different approaches to that issue. It was suggested that those different approaches should be discussed in the commentary. Some support was expressed in favour of the proposal that where a conflict of interest affected the independence or impartiality of the insolvency representative, then that individual should not be appointed or, if the conflict arose in the course of the proceedings, disqualified from continuing. It was agreed that such a rule should apply to employees, or potential employees, of the insolvency representative, and that that should be reflected in any revision of the recommendations. Drafting suggestions included revising the current repetitious text in recommendation (99), and inserting words at the beginning of the recommendation to the effect that it would be undesirable for a person who disclosed a material conflict of interest to be appointed as insolvency representative. It was also suggested that the Guide should indicate the party to whom a conflict of interest should be disclosed. The connection between recommendations (99) and (102) was noted, and it was suggested that the two provisions might be combined. It was further suggested that the Guide should clearly state that the obligation to disclose should be ongoing throughout the insolvency proceedings.

51. With respect to recommendation (100), it was recalled that the Working Group, at previous sessions, had considered two different approaches to that recommendation—including placing the list of the insolvency representative’s duties and functions in the recommendation or in the commentary—and support had been expressed in favour of both approaches. After further discussion, it was agreed that the examples listed in paragraphs (a) to (n) of the recommendation should be included in the commentary, with some additions including a duty to observe confidentiality and to maintain an updated list of the claims verified and admitted. It was noted that inconsistencies between the different duties and functions, such as between paragraphs (a) and (g) of the recommendation, and between the examples given in paragraph 242 and those in the recommendation could more easily be explained if the list was to be included only in the commentary. On the basis that recommendation (94) (c) referred to the debtor-in-possession as a possible approach in reorganization, it was

suggested that in revising the list of duties and functions to be included in the commentary, those specifically affected by the debtor-in-possession approach could be identified. In revising the recommendation, the Secretariat was requested to consider the addition of some words after “duties and functions” to elaborate the focus of those duties and functions, along the lines of “in respect of the administration of the proceedings and preservation and protection of the insolvency estate”.

52. In view of the Working Group’s decision in respect of recommendations (99) and (100), it was agreed that the references to those recommendations in recommendation (101) should be deleted. While it was noted that there was a problem of drafting in the first sentence in relation to the “consequences ... arising from ... the insolvency representative’s performance of its duties”, there was agreement that the sentence should address the ideas of non-performance of, and failure to properly perform, the insolvency representative’s duties and the possible liability arising in each instance. A suggested addition was a reference to the possibility that in certain cases the insolvency representative would not be personally liable, for example, under certain insolvency laws there would be no personal liability for environmental damage caused by the debtor prior to the appointment of the insolvency representative.

53. It was proposed in respect of recommendation (102) that paragraph (b) should include a reference to qualifications in addition to the reference to competency. A further proposal was to include a reference to circumstances where the function of the insolvency representative changed, such as where proceedings were converted from liquidation to reorganization. That conversion might require the existing insolvency representative to be replaced on the basis of qualifications or competency or, as in the case of a debtor-in-possession in reorganization, to be removed and not replaced. Those proposals received some support. It was suggested that where the insolvency representative was sued in its official capacity the Guide should discuss the need for that suit to be considered by the same court as had appointed the insolvency representative in order to avoid uncertainty and confusion.

54. As matters of drafting, it was agreed that recommendation (103) should commence with the words, “The insolvency law should include a procedure for removal of the insolvency representative ...”; and that the word “but” be replaced by “and”. It was also agreed that the recommendation should provide the insolvency representative with the right to be heard in any instance where it was to be removed, whether at the instigation of creditors or by a decision of the court, on the basis that removal was a sanction and the insolvency representative would always have the right to present its case.

55. It was suggested that since some insolvency laws required the resignation of the insolvency representative to be approved by the court, that possibility should be reflected in recommendation (104). It was agreed that the recommendation should not specifically require that approval, but could refer to the need for the insolvency law to indicate whether or not approval might be necessary.

56. In respect of recommendation (105), it was suggested that the priority be specified to be an administrative priority. In response, it was recalled that the reference to the level of priority was not specific in order to accommodate the different views on that matter that had been expressed in previous sessions of the Working Group.

### C. Creditors (A/CN.9/WG.V/WP.63/Add.11)

#### *Recommendations*

##### *— Classes of creditors*

57. With respect to the purpose clause, the Secretariat was requested to prepare a draft based upon lines 5-12 of paragraph 261 of the commentary, incorporating the ideas of equal treatment of similarly situated creditors, and to consider the placement of the topic in the Guide.

58. The Working Group agreed that the text in square brackets at the end of recommendation (106) should be moved to the commentary and the examples expanded to include other provisions of the insolvency law that provided different treatment on the basis of classes of creditors.

##### *— Participation of creditors*

59. With respect to the purpose clause, it was suggested that paragraph (b) was too narrow and would not accommodate those situations where a creditor committee was not required or was not appropriate. It was also suggested that the focus should be upon facilitating the participation of creditors, which could be achieved through the mechanism of a creditor committee. To reflect those suggestions, it was proposed that paragraphs (b) and (c) be combined along the following lines: “(b) to provide a mechanism for the appointment of a creditor committee where to do so would facilitate the participation in the insolvency proceedings of the general body of creditors”. That proposal was accepted.

60. While the Working Group agreed that the general body of creditors should be required to approve a reorganization plan under paragraph (a) of recommendation (107), some concern was expressed as to the intended interpretation of paragraph (b). It was suggested that the creditors should be able to determine the matters on which they wished to advise the insolvency representative (rather than those matters being determined by the insolvency representative) and that the issues on which they could advise should be generally formulated as “relating to administration and property of the estate”. Another suggestion was that the creditors should have the right to make decisions on a number of matters included in paragraph (b) in addition to providing advice. It was recalled that recommendation (107) was intended to establish a minimum standard and on that basis the chapeau to the second sentence might be redrafted along the lines of “Those powers and functions could include”, which would be followed by paragraph (a) and a more general formulation of paragraph (b). The detail of paragraph (b) could be included in the commentary. The Secretariat was requested to prepare a revised draft based on those considerations.

61. With respect to recommendation (108) it was proposed that the reference to voting requirements was too narrow and eligibility requirements should also be included.

62. A proposal that recommendation (109) be reformulated along the lines of "The insolvency law should specify matters on which creditors should have the individual right to be heard in the insolvency proceedings" was supported. The specific matters to be included in the insolvency law should then be discussed in the commentary.

63. A number of views were expressed on recommendation (110). Some support was expressed in favour of the use of the word "may" where it appeared in square brackets in the first and second sentences and for amending the words "claim is secured" at the end of the second sentence to "claim is unsecured". Some concern was expressed that the Working Group might not have a common understanding of the word "participation"; in some cases it might be understood to include the right to appear, to be heard and to vote while in others it might only include the right to vote. To overcome any possible differences in interpretation, it was suggested that the recommendation should clearly indicate what "participation" was intended to encompass. As a matter of drafting it was observed that there were several possible interpretations of the words "limit their participation" in the second sentence of the recommendation and an amendment to "permit their participation" was proposed. To ensure the right of secured creditors to be heard and to participate it was suggested that in addition to the changes proposed for recommendation (110), recommendation (109) should refer to "all creditors, whether secured or unsecured". With respect to the last sentence of recommendation (110), it was suggested that the participation of secured creditors should be limited to the extent that their interests were prejudiced under the reorganization plan and that the words "restructured under" should be amended to "affected by". Another suggestion was that secured creditors should be required to participate in reorganization proceedings in order to ensure the best possibility of success of the proceedings. A different view was that that participation could not be expressed as a requirement. A further suggestion was that that issue was addressed elsewhere in the Guide and the last sentence of the recommendation could therefore be deleted. After discussion, the prevailing view was that the word "may" in the first and second sentences was preferred; that the reference to participation in the second sentence should be limited to the extent the claim was unsecured; and that the words "restructured under" in the last sentence should be amended to "affected by". It was recalled that the issues addressed in recommendation (110) had been discussed in the context of the first joint session of Working Groups V and VI (document A/CN.9/535, paras. 15-16) and it was agreed that the text should be aligned with the decisions of that meeting.

64. As a matter of drafting it was suggested that the order of recommendation (111) should be amended along the following lines: "The insolvency law should provide that the court, the insolvency representative or creditors holding (*specify a percentage of the value of*) unsecured

claims." In terms of substance, it was suggested that the recommendation should distinguish between several different ideas; firstly, between the party that may call for a meeting to be held (which could be the creditors, the insolvency representative or the court on its own motion) and the party that would be responsible for advising creditors of the meeting (which generally would not include creditors), and secondly, between a first meeting of creditors (which it was noted was a requirement of some insolvency laws but not of others) and other ad hoc meetings of creditors which might be requested by the parties noted above. To reflect the second distinction, it was proposed that an additional recommendation should be included along the lines of: "The insolvency law may provide that there be a first meeting of creditors" or "The insolvency law should set forth the circumstances in which a meeting of the general body of creditors is convened. Those circumstances may include: [...]" The Working Group agreed that the recommendation should reflect those different ideas and the Secretariat was requested to prepare a revised version on that basis.

65. In respect of recommendation (112), some support was expressed in favour of removing the square brackets from the text in the first sentence. As a matter of substance, there was general agreement that the participation of creditors should be facilitated and encouraged and that some mechanism, such as a creditor committee, was desirable, although it was recognized that there were other possible mechanisms. To recognize the use of other mechanisms, it was proposed that the words "or other representative" could be added at the end of the first sentence.

66. A proposal to replace the words "provides for" in the first sentence of recommendation (113) with the word "permits" was supported. Some support was also expressed in favour of the view that the second sentence of recommendation (113) be deleted and the content included in a footnote, or discussed in the commentary. It was observed that one of the checks and balances that should apply in the case of a debtor-in-possession in reorganization was provided by a creditor committee and that a cross-reference to recommendation (94) and the associated footnote would be appropriate. It was also observed that dispute resolution mechanisms might be a matter more appropriately left to States and the Guide should refrain from discussing the issue in detail.

67. With regard to recommendation (114), the Working Group agreed that the opening sentence might be simplified. Drafting suggestions included to separate the two points made by inserting a full stop after the words, "to the committee", and to redraft the opening words to read, "The insolvency law should specify which creditors are eligible to be appointed to the committee". It was pointed out that since "related person" was a defined term it did not need further clarification in the recommendation. Preference was expressed in favour of retaining "may" in the second sentence rather than "should", and replacing the examples of related persons with words to the effect of "others who for any reason might not be impartial".

68. The substance of recommendation (115) was agreed to be acceptable.



69. After discussion, support was expressed for strengthening the functions of the creditor committee in recommendation (116), while noting that the list included was not exhaustive. The Working Group affirmed the right to be heard in (116) (c) and noted the need for alignment with recommendation (109). Support was also expressed in favour of clarifying that the right of creditors to require information from the insolvency representative extended to the creditors committee. A number of drafting suggestions were made including removing the opening words in (116) (a) up to, and including, “function”; adding the words, “and the debtor-in-possession” at the end of (a); replacing the word, “supervisory” in (b) with “participatory”; after the word, “matters” in paragraph (b), inserting the text, “in which their class has an interest”; and adding at the end of (c) the words, “by the insolvency representative or the court”. It was also suggested an additional clause (d) could be added to provide a right for the creditor committee to hear the insolvency representative at any time. It was agreed that the right of the creditor committee to act independently of the insolvency representative should be included in the commentary in respect of both recommendations (116) and (107).

70. In recommendation (117), the Working Group agreed that the approval required was that of the court, and that the reference to the general body of creditors be deleted. It was also agreed that the approval should relate not only to selection and employment, but also to remuneration. A question was raised as to whether or not the insolvency representative could have a role to play in that regard, but no views were expressed on that issue. It was agreed that although recommendation (117) covered both employment and remuneration, those issues should be addressed as drafted because of the links between them and that compensation and payment should be further addressed in the commentary. It was observed that the relevance of the employment of professionals depended upon the mandate given to the creditor committee in any particular State.

71. So as not to provide a disincentive to participation in the creditors committee but to ensure that members of the committee should not be entirely exempt from liability for failing to act honestly and in good faith, it was agreed that recommendation (118) should refer to fraudulent and [wilful] misconduct, rather than negligence, as the only grounds for liability, and that discussion of the need for the exemption be included in the commentary. It was suggested that that discussion should include what might be required for compliance with a standard of acting honestly and in good faith. It was also suggested that the commentary might note that, in terms of liability, creditor committee members could be distinguished from the insolvency representative on the basis that they were not insolvency professionals and were not remunerated. It was agreed that the words “for example” be deleted.

72. The Working Group agreed that the examples in recommendation (119) should be deleted and discussed the commentary with the additional grounds of independence and conflicts of interest. It was also suggested that the commentary point out that the exercise of the power to remove members of a creditor committee depended upon the method of appointment adopted.

73. While noting that recommendation (120) was generally useful, the Working Group agreed that it should be deleted as a recommendation, but included in the commentary.

#### ***D. Institutional framework (A/CN.9/WG.V/WP.63/Add.11)***

74. It was agreed that the current drafting of the commentary covered the relevant issues and that recommendations were neither necessary or appropriate. It was suggested that the importance of the institutional framework could be better emphasized by including the discussion in the opening chapters of the Guide.

### **Part Two. Chapter V. Reorganization**

#### ***A. The reorganization plan (A/CN.9/WG.V/WP.63/ Add.12)***

##### *Recommendations*

75. A number of suggestions were made with respect to the purpose clause. With respect to paragraph (a) it was proposed that the principal purpose of rescuing businesses should be to maximize the value of the insolvency estate for the benefit of all creditors, as noted in paragraph (b), rather than the protection of investment and the preservation of employment as noted in paragraph (a). With respect to paragraph (c) it was suggested that the use of the word “approved” should be clarified in terms of court or creditor approval. In response it was observed that “approval” was used with respect to creditors and “confirmed” with respect to the court, and it was suggested that a reference to confirmation needed to be added to the purpose clause. A contrary view was that since other recommendations left open the issue of whether or not court confirmation was required, it should not be added as a requirement to the purpose clause. It was also suggested that the words “an approved” could be deleted in reference to the plan in paragraph (c). An additional suggestion was to add a reference to the purpose of the provisions being to identify those businesses that were salvageable and, by implication, those that were not.

76. With respect to recommendation (121), support was expressed in favour of the word “proposed” being used rather than “prepared” or “filed”. Support was also expressed in favour of revising the recommendation to accommodate timing issues that would arise where the proceedings were converted to reorganization from liquidation and where unitary proceedings were commenced, as well as to take into account those cases where no reorganization plan might be required.

77. The substance of recommendation (122) was found to be generally acceptable, with a preference being expressed for the phrase “permitted to propose”.

78. The substance of recommendation (123) was found to be generally acceptable, provided the words in square brackets in both the chapeau and paragraph (b) were deleted and both issues were discussed in the commentary, and the word “should” in paragraph (a) was adopted.

79. Some concern was expressed as to the need for both recommendations (124) and (125). In response it was recalled that the Working Group had agreed on the need for both recommendations on the basis that they performed different functions, and that that approach should be maintained. In response to a query concerning the meaning of the phrase “debtor’s charter” in recommendation (124) (c) (iii), it was noted that that phrase was intended to be a reference to an organic document of the company, such as the company charter or statute (however generally described), that may need to be modified in order to give effect to proposals contained in the reorganization plan. To ensure flexibility, it was suggested that the chapeau should provide that the plan “may” include the information set forth in paragraphs (a) to (d).

80. Support was expressed in favour of describing the statement in recommendation (125) as a disclosure statement. With respect to the underlined text in the second sentence of the chapeau, some concern was expressed as to the requirement that the statement and the plan be prepared by the same party, on the basis that it might not always be appropriate depending upon who prepared the plan or to accommodate preparation by a professional adviser. Retention of the underlined text, however, received support, and it was noted that that matter was satisfactorily addressed in the commentary. To accommodate the situation where the insolvency representative did not prepare the plan or the statement, it was suggested that the insolvency representative could usefully be required to provide its view on the plan proposed. That proposal received support. With respect to paragraph (d), it was proposed that the words following “effect of the plan” be replaced by the words “adequate provision has been made for satisfaction of all obligations provided for in the plan”. An alternative suggestion, which received support, was that the reference to matured debts should be deleted and the square brackets removed from the alternative text, and that the words “and the debtor will have” be amended to “and the debtor is expected to have”.

81. The substance of recommendation (126) was found to be generally satisfactory, subject to expanding the parties to whom the statement and plan should be submitted to include other interested parties, such as shareholders. It was noted that that change would also need to be made to other recommendations in the chapter.

82. With respect to recommendation (127), support was expressed in favour of the following drafting changes: in the second sentence, changing “address:” to “specify”; “creditors who are required” to “creditors who are entitled”; and the vote “can be conducted” to “will be conducted”. A suggestion was made that the disclosure statement referred to in recommendation (125) could usefully include information on voting mechanisms. Another suggestion was that the reference to “general body of credi-

tors” in the last line should refer to the general body of “unsecured” creditors on the basis that it would be difficult to see how creditors with different legal rights could be included in a single voting body. In response, it was suggested that since the phrase “general body of creditors” had a particular meaning in the text, that that proposal required some further consideration. The Secretariat was requested to take that suggestion into account in revising the recommendation.

83. Several views were expressed in respect of the reference in the third sentence of recommendation (128) to the majority of creditors “actually voting”. One view was that it was inappropriate, in view of the prevalence of creditor apathy, to allow what might amount to a very small, unrepresentative group of the total number of creditors to decide the course to be followed. In response, the acceptability of the contrary approach of allowing those not participating in the process to effectively disenfranchise those creditors who did participate and vote was questioned. It was observed that in practice requiring the approval of a majority of creditors would make it very difficult to obtain approval of a reorganization plan. It was also noted that the use of proxies and electronic means of voting made it increasingly easy to vote without having to physically attend a meeting of creditors. A number of different approaches to the manner in which insolvency laws treated creditors not voting were noted. After discussion, the prevailing view was that the reference to the majority of creditors actually voting should be retained. A further suggestion was that the first sentence should include the possibility of voting on the plan by the general body of creditors in addition to classes of creditors. The view was expressed that the recommendation needed to be more flexible in order to provide for the possibility that the plan presented to creditors for approval might be negotiated with creditors in the course of approval and ultimately not be exactly the same as the plan submitted for approval. As a matter of drafting, it was suggested that the word “supporting” in the second sentence be replaced with “approving” or “voting in favour of”.

84. Concerns were expressed as to the current formulation of recommendation (129) and the difficulty of applying it in practice, given the need to recognize the different priorities and rights of creditors. In response to a suggestion that the Guide note the need to address the issue and cite possible approaches, it was observed that the issue was of particular importance and required the provision of specific guidance. That guidance might be provided either by requiring all classes of creditors to approve the plan or adopting a more complicated formula which took into account the different priorities and interests of creditors. The Working Group decided to delay its consideration of the issue to a later time.

85. The substance of recommendation (130) was agreed to be acceptable.

86. The Working Group discussed the relationship between recommendations (131) and (133) and the question of whether the grounds for challenge should be the same in each case. It was recalled that the Working Group had

originally decided to adopt separate recommendations with different criteria, but some support was expressed in favour of reconsidering that decision and amalgamating the two recommendations. In that regard, it was proposed that (131) could be expressed as a paragraph of (133) to address those cases where the law did not require confirmation of the plan. It was also suggested that the recommendations should make it clear that creditors could object to a plan (and that that objection be made to the court) notwithstanding the majority support of the class to which they belonged. It was observed that there was a potential problem in relation to recommendation (131) with the timing of the objection being required to be made before the plan “otherwise [became] binding”, especially where it was the approval of the plan that established its binding effect. A ground of objection suggested for addition to recommendation (131) was that a particular creditor had been treated very badly by the majority of creditors. That addition was supported. In revising the recommendations, the Secretariat was requested to take account of the proposal to amalgamate recommendations (131) and (133) as discussed.

87. The Working Group agreed that it needed to undertake further discussion at a future session with the aim of consolidating and elaborating upon the treatment of cramdowns and related issues in this section of the Guide. It was suggested that recommendations (131) and (133) should refer to the fair and equitable treatment of creditors and it was agreed that a new paragraph (*d*) be added to both (131) and (133), as amended, to the effect that the treatment of the plan must conform to the ranking of claims as set out in the insolvency law, with a discussion of the priorities of creditors and issues of discrimination to be included in the commentary. A suggestion was that the Guide might need to address what would occur where the plan was not approved by the requisite majority.

88. Support was expressed for retaining the words, “specified in the plan”, in recommendation (132) without the brackets. Drafting suggestions included retaining the term, “stakeholders”, but defining it in the Glossary; clarifying in the second part of the recommendation that the plan was binding because it had either been approved by majority vote or confirmed by the court; and noting the effect the plan would have on third parties.

89. Regarding recommendation (134), the Working Group agreed that the insolvency law should provide for amendment of the plan after approval by creditors, and before and after confirmation (where required) in certain circumstances. It was agreed to remove from the recommendation both instances of the qualification “limited” and the grounds or examples detailed in the second sentence and to place that discussion in the commentary, noting that those grounds should be limited. A further suggestion was that the order of (134) and (133) be reversed.

90. There was strong support for requiring in recommendation (135) the provision of notice to affected creditors and an indication as to the party responsible for providing notice. It was also observed that if the original plan had to be approved by the court, it would be appropriate for any amendment also to be so approved and for a requirement

for disclosure of information relevant to the amendment. It was also suggested that recommendation (135) be expanded to discuss what consequences would follow from the rejection of a proposed amendment to the plan.

91. After extensive discussion, it was agreed that the drafting of recommendations (131), (133) and (136) needed to be reconsidered to provide a structured response to the issues raised in the Working Group, and in particular the distinction to be drawn between an approach requiring approval of the plan by creditors and confirmation by the court on the one hand and the approach which required only approval by creditors on the other. While recommendations (131) and (133) appeared to address, in turn, the requirements for creditor approval and court confirmation of the plan, it was agreed that the grounds and possible limitations for the recommendations needed to be coordinated. While recommendation (136) might apply to both of these situations, it would be distinguished from recommendations (131) and (133) by allowing, in limited circumstances, a post-approval challenge to the plan. In recommendation (136), there was support for substituting the word “should” for “may”, and deleting the words, “improper conduct of the approval process” and “or [other grounds]” to limit the scope of (136) to fraud. Support was also expressed for introducing a time limitation based on the discovery of the fraud, to state who might challenge the plan, that the challenge be in the court and to outline the consequences of a successful challenge. It was observed that the coordinated effect of the three existing recommendations should be that a plan confirmed by the court should only be subject to objections on substantive, or non-procedural, grounds.

92. The Working Group agreed to the substance of recommendation (137) as currently drafted, although noting that the optional nature might be appropriate in the situation of a debtor-in-possession, but that where the proceedings involved an insolvency representative up to the point of approval of the plan, it may be appropriate to consider some form of supervision of the implementation of the plan. It was noted that insolvency laws that provided for conclusion of the proceedings once a plan had been approved did not address the possible supervision of implementation.

93. It was agreed that the grounds for conversion in recommendation (138) should be expanded to include those situations where reorganization did not maximize the value of the estate; the plan was not approved; a confirmed plan was not implemented; or there was a successful challenge to a confirmed plan. Strong support was expressed for replacing the concept of failure in the recommendation with language indicating a material or substantial breach of the terms of the plan and a material or substantial default under the plan, and replacing “should” in the second sentence with “may”. It was also suggested that the words, “and the plan cannot be amended”, be deleted. Strong support was expressed in favour of the conversion to liquidation not occurring automatically and requiring consideration by the court. With regard to the second sentence, it was suggested that the effect of the conversion on other matters agreed in the reorganization, such as reduction of claims (“haircuts”), be addressed in the commentary.

**B. Expedited reorganization  
(A/CN.9/WG.V/WP.63/Add.12)**

*Recommendations*

94. Some concerns were expressed as to the length of the purpose clause and the level of detail included. In response it was recalled that the Working Group had decided on that level of detail in order to introduce and explain a concept that was unfamiliar in many jurisdictions, but it was noted that some changes could be made to improve the drafting. Drafting changes proposed included: in paragraphs (a) to (d) to replace “out-of-court reorganization” with “out-of-court negotiation”; in paragraph (c) (i) to delete the reference to equity holders; in paragraph (c) (iv) to replace “procedural” requirements with “substantive” requirements and delete the words “for dissenting affected creditors”; and in paragraph (d) to replace the opening words “recognize that” with “suspend with appropriate safeguards”. Some support was expressed in favour of those amendments. It was also suggested that in order to shorten the purpose clause some of the detail, such as in paragraph (d), could be reconsidered and placed in the commentary. A proposal of a substantive nature was that the Guide should consider addressing two types of procedure: firstly, a procedure which provided expedited access to reorganization proceedings based upon the approval conditions of the insolvency law (which would be appropriate for those systems which had developed effective reorganization laws) and secondly, a procedure which established special approval conditions for those systems which did not have effective reorganization laws. It was proposed that the Working Group defer its consideration of the purpose clause until it had revised the substantive recommendations.

95. With respect to recommendation (139), support was expressed in favour of the expedited procedure being available to debtors who were natural persons. Suggestions as to drafting were to replace the words “will be unable to pay” with “is likely to be unable to pay” and to delete the reference to equity holders. Those proposals were supported. With respect to the commencement criteria, it was observed that they should be the same as those generally applicable to reorganization proceedings as contained in revised recommendation (18 A). A different suggestion was that the procedure needed to encompass both debtors who were insolvent and debtors who were in financial difficulty, but not yet insolvent. After discussion, the prevailing view was that the recommendation should address debtors who were unlikely to be able to pay their debts and debtors eligible under revised recommendation (18 A). In terms of the voting requirements referred to in the recommendation, it was suggested that they should mirror those applicable under the insolvency law (recommendation (128)) and that that could be facilitated in recommendation (139) by deleting the words “the vote of a majority of”.

96. Different views were expressed on the desirability of retaining paragraphs (a) to (g) in the recommendation, but after discussion it was agreed that they provided necessary information and should be retained. Several drafting changes were proposed: in paragraph (b) to delete the reference to equity holders; in paragraph (e) to replace the words after “creditors” with the phrase “whose rights are modified

by the plan”; in paragraph (f) to delete the words after “reorganization plan” and substitute, “satisfies all applicable requirements for reorganization”; and to delete the reference to the party preparing the financial statement. Some concern was expressed as to the limitation in respect of fiscal authorities, and support was expressed in favour of their rights being capable of impairment provided they agreed. An additional proposal was to add a reference to social security authorities. A suggestion that the recommendations should be harmonized with the requirements for approval of a reorganization plan was generally supported.

97. The Working Group agreed that the chapeau of recommendation (141) should include both texts in square brackets as alternatives. In response to concerns expressed as to the need for paragraph (b), it was noted that there would be cases where a creditor committee could facilitate negotiations with a large group of creditors such as public bondholders or where a large number of banks appointed a bank steering committee and that it should therefore be retained. That proposal was supported. With respect to paragraph (c), it was suggested that it was of central importance to the type of procedure addressed in the section and should be placed above existing paragraph (a). In paragraph (a), it was suggested that the square brackets should be removed from “equity holders”.

98. With respect to recommendation (142), it was agreed that the reference to equity holders in the chapeau should be retained and a new paragraph (d) added to include the impact of the plan on equity holders. A further addition proposed was a paragraph addressing the time and procedure for submission of an objection to the amount of claims made by third parties. It was observed that the recommendation on notice should be coordinated with similar recommendations in other chapters of the Guide.

99. The Working Group agreed that the emphasis of recommendation (143) should be on expedited reorganization requiring judicial approval and that the general process for confirmation in expedited proceedings should be coordinated with that for conventional reorganization proceedings in recommendation (133). As a matter of drafting, support was expressed in favour of inserting the word “substantive” before the word “requirements” in paragraph (a) and for deleting the idea of “feasibility” in paragraph (c).

100. Drafting changes suggested with respect to recommendation (144) included deleting the words commencing with “who” at the end of the recommendation and substituting the words “and equity holders affected by the approved plan”; and including a reference to the debtor. It was suggested that consideration be given to how the effect of an expedited plan should or did differ from the effect of a conventional plan.

101. The Working Group discussed the rights that creditors would have in the circumstances outlined in recommendation (145) and it was generally agreed that creditors should be able to exercise the rights they would have at law, whatever they might be. It was suggested that a discussion of the different alternatives could be included in the commentary. It was also suggested that the consequences of failure of implementation of a plan should be

considered and coordinated with similar provisions in respect of conventional reorganization plans (see recommendation (138)), although it was noted that there may be reasons for maintaining a different provision, for example, on the basis that the debtor under an expedited procedure was not insolvent.

## Part Two. Chapter VI. Management of proceedings

### A. Creditor claims

#### *Recommendations*

102. The substance of the purpose clause was found to be acceptable with the deletion of the words after “admission” in paragraph (a).

103. With respect to recommendation (146), it was suggested that the reference to a “mechanism” was not sufficient and the recommendation should establish a “requirement” for creditors to file claims. It was also suggested that “automatic” admission probably was not appropriate and the recommendation should recognize the need to minimize formalities for submission. In support of that view, it was proposed that claims that were not challenged might be admitted with minimum requirements for evidence, such as by reference to the list of creditors that was to be filed under recommendation (92) (b) (v), rather than to the books and records of the debtor. A further suggestion was that claims denoted in foreign currency should not be entitled to special treatment on that basis alone and that the reference to that effect should be deleted from the footnote.

104. After discussion, the Working Group agreed that the detail in recommendation (147) should be retained in the recommendation rather than moved to the commentary. As matters of drafting, agreement was expressed in favour of the use of the terms liquidated and unliquidated; adding a cross-reference to recommendation (59) in respect of claims arising from the rejection of contracts; aligning the terminology with the Glossary; and deleting the words “if any” from the second sentence. It was also suggested that the recommendation should include a reference to whether or not the claim was subject to a set-off. A question was raised as to whether the recommendation was limited to claims for payment by the debtor or would also include claims for payment by a third party or guarantor arising from acts or omissions of the debtor. It was agreed that an explanation should be included in a footnote.

105. It was agreed that recommendation (148) should be coordinated with recommendation (151) and the decisions of the joint session of Working Groups V and VI (Vienna, 16 December 2002).

106. After discussion, it was agreed that recommendation (149) should focus on the equal treatment of claims both in respect of the submission procedure and the processing of claims, and that the references to similarly situated creditors should be retained.

107. Concern was expressed with respect to the first phrase of recommendation (150) (b) “at any time prior”,

and its deletion was supported. It was observed that the recommendation should clarify what was meant by the word “consideration” in paragraph (b). Preference was expressed in favour of retaining the second bracketed text regarding the giving of notice of commencement.

108. The substance of recommendation (151) was generally found to be acceptable with the deletion of the words after “specified time”.

109. In respect of recommendation (152), general support was expressed for including a discussion of whether it was necessary to require claims denoted in foreign currency to be converted and the reasons for requiring conversion, e.g. for purposes of determining voting rights. Support was also expressed in favour of the need to determine a specific time for conversion, with some preference expressed for commencement, but it was also noted that there could be different national approaches and that there may be a need to adopt special measures to address situations of high currency instability.

110. The substance of recommendations (153) and (154) was generally found to be satisfactory.

111. In respect of recommendation (155), the Working Group agreed that there was a need to provide for claims to be disputed before they are admitted and to clearly identify who may dispute a claim, including whether a creditor could dispute the claim of another creditor. It was agreed that the recommendation should focus on disputes arising in the context of the insolvency proceedings and disputes already in existence at the time of commencement would be affected by that commencement (e.g. the stay) and addressed elsewhere in the law.

112. A proposal was made to amend the last phrase of recommendation (156) along the lines of “could take into account any question relating to set-off”. After consideration, it was agreed to defer the Working Group’s deliberations on the recommendation in light of the decision already taken to defer consideration of chapter III. F on set-off to a future session.

113. The substance of recommendations (157) and (158) was found to be generally acceptable.

114. The substance of recommendation (159) was found to be generally acceptable, provided it was clear that the admission of a claim would entitle a creditor to participate in the proceedings more broadly than provided in paragraph (a) and that the issue of admission would not operate to limit the right to be heard.

115. With respect to recommendation (160), some concern was expressed that the use of the phrase “for example” should not be interpreted to be exhaustive and that the terms “undercapitalization” and “self-dealing” might not be sufficiently clear and warranted further explanation. It was also suggested that restriction of voting rights should occur only in limited circumstances and that the possibility of subordination of claims should not be eliminated, and should be possible in cases other than those involving related persons.

## *B. Post-commencement finance*

### *Recommendations*

116. The substance of the purpose clause was found to be generally acceptable.

117. Drafting changes agreed in respect of recommendation (161) were that the word “permit” should be changed to “facilitate”; and that the reference to “creditors” be broadened to include the creditor committee since that body may also have powers of authorization on that issue.

118. Support was expressed in favour of retaining the words in square brackets in recommendation (162), although it was acknowledged that those assets would not generally be relevant. It was suggested that the commentary should note that frequently the only unencumbered assets available for securing post-commencement finance were assets recovered through avoidance proceedings. It was also suggested that the commentary should clearly address the difference between obtaining security and giving priority and note that security was only relevant where assets that were not totally encumbered were available.

119. With respect to recommendation (163), the view was expressed that the rule on priority may be contained in law other than the insolvency law and the recommendation should accommodate that possibility. In response, it was suggested that the rule should be in the insolvency law or

at least referred to in the insolvency law. As a matter of drafting, it was suggested that it was unnecessary to include a notice requirement, since the obtaining of consent would necessarily imply the giving of notice.

120. The Working Group agreed that the first sentence of recommendation (164) should be discretionary and “should” therefore be replaced with “may”. As a matter of drafting, support was expressed for retaining the word “creation”; retaining “secured creditor” in paragraph (a); aligning paragraph (a) with recommendation (163) in terms of the giving of notice; deleting the words after “unreasonable harm” in paragraph (c); redrafting paragraph (c) to refer to “protection of the secured asset over which security is given”; and amending the words “will not suffer unreasonable harm” to “will not be exposed to an unreasonable risk of harm”. It was agreed that the concept of “adequate protection” should be defined.

121. With respect to recommendation (165), it was suggested that the square brackets be removed from the words “including ...” and the text retained. Some concern was expressed as to the effect of the second sentence and it was suggested that, while the priority from the reorganization should continue to be recognized, it should not necessarily be of the same order. For example, it should not rank ahead of the administrative claims arising from the liquidation. It was suggested that that qualification could be added.

122. For lack of time, the Working Group completed its deliberations with recommendation (165).

**E. Working paper submitted to the Working Group on Insolvency Law at its twenty-eighth session:**

**Draft legislative guide on insolvency law  
(A/CN.9/WG.V/WP.63/Add.1-2 and Add.16-17)**

**[Original: English]**

**A/CN.9/WG.V/WP.63/Add.1**

**Note by the Secretariat**

*[Part One, Chapters I and II of the Guide appear in document A/CN.9/WG.V/WP.63/Add.2; Part Two of the Guide appears in documents A/CN.9/WG.V/WP.63/Add.3-17]*

**Glossary**

**A. Notes on the terminology used in the Guide**

1. The following terms are intended to provide orientation to the reader of the Guide—many terms such as “secured creditor”, “liquidation” and “reorganization” may have fundamentally different meanings in different jurisdictions and the inclusion of a definition in the Guide may assist in ensuring that the concepts as discussed in the Guide are clear and widely understood.

*— References in the Guide to the “court”*

2. The Guide assumes that there is reliance on court supervision throughout the insolvency proceedings which may include the power to commence insolvency proceedings, to appoint the insolvency representative, to supervise its activities and to take decisions in the course of the proceedings. Although this reliance may be appropriate as a general principle, alternatives may be considered where, for example, the courts are unable to handle insolvency work (whether for reasons of lack of resources or lack of requisite experience) or supervision by an administrative agency is preferred (see Part two, chapter IV.D Institutions).

3. For the purposes of simplicity the Guide uses the word “court” in the same way as article 2(e) of the UNCITRAL Model Law on Cross-Border Insolvency to refer to a judicial or other authority competent to control or supervise an insolvency proceeding.

**B. Terms and definitions**

Administrative claim	Claims that are generally accorded priority over unsecured claims and which relate to costs and expenses of the proceedings such as remuneration of the insolvency representative and any professionals employed by the insolvency representative, debts arising from the proper exercise of the insolvency representative’s functions and powers, costs arising from continuing contractual obligations, and costs of proceedings [see para. 426, A/CN.9/WG.V/WP.63/Add.14].
Appropriate protection	Measures directed at maintaining the economic value of a security interest during the insolvency proceedings (in some jurisdictions referred to as “adequate protection”). This protection may be particularly relevant where the value of the secured claim is greater than the value of the secured asset or even where the value of the secured asset exceeds the value of the secured claim, but the value of the secured asset is diminishing and ultimately may be insufficient to satisfy the secured claim. Such diminution in value may be affected by the application of the stay to secured creditors and by the use of the secured asset in the insolvency proceedings (see recommendation (42)). Appropriate protection may be provided by way of cash payments, provision of alternative or additional security or by other means as determined by a court to provide the necessary protection.

Avoidance action	Action which allows transactions [occurring prior to the application for commencement of insolvency proceedings or commencement of insolvency proceedings] to be cancelled or otherwise rendered ineffective. Transactions that may be avoided include [ <i>terms of recommendation (70) to be added</i> ].
Centre of main interests	The place where the debtor conducts the administration of its interests on a regular basis and that is therefore ascertainable by third parties [EC Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings, recital (13)].
Claim	Enforceable right to money or assets which may be based upon a judgement, may be liquidated or unliquidated, matured or unmatured, disputed or undisputed, secured or unsecured, fixed or contingent.
Close-out netting	See Netting
Commencement of proceedings	Date as of which the effects of insolvency are applicable or [date as of which the judicial decision to commence insolvency proceedings becomes effective, whether it is a final decision or not], in some jurisdictions referred to as “opening” of proceedings.
[Composition	[In the context of reorganization,] an agreement between the debtor and the [majority of] creditors where the creditors agree with the debtor and between themselves to accept from the debtor payment of less than the amount due to them in full satisfaction of their claims or to a reduction or postponement of debts or the redefinition of payment terms]
Court	A judicial or other authority competent to control or supervise an insolvency proceeding [UNCITRAL Model Law on Cross-Border Insolvency, art. 2(e)].
Cram-down provision	A mechanism that will enable the support of one class of creditors for a reorganization plan to be used to make the plan binding on other classes without their consent.
Creditor committee	Representative body appointed by [the court] [the insolvency representative] [creditors as a whole] to act on behalf and in the interests of the general body of creditors and having consultative and other powers as specified in the insolvency law.
Debtor	A person or entity, engaged in a business, which meets the criteria for commencement of insolvency proceedings; or [an individual or legal entity that is indebted to a creditor].
Discharge	A court order releasing a debtor from all liabilities that were, or could have been, addressed in the insolvency proceedings, including contracts that were modified as part of a reorganization.
Establishment	Any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services [UNCITRAL Model Law on Cross-Border Insolvency art. 2(f)].
Financial contract	Means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above [UNCITRAL Convention on the Assignment of Receivables in International Trade (2002) art. 5(k)].
Formal insolvency proceedings	Insolvency proceedings commenced under the insolvency law and governed by that law, generally including both a liquidation and a reorganization process.



Going concern	The sale of a business as a “going concern” is where the business is continued after commencement of insolvency proceedings and sold as a working whole, as opposed to a piecemeal sale of individual assets of the business.
Informal insolvency proceedings	Insolvency processes that are not regulated by the insolvency law and will generally involve negotiation between the debtor and some or all of its creditors. Often these processes have been developed through the banking and commercial sectors and typically provide for some form of reorganization of the insolvent debtor. Whilst not regulated by an insolvency law, these informal reorganization processes nevertheless depend for their effectiveness upon the existence of an insolvency law which can provide some indirect incentive or persuasive force to achieve a reorganization.
Initiation of proceedings	The making of an application for commencement of insolvency proceedings by the debtor; one or more creditors; and in rare cases by a public authority. Such an application may affect the legal rights of the debtor and creditors before commencement of the insolvency proceedings.
Insolvency	When the debtor is unable [or is likely to be unable] to pay its debts and other liabilities as they fall due or when the value of debts and liabilities of the debtor exceeds the value of assets.
Insolvency estate	Assets and rights of the debtor that are controlled by the insolvency representative and subject to the insolvency proceedings.
Insolvency proceedings	Collective judicial or administrative proceedings, including an interim proceeding, for the benefit of creditors and others conducted according to the insolvency law [in which the assets and affairs of the debtor are subject to control or supervision by a court or other competent authority] [which involve the [partial or total] divestment of the debtor and the appointment of an insolvency representative] for the purpose of either liquidation or reorganization of the business.
Insolvency representative	A person or body including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the debtor’s assets or affairs [UNCITRAL Model Law on Cross Border Insolvency, art. 2(d)] (see also “interim insolvency representative”).
Insolvency decision	Decision of the court to commence an insolvency proceeding [and to appoint an insolvency representative] (see also “commencement of proceedings”).
Interim insolvency representative	Person or entity appointed by the insolvency court in case of a serious crisis of the debtor which prevents the normal operation of its business, and is required to ensure, temporarily, the further operation of the business in connection with suspension of the debtor or of the debtor’s management (possibly in connection with reorganization) (see also “insolvency representative”).
Involuntary proceedings	Insolvency proceedings commenced on the application of a party other than the debtor such as creditors or a public authority.
Liquidation	Process of assembling and selling a debtor’s assets in an orderly and expeditious fashion in order to distribute the proceeds of sale to creditors according to established law and dissolve (where the debtor is a corporate or other legal entity) or discharge (where the debtor is an individual) the debtor either by way of a piecemeal sale or a sale of all or most of the debtor’s assets in productive operating units or as a going concern [see World Bank Principles and Guidelines, 2001] Other terms for this type of proceeding include winding up, bankruptcy, <i>faillite</i> , <i>quiebra</i> , and <i>Konkursverfahren</i> .

Netting	In one form it can consist of set-off (see “set-off”) of non-monetary fungibles (such as securities or commodities deliverable on the same day, known as settlement netting) and in its more important form it consists of a cancellation by a counterparty of open contracts with the debtor, followed by a set-off of losses and gains either way (close-out netting).
Netting agreement	An agreement between two or more parties that provides for one or more of the following: <ul style="list-style-type: none"> <li>(i) The net settlement of payments due in the same currency on the same date whether by novation or otherwise;</li> <li>(ii) Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; or</li> <li>(iii) The set-off of amounts calculated as set forth in subparagraph (ii) of this definition under two or more netting agreements. [UNCITRAL Convention on the Assignment of Receivables in International Trade (2002) art. 5(l)].</li> </ul>
Ordinary course of business	[ <i>Note: is a definition required in the Guide?</i> ]
<i>Pari passu</i>	The principle according to which creditors of the same class are treated equally [and are paid proportionately out of the assets of the estate].
Post-commencement creditor	A creditor whose claim arises after commencement of the insolvency proceedings.
Preference	A payment or other transaction made by an insolvent debtor which places a creditor in a better position than it would have been otherwise to the detriment or prejudice of the general body of creditors [other than in the normal course of trade].
Priming lien	A priority given to lenders of post-commencement finance which ranks ahead of all creditors, including secured creditors.
Priority	The right of a person in preference to the right of another person and, to the extent relevant for such purpose, includes the determination of whether the right is a personal or a property right, whether or not it is a security right for indebtedness or other obligation and whether any requirements necessary to render the right effective against a competing claimant have been satisfied [UNCITRAL Convention on the Assignment of Receivables in International Trade art. 5].
Priority claim	A claim that will be paid out of available assets before payment of general unsecured creditors.
Priority rules	The rules by which distributions are ordered among creditors and equity interests.
Related person	A person who is or has been in a position of control of the debtor including a director or officer of a legal entity, a shareholder or member of such legal entity, a director or officer or shareholder of a legal entity that is related to the debtor, including any relative of such a person; a “relative” in relation to a related person means the spouse, parent, grandparent, son, daughter, brother or sister of the related person.
Reorganization	Process by which the financial well-being and viability of a debtor’s business can be restored and the business continue to operate, using various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or parts of it) as a going concern. Other terms for this type of proceeding include rescue, restructuring, turnaround, rehabilitation, arrangement, composition, <i>concordat préventif de faillite</i> , <i>suspensión de pagos</i> , <i>administración judicial de empresas</i> , and <i>Vergleichsverfahren</i> .

Reorganization plan	A plan by which the financial well-being and viability of the debtor's business can be restored. The insolvency law may provide for the plan to be submitted by various parties (the debtor, the creditors, the insolvency representative) and may require confirmation of the plan by the court following its approval by the requisite number of creditors. The plan may address issues such as timing of the process, commitments to be undertaken, terms of payment and securities to be offered to creditors, avoidance actions to be filed and treatment of pending contracts including employment contracts.
Retention of title (title financing)	Provision of a contract for the supply of goods which purports to reserve ownership of the goods with the supplier until payment of the purchase price.
Secured asset	An asset or property, movable or immovable, in respect of which a security interest has been granted to a creditor. If an obligation is not satisfied the asset or property subject to the security interest may be recovered or held, or the value realized by the creditor holding the security interest. Other terms include collateral and encumbered asset.
Secured claim	A claim assisted by a security interest taken as a guarantee for a debt enforceable in case of the debtor's default when the debt falls due.
Secured creditor	A creditor holding either a security interest covering all or part of the debtor's assets or a security interest in a specific asset entitling the creditor to priority ahead of other creditors with respect to the secured asset.
Secured debt	[Aggregate amount of secured claims] or [claims pertaining to secured creditors].
Security interest	A right or interest granted by a party committing the party to pay or perform an obligation. Whether established voluntarily by agreement or involuntarily by operation of law, a security interest generally includes, but is not necessarily limited to, mortgages, pledges, charges and liens [World Bank Principles and Guidelines, 2001].
Set-off	Where a claim for a sum of money owed to a person is "set-off" (balanced) against a claim by the other party for a sum of money owed by that first person. A set-off may operate as a defence in whole or part to a claim for a sum of money.
State-owned enterprise	[ <i>Note: is a definition required in the Guide?</i> ]
Stay of proceedings	A measure which prevents the commencement, or suspends the continuation, of judicial, administrative or other individual actions concerning the debtor's assets, rights, obligations or liabilities, including the perfection or enforcement of any security interest; and prevents execution against the assets of the insolvency estate, the termination of a contract with the debtor, and the transfer, encumbrance or other disposition of any assets or rights of the insolvency estate (recommendation (35)).
Superpriority	A priority that will result in claims to which the superpriority attaches being paid before administrative claims.
Unsecured creditor	Any creditor who does not hold security or any ordinary creditor who has no preferential rights.
Unsecured debt	Aggregate amount of claims not supported by security.
Voluntary proceeding	Insolvency proceedings commenced on the application of the debtor.

## A/CN.9/WG.V/WP.63/Add.2

## Draft legislative guide on insolvency law

## Note by the Secretariat

*[The Glossary to the Guide appears in A/CN.9/WG.V/WP.63/Add.1; Part Two of the Guide appears in documents A/CN.9/WG.V/WP.63/Add.3-17]*

*Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.57, the previous version of this introductory chapter.*

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## Part One

### Designing the structure and key objectives of an effective and efficient insolvency regime

#### I. INTRODUCTION TO INSOLVENCY PROCEDURES

1. [23] When a debtor is unable to pay its debts and liabilities as they become due, most legal systems provide a legal mechanism to address the collective satisfaction of the outstanding claims from all assets (whether tangible or intangible) of the debtor. A range of interests needs to be accommodated by that legal mechanism—firstly, the parties including the debtor, the owners and management of the debtor, the creditors who may be secured to varying degrees (including tax agencies and other government debtors), employees, guarantors of debt and suppliers of goods and services, as well as the legal, commercial and social institutions and practices that are relevant to the design of the insolvency law, including the institutional framework required for its operation. Generally, the mechanism must strike a balance not only between the different interests of these stakeholders but also between those interests and the relevant social, political and other policy considerations that impact upon the economic and legal goals of insolvency.

2. [23] Most legal systems contain rules on various types of proceedings (which are referred to in this Guide by the generic term “insolvency proceedings”) that can be initiated to resolve a debtor’s financial difficulties. While addressing that resolution as a common goal, these proceedings take a number of different forms, for which uniform terminology is not always used, and may include both “formal” and “informal” elements. Formal insolvency proceedings are commenced under the insolvency law and governed by that law. They generally include both a liquidation and a reorganization process. Informal insolvency processes are not regulated by the insolvency law and will generally involve negotiation between the debtor and some or all of its creditors. Often these processes have been developed through the banking and commercial sectors and typically, provide for some form of reorganization of the insolvent debtor. Whilst not regulated by an insolvency law, these informal reorganization processes nevertheless depend for their effectiveness upon the existence of an insolvency law which can provide some indirect incentive or persuasive force to achieve a reorganization (discussed further below).

#### A. Key objectives of an effective and efficient insolvency regime

3. Although country approaches vary, there is broad agreement that effective and efficient insolvency regimes should aim to achieve the key objectives identified below. Whatever design is chosen for an insolvency law that will meet these key objectives, the insolvency law must be complementary to, and compatible with, the legal and value systems of the society in which it is based and which it must ultimately sustain. Although insolvency law generally forms a distinctive regime, it ought not to produce results that are

fundamentally in conflict with the premises upon which the general law is based. Where the insolvency law does seek to achieve a result that differs or fundamentally departs from the general law (e.g. with respect to treatment of contracts, avoidance of antecedent acts and transactions or treatment of the rights of secured creditors) it is highly desirable that that result be the product of careful consideration and conscious policy in that direction.

#### 1. *Maximize value of assets*

4. Participants in the insolvency process should have strong incentives to achieve maximum value for assets as this will facilitate higher distributions to creditors as a whole and reduce the burden of insolvency. The achievement of this goal is often furthered by achieving a balance between the risks allocated between the parties involved in an insolvency proceeding. The manner in which prior transactions are treated, for example, can ensure that creditors are treated equitably and enhance the value of the debtor’s assets by recovering value for the benefit of all creditors. At the same time, the treatment afforded those transactions can undermine the predictability of contractual relations that is critical to investment decisions, creating a tension between the different objectives of an insolvency regime. Similarly, a balance has to be struck between rapid liquidation and longer term efforts to reorganize the business which may generate more value for creditors, between the need for new investment to preserve or improve the value of assets and the implications and cost of that new investment on existing stakeholders, and between the different roles allocated to the different stakeholders, in particular the discretion that can be exercised by the insolvency representative and the extent to which creditors can monitor the exercise of that discretion to safeguard the process.

#### 2. *Strike a balance between liquidation and reorganization*

5. The first objective of maximization of value is closely linked to the balance to be achieved in the insolvency regime between liquidation and reorganization. [16] An insolvency regime needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against maintaining the debtor as a viable business through reorganization (often the preference of unsecured creditors). Achieving that balance may implicate other social policy considerations such as encouraging the development of an entrepreneurial class and protecting employment. [15] Insolvency law should provide for the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized

by allowing it to continue. This is predicated on the basic economic theory that greater value may be obtained from keeping the essential components of a business organization together, rather than breaking them up and disposing of them in fragments. To ensure that the insolvency process is not abused by either creditors or the debtor, and that the procedure most appropriate to resolution of the debtor's financial difficulty is available, the insolvency law should also provide for conversion between the different types of proceedings in appropriate circumstances.

### **3. *Ensure equitable treatment of similarly situated creditors***

6. The objective of equitable treatment is based on the notion that in collective proceedings, creditors with similar legal rights should be treated equally, receiving a distribution on their claim in accordance with their relative priority and interests. [17] Equitable treatment recognizes that all creditors do not need to be treated equally, but in a manner that reflects the different bargains they have struck with the debtor, although this becomes less relevant as a defining factor where there is no specific debt contract with the debtor, such as in the case of damage claimants (e.g. for environmental damage). To the extent that equitable treatment is modified by social policy on claim priorities and should give way to the prerogatives pertaining to holders of claims or interests that arise, for example, by operation of law, the principle of equitable treatment retains its significance by ensuring that the priority accorded to the claims of a similar class affects all members of the class in the same manner. The policy of equitable treatment permeates many aspects of an insolvency law, including the application of the stay or suspension, provisions to set aside acts and transactions and recapture value for the insolvency estate, classification of claims, voting procedures in reorganization, and distribution mechanisms. [17] The insolvency regime should address problems of fraud and favouritism that may arise in cases of financial distress, by providing, for example, that acts and transactions detrimental to equitable treatment of creditors can be avoided.

### **4. *Provide for timely, efficient and impartial resolution of insolvency***

7. [18] Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business and the activities of the debtor and to minimizing the cost of the proceedings. Achieving timely and efficient administration will support the objective of maximizing asset value, while impartiality supports the goal of equitable treatment. The entire process needs to be carefully considered to ensure maximum efficiency without sacrificing flexibility. At the same time, it should be focused on the goal of liquidating non-viable and inefficient businesses and the survival of efficient, potentially viable businesses.

8. [18] Quick and orderly resolution of a debtor's financial difficulties can be facilitated by an insolvency law that provides easy access to the insolvency process by reference

to clear and objective criteria, provides a convenient means of identifying, collecting, preserving and recovering assets and rights that should be applied towards payment of the debts and liabilities of the debtor, facilitates participation of the debtor and its creditors with the least possible delay and expense, provides an appropriate structure for supervision and administration of the process (including both professionals and the institutions involved) and provides, as an end result, effective relief to the financial obligations and liabilities of the debtor.

### **5. *Prevent premature dismemberment of the debtor's assets***

9. [19] An insolvency regime should prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts. Such activity often reduces the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganization or the sale of the business as a going concern. A stay of creditor action provides a breathing space for debtors, enabling a proper examination of its financial situation and facilitating both maximization of the value of the estate and equitable treatment of creditors. Some mechanism may be required to ensure that the rights of secured creditors are not impaired by a stay.

### **6. *Provide for a procedure that is transparent and predictable and contains incentives for gathering and dispensing information***

10. [20] The insolvency law should be transparent and predictable. This will enable potential lenders and creditors to understand how the insolvency process operates and to assess the risk associated with their position as a creditor in the event of insolvency. This will promote stability in commercial relations and foster lending and investment at lower risk premiums. Transparency and predictability will also enable creditors to clarify priorities, prevent disputes by providing a backdrop against which relative rights and risks can be assessed, and help define the limits of any discretion. Unpredictable application of the insolvency law has the potential to undermine not only the confidence of all participants in insolvency proceedings, but also their willingness to make credit and other investment decisions. [20] As far as possible, an insolvency law should clearly indicate all provisions of other laws that may affect the conduct of the insolvency proceedings (e.g. labour law; commercial and contract law; tax law; laws affecting foreign exchange, netting and set-off, debt for equity swaps; and even family and matrimonial law).

11. [20] The insolvency law should ensure that adequate information is available in respect of the debtor's situation, providing incentives to encourage the debtor to reveal its positions or, where appropriate, sanctions for failure to do so. The availability of this information will enable those responsible for administering and supervising the insolvency process (courts or administrative agencies, the insolvency representative) and creditors to assess the financial situation of the debtor and determine the most appropriate solution.

### 7. *Recognize existing creditor rights and establish clear rules for ranking of priority claims*

12. [21] Recognition and enforcement within the insolvency process of the differing rights that creditors have outside of insolvency will create certainty in the market and facilitate the provision of credit, particularly with respect to the rights and priorities of secured creditors. Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide clarity to lenders, to ensure that the rules can be consistently applied, that there is confidence in the process and that all participants are able to adopt appropriate measures to manage risk. To the greatest extent possible, those priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency. According priority to claims that are not based on commercial bargains should be avoided.

### 8. *Establish a framework for cross-border insolvency*

13. [22] To promote coordination among jurisdictions and facilitate the provision of assistance in the administration of an insolvency proceeding originating in a foreign country, insolvency laws should provide rules on cross-border insolvency, including the recognition of foreign proceedings, by adopting the UNCITRAL Model Law on Cross-Border Insolvency.

## B. Balancing the key objectives

14. Since an insolvency regime cannot fully protect the interests of all parties, some of the key policy choices to be made when designing an insolvency law relate to defining the goals of the insolvency law and achieving the desired balance between the objectives identified above. Insolvency laws achieve that balance by reapportioning the risks of insolvency in a way that suits a country's economic, social and political goals. As such insolvency regimes can have widespread effects in the broader economy.

15. The first task for any insolvency system is to establish a framework of principles that determines how the estate of the insolvent debtor is to be administered for the benefit of all affected parties. The creation of such a framework and its integration with the wider legal process are vital to maintaining social order and stability. All parties need to be able to anticipate their legal rights in the event of a debtor's inability to pay, or to pay in full, what is owed to them. This allows both creditors and equity investors to calculate the economic implications of default by the debtor, and so estimate their risks.

16. There is no universal solution to the design of an insolvency regime because countries vary significantly in their needs, as do their laws on other issues of key importance to insolvency, such as security interests, property and contract rights, remedies and enforcement procedures. Although there may be no universal solution, most insolvency systems address the range of issues raised by the key objectives, albeit with different emphasis and focus. Some

laws favour stronger recognition and enforcement of creditor rights and commercial bargains and give creditors more control over the insolvency process than the debtor (sometimes referred to as "creditor-friendly" regimes), while other laws lean towards giving the debtor more control over the process (referred to as "debtor-friendly" regimes). Some laws give more prominence to liquidation of the debtor to weed out inefficient and incompetent market players while others favour reorganization. The focus on reorganization may serve a number of different aims: as a means of enhancing the value of creditors' claims as part of an ongoing business concern, providing a second chance to the shareholders and management of the debtor; providing strong incentives for the adoption by entrepreneurs and managers of appropriate attitudes to risk; or protecting vulnerable groups, such as the debtor's employees, from the effects of business failure.<sup>1</sup>

17. But adopting a reorganization-friendly approach should not result in establishing a safe haven for moribund enterprises—enterprises that are beyond rescue should be liquidated as quickly and efficiently as possible. To the extent that some interests may be regarded as being of lower priority than others, the establishment of mechanisms outside of the insolvency regime may provide a better solution than trying to address those interests under the insolvency regime. For example, where the insolvency law ranks employee claims lower than secured and priority creditors, insurance arrangements can be used to protect employee entitlements (see Part two, chapter ..).

18. Because society is constantly evolving, insolvency law cannot be static but requires reappraisal at regular intervals to ensure that it meets current social needs. Responses to perceived social change involve an act of judgement that can be informed by international best practice and those practices transposed into national insolvency regimes, taking into account the realities of the system and available human and material resources.

## C. General features of an insolvency regime

19. [24] Designing an effective and efficient insolvency regime involves the consideration of a common set of issues relating to both the legal framework (rights and obligations of the parties, both substantively and procedurally) and the institutional framework (to implement these rights and obligations) required. The substantive issues, which are discussed in detail in Part two, chapters [...] of this Guide, include:

(a) Identifying the debtors that may be subject to insolvency proceedings, including those debtors that may require a special insolvency regime;

<sup>1</sup>There is not necessarily a direct correlation between the debtor or creditor friendliness of an insolvency regime, the emphasis on liquidation or reorganization and the subsequent success or failure of reorganization. While it is beyond the scope of this Guide to discuss these issues in any detail, they are important for the design of an insolvency regime and deserve consideration. While the rate of successful reorganization varies considerably even among those regimes classified as creditor-friendly, research appears to suggest that the assumption that creditor-friendly regimes lead to fewer or less successful reorganizations than debtor-friendly regimes is not necessarily true.

(b) Determining when insolvency proceedings may be commenced and the type of proceeding that may be commenced, the party that may request commencement and whether the commencement criteria should differ depending upon the party requesting commencement;

(c) The extent to which the debtor should be allowed to retain control of the business once insolvency proceedings commence or be displaced and an independent party (in this Guide referred to as the insolvency representative) appointed to supervise and manage the debtor, and the distinction to be made between liquidation and reorganization in that regard;

(d) Protection of the assets of the debtor against the actions of creditors, the debtor itself and the insolvency representative, and where the protective measures apply to secured creditors, the manner in which the economic value of the security interest be protected during the insolvency proceedings;

(e) The manner in which the insolvency representative may deal with contracts entered into by the debtor before the commencement of proceedings and in respect of which both the debtor and its counterparty have not fully performed their respective obligations;

(f) The extent to which set-off or netting rights will be suspended by the commencement of the insolvency proceedings;

(g) The manner in which the insolvency representative may use or dispose of assets of the insolvency estate;

(h) The extent to which the insolvency representative can avoid certain types of transactions that result in the interests of creditors being prejudiced;

(i) In the case of reorganization, preparation of the reorganization plan and the limitations, if any, that will be imposed on the content of the plan, the preparer of the plan and the conditions required for its approval and implementation;

(j) The ranking of creditors for the purposes of distributing the proceeds of liquidation; and

(k) Implementation of the reorganization plan, distribution of the proceeds of liquidation, discharge or dissolution of the debtor and conclusion of the proceedings.

20. [25] In addition to these specific subject areas, a more general issue to be considered is how an insolvency law will relate to other substantive laws and whether the insolvency law will effectively modify those laws. Relevant laws may include labour laws that provide certain protections to employees, laws that limit the availability of set-off and netting, laws that limit debt-for-equity conversions and laws that impose foreign exchange and foreign investment controls that may affect the content of a reorganization plan (see labour contracts and employees [Part two, chapter ..]; set-off and netting [Part two, chapter ..]; and content of reorganization plan [Part two, chapter ..]).

21. While the institutional framework is not discussed in any detail in this Guide, some of the issues are touched upon in Part two, chapter ... Notwithstanding the variety of substantive issues that must be resolved, insolvency laws are highly procedural in nature. The design of the procedural rules plays a critical role in determining how roles are

to be allocated among the various participants, particularly in terms of decision-making. To the extent that the insolvency law places considerable responsibility upon the institutional infrastructure to make key decisions, it is essential that that infrastructure be sufficiently developed to perform the required functions.

## II. TYPES OF INSOLVENCY PROCEEDINGS

22. [26] Two main types of proceedings are common to the majority of insolvency regimes—liquidation (typically a formal proceeding) and reorganization (which may be a formal proceeding, an informal process or in some cases a process which combines informal and formal elements).

23. [26] The traditional division or distinction between these two types of processes can be somewhat artificial and can create unnecessary polarization and inflexibility. It does not accommodate, for example, cases not easily situated at the poles—those cases where a flexible approach to the debtor's financial situation is likely to achieve the best result for both the debtor and the creditors in terms of maximizing the value of the insolvency estate. For example, the term "reorganization" is sometimes used to refer to a particular way of ensuring preservation and possible enhancement of the value of the insolvency estate in the context of liquidation proceedings, such as where the law provides for liquidation to be carried out by transferring the business to another entity as a going concern. In that situation, the term "reorganization" merely points to a technique other than traditional liquidation (i.e. straight-forward, piecemeal sale of the assets), being used in order to obtain as much value as possible from the insolvency estate. Similarly, reorganization may require the sale of significant parts of the debtor's business or [27] contemplate an eventual liquidation or sale of the business to a new company and the dissolution of the existing debtor.

24. [27] For these reasons, it is desirable that an insolvency law provide more than a choice between a strictly traditional liquidation process and a single, narrowly defined type of reorganization process. Since the concept of reorganization can accommodate a variety of arrangements, it is desirable that an insolvency law adopt an approach that is not prescriptive and supports arrangements that will achieve a result that provides more value to creditors than if the debtor was liquidated.

25. [28] In discussing the core provisions of an effective and efficient insolvency regime, this Guide focuses upon a liquidation procedure on the one hand and a reorganization procedure on the other. However, the adoption of this approach is not intended to indicate a preference for particular types of processes or a preference for the manner in which the different processes should be integrated into an insolvency law. Rather, the Guide seeks to compare and contrast the core elements of the different types of procedures and to promote an approach that focuses upon maximizing the result for the parties involved in an insolvency process. This may be achieved by designing an insolvency law that incorporates the traditional formal elements in a way that promotes both maximum flexibility and the use of informal processes where they will be most effective.



## A. Liquidation

26. [29] The type of proceedings referred to as “liquidation” is regulated by the insolvency law and generally provide for a public authority (typically, although not necessarily, a judicial court acting through a person appointed for the purpose) to take charge of the debtor’s assets, with a view to terminating the commercial activity of the debtor, transforming non-monetary assets into monetary form and subsequently distributing the proceeds of sale of the assets proportionately to creditors. The sale of assets may occur in a piecemeal manner or may involve sale of the business in productive units or as a going concern and these proceedings usually result in the dissolution or disappearance of the debtor as a commercial legal entity. Other terms used for this type of proceedings include bankruptcy, winding-up, *faillite*, *quiebra*, and *Konkursverfahren*.

27. [30] Liquidation proceedings tend to be close to “universal” in their concept, acceptance and application and normally follow a pattern that includes:

- (a) An application to a court or other competent body either by the debtor or by creditor(s);
- (b) An order or judgement that the debtor be liquidated;
- (c) Appointment of an independent person to conduct and administer the liquidation;
- (d) Closure of the business activities of the debtor;
- (e) Termination of the powers of owners and management and the employment of employees;
- (f) Sale of the debtor’s assets, either piecemeal or as a going concern;
- (g) Adjudication of the claims of creditors;
- (h) Distribution of available funds to creditors (under some form of priority); and
- (i) Dissolution of the debtor, where it is a corporation or has some other form of legal personality, or discharge, in the case of an individual debtor.

28. [31] There are a number of legal and economic justifications for the liquidation process. Broadly speaking, it can be argued that a commercial business that is unable to compete in a market economy should be removed from the market place. A principal identifying mark of an uncompetitive business is one that satisfies one of the tests of insolvency, that is, it is unable to meet its mature debts as they become due or its debts exceed its assets. More specifically, the need for liquidation procedures can be viewed as addressing inter-creditor problems (when an insolvent debtor’s assets are insufficient to meet the claims of all creditors it will be in a creditor’s own best interests to take action to recover its claim before other creditors can take similar action) and as a disciplinary force that is an essential element of a sustainable debtor-creditor relationship. An orderly and effective liquidation procedure addresses the inter-creditor problem by setting in motion a collective proceeding that seeks to avoid those actions that, whilst viewed by individual creditors as being in their own best self-interest, essentially lead to the loss of value for all

creditors. A collective proceeding is designed to provide equitable treatment to creditors, by treating similarly situated creditors in the same way, and to maximize the value of the debtor’s assets for the benefit of all creditors. This is normally achieved by the imposition of a stay on the ability of creditors to enforce their individual rights against the debtor and the appointment of an independent person whose primary duty is to maximize the value of the debtor’s assets for distribution to creditors.

29. [32] An orderly and relatively predictable mechanism for the enforcement of the collective rights of creditors can also provide creditors with an element of predictability at the time when they make their lending decisions, as well as more generally promote the interest of all participants in the economy by facilitating the provision of credit and the development of financial markets. This is not to say that an insolvency regime should function as a means of enforcing the rights of individual creditors, although there is a clear and important relationship between the two types of processes. The efficiency and effectiveness of procedures for the individual enforcement of creditors’ rights will mean that creditors are not forced to use the insolvency process for that purpose, especially since insolvency proceedings generally require a level of proof, cost and procedural complexity that make it unsuitable for use in that way. Nevertheless, an effective insolvency process will ensure that where debt enforcement mechanisms fail, creditors will have an avenue of final recourse that can operate as an effective incentive to a recalcitrant debtor to encourage payment of the particular creditor.

## B. Reorganization

30. [33] An alternative to liquidation is a process that is designed to save a business rather than sell off its assets and terminate it. This process, which may take one of several forms and may be less universal in its concept, acceptance and application than liquidation, is referred to by a number of different names including reorganization, rescue, restructuring, turnaround, rehabilitation, arrangement, composition, *concordat préventif de faillite*, *suspensión de pagos*, *administración judicial de empresas*, and *Vergleichsverfahren*. For the sake of simplicity, the term “reorganization” is used in the Guide in a broad sense to refer to the type of proceedings whose ultimate purpose is to allow the debtor to overcome its financial difficulties and resume or continue normal commercial operations (even though in some cases it may include a reduction in the scope of the business, its sale as a going concern to another company or its eventual liquidation).

### 1. Formal reorganization proceedings

31. [34] As noted above, reorganization proceedings may be covered by the insolvency law or be an informal process or a process which combines both formal and informal elements. One of the justifications for including a formal reorganization procedure in an insolvency law is that not all debtors that falter or experience serious financial difficulty in a competitive market place should necessarily be

liquidated; a debtor with a reasonable prospect of survival (such as one which has a potentially profitable business) should be given that opportunity where it can be demonstrated that there is greater value (and, by deduction, greater benefit for creditors in the long term) in keeping the essential business and other component parts of the debtor together. Reorganization procedures are designed to give a debtor some breathing space to recover from its temporary liquidity difficulties or more permanent overindebtedness and, where necessary, provide it with an opportunity to restructure its operations and its relations with creditors. Where reorganization is possible, generally it will be preferred by creditors if the value derived from the continued operation of the debtor's business will enhance the value of their claims. Reorganization, however, does not imply that all of the stakeholders must be wholly protected or that they should be restored to the financial or commercial position that would have obtained had the event of insolvency not occurred. It does not imply that the debtor will be completely restored or its creditors paid in full, or that ownership and management of an insolvent debtor will maintain and preserve their respective positions. Management may be terminated and changed, the equity of shareholders may be reduced to nothing, employees may be retrenched and the source of a market for suppliers may disappear. In general, however, reorganization does imply that whatever form of plan, scheme or arrangement is agreed, the creditors will eventually receive more than if the debtor was to be liquidated.

32. Additional factors supporting the use of reorganization include that [38] the modern economy has significantly reduced the degree to which the value of the debtor's assets can be maximized through liquidation. In cases where technical know-how and goodwill are more important than physical assets, the preservation of human resources and business relations are essential elements of value that cannot be realized through liquidation. Also, long-term economic benefit is more likely to be achieved through reorganization procedures, since they encourage debtors to take action before their financial difficulties become severe. Lastly, there are social and political considerations which are served by the existence of reorganization procedures which protect, for example, the employees of a troubled debtor.

33. [35] Reorganization procedures may take a number of different forms. They may include a simple agreement concerning debts (referred to as a composition) where, for example, the creditors agree to receive a certain percentage of the debts owed to them in full, complete and final satisfaction of their claims against the debtor. The debts are thus reduced and the debtor becomes solvent and can continue to trade. They may also include a complex reorganization under which, for example, debts are restructured (e.g., by extending the length of the loan and the period in which payment may be made, deferring payment of interest or changing the identity of the lenders); some debt may be converted to equity together with a reduction (or even extinguishment) of existing equity; the non-core assets may be sold; and the unprofitable business activities closed. The choice of the way in which reorganization is carried out is typically a response to the size of the business and the degree of complexity of the debtor's specific situation.

34. [36] Although the reorganization process is not as universal as liquidation, and may not therefore follow such a common pattern, there are a number of key or essential elements that can be determined:

(a) Submission of the debtor to the process (whether voluntarily or on the basis of an application by creditors), which may or may not involve judicial control or supervision;

(b) Automatic and mandatory stay or suspension of actions and proceedings against the assets of the debtor affecting all creditors for a limited period of time;

(c) Continuation of the business of the debtor, either by existing management, an independent manager or a combination of both;

(d) Formulation of a plan which proposes the manner in which creditors, equity holders and the debtor itself will be treated;

(e) Consideration of, and voting on, acceptance of the plan by creditors;

(f) Possibly, the judicial approval/confirmation of an accepted plan; and

(g) Implementation of the plan.

35. [37] The benefits of reorganization are increasingly accepted, and many insolvency laws include provisions on formal reorganization proceedings. The extent to which formal reorganization proceedings as opposed to some form of informal process are relied upon to achieve the objectives of reorganization varies between countries. It is generally recognized that the existence of a liquidation procedure can facilitate the reorganization of a debtor, whether by formal reorganization proceedings or informal means through an out-of-court process, by providing an incentive to both creditors and debtors to reach an appropriate agreement. Indeed, in many economies, reorganization largely takes place informally "in the shadow" of the formal insolvency regime.

36. [37] There is often, however, a correlation between the degree of financial difficulty being experienced by the debtor, the complexity of its business arrangements, and the difficulty of the appropriate solution. Where, for example, a single bank is involved, it is likely that the debtor can negotiate informally with that bank and resolve its difficulties without involving trade creditors and without the need for formal proceedings to be commenced. Where the financial situation is more complex and requires the involvement of a large number of different types of creditors, a greater degree of formality may be needed to find a solution which addresses the disparate interests and objectives of these creditors [38] since out-of-court reorganization requires unanimity. Formal reorganization procedures may assist in achieving the desired goal where those procedures enable the debtor and a majority of creditors to impose a plan upon a dissenting minority of creditors, especially where there are creditors who "hold-out" during out-of-court negotiations.

**2. Informal reorganization processes**  
*[to be coordinated with paras. 363-366,*  
*A/CN.9/WP.63/Add.12]*

37. [39] Informal processes were developed some years ago by the banking sector, as an alternative to formal reorganization proceedings. Led and influenced by internationally active banks and financiers, the informal process has gradually spread to a considerable number of jurisdictions, although use of such processes varies—in some jurisdictions they are reported to be rarely used, whilst in others most reorganizations are reported to be conducted informally. To some extent these results may reflect the existence (or not) of what is sometimes described as a “rescue culture”—the degree to which participants regard informal processes as likely to be successful, irrespective of the formal absence of features of proceedings under the insolvency law, such a moratorium, and the need to achieve consensus among creditors in order for an informal agreement to be achieved.

38. [39] The application of the informal process has generally been limited to cases of corporate financial difficulty or insolvency in which there is a significant amount of debt owed to banks and financiers. The process is aimed at securing an agreement both between the lenders themselves and the lenders and the debtor for the reorganization of the debtor, with or without rearrangement of the financing. An informal reorganization can provide a means of introducing flexibility into an insolvency system by reducing reliance on judicial infrastructure, facilitating an earlier proactive response from creditors than would normally be possible under formal regimes and avoiding the stigma that often attaches to insolvency. While not based or reliant upon the provisions of the insolvency law, informal processes do rely upon the existence and availability of the formal insolvency framework to provide sanctions that can assist to make the informal process successful. Unless the debtor and its bank and financial creditors take the opportunity to join together and commence the informal process, the debtor or the creditors can invoke the formal insolvency law, with some potential for detriment to both the debtor and its creditors in terms of delay, cost and outcome.

39. Although not regulated by the insolvency law, many legal systems do contemplate that a debtor can enter into agreement or arrangements with some of all of its creditors which may be governed by, for example, contract law, company or commercial law or civil procedural law, or in some cases relevant banking regulations. However, there are a few jurisdictions which do not allow reorganization to occur outside of the court system or the insolvency law or which would regard the steps associated with such informal reorganization as sufficient for the courts to make a declaration of insolvency. Similarly, there are a number of jurisdictions which, because they impose on the debtor an obligation to commence formal insolvency proceedings within a certain time after a defined event of insolvency, restrict the conduct of such informal proceedings to circumstances where the formal conditions for commencement of proceedings have not been met. [Nevertheless, it is suggested that banks and other creditors in these jurisdictions do often use various techniques to achieve some form of reorganization of debtors.]

*(a) Necessary preconditions*

40. The informal reorganization depends for its effectiveness on a number of well-defined initial premises. These may include:

- (a)* A significant amount of debt owed to a number of main banks or financial institution creditors;
- (b)* The present inability of the debtor to service that debt;
- (c)* Acceptance of the view that it may be preferable to negotiate an arrangement, as between the corporate debtor and the financiers and also between the financiers themselves, to resolve the financial difficulties of the corporate debtor;
- (d)* The use of relatively sophisticated refinancing, security and other commercial techniques that might be employed to alter, rearrange or restructure the debts of the debtor or the debtor itself;
- (e)* The sanction that if the negotiation process cannot be started or breaks down there can be swift and effective resort to the insolvency law;
- (f)* The prospect that there may be a greater benefit for all parties through the negotiation process than by direct and immediate resort to the insolvency law (in part because the outcome is subject to the control of the negotiating parties and the process is less expensive and can be accomplished quickly without disrupting the debtor’s business);
- (g)* The debtor does not need relief from trade debts, or the benefits of formal insolvency, such as the automatic stay or the ability to reject burdensome debts; and
- (h)* Favourable or neutral tax treatment for reorganization both in the debtor’s jurisdiction and the jurisdictions of foreign creditors.

*(b) Main processes*

41. To be effective, an informal reorganization process requires a number of different steps to be followed and range of skills to be employed. The main elements in the process are discussed below.

*(i) Commencing the process*

42. The informal process essentially involves bringing together the debtor and creditors or at least the main creditors, one or more of whom must initiate the process (as there can be no reliance upon a law or a facilitator for initiation, imposition or assistance of the process). A debtor might be unwilling to commence a dialogue with creditors or at least with all of its creditors and creditors, while concerned for their own position, may have little interest in a collective process. It is at this point that the availability and effectiveness of individual creditor remedies or formal insolvency proceedings can be used to encourage the commencement and progress of the informal process. A debtor who remains reluctant to participate may find itself subject to individual debt or security enforcement actions or even insolvency proceedings, which it will not be able to defeat or delay. At the same time, creditors may also find themselves subject to formal insolvency

proceedings which effectively prevent them from enforcing their individual rights and might not represent the optimal process for recovery of their debt. Creating a forum in which the debtor and creditors can come together to explore and negotiate an arrangement to deal with the debtor's financial difficulty therefore is crucial to this type of process.

*(ii) Coordinating participants—appointing a lead creditor and steering committee*

43. The reorganization should involve all key constituencies; generally the lenders group and sometimes key creditor constituencies who may be affected by the reorganization are critical to the process. To better coordinate negotiations, a principal creditor should be appointed to provide leadership, organization, management and administration. This creditor typically reports to a committee that is representative of creditors (a steering committee) and can provide assistance and act as a sounding board for proposals regarding the debtor.

*(iii) Agreeing a “standstill”*

44. To allow business operations to continue and to ensure that sufficient time is available to obtain and evaluate information about the debtor and to formulate and assess proposals to resolve the debtor's financial difficulties, a contractual agreement to suspend adverse actions by both the debtor and the main creditors may be required. That agreement would generally need to endure for a defined, usually short period, unless inappropriate in a particular case.

*(iv) Engaging advisors*

45. Few, if any, attempts are made at an informal reorganization without the involvement of independent experts and advisors from various disciplines (e.g. legal, accounting, finance and business regulation, marketing). While it may be suggested that this involvement will lead to unnecessary cost and intrusion into the affairs of the debtor and creditors, as well as a loss of control, it is generally necessary to ensure the provision of information, independently verified, as well as professionally developed plans for refinancing, restructuring, management and operation that are essential to the success of the process.

*(v) Ensuring adequate cash flow and liquidity*

46. A debtor that becomes a candidate for a possible informal reorganization will often require continued access to established lines of credit or the provision of fresh credit. Provision of credit by existing secured creditors may not present a problem. Where this is not available, however, and fresh credit is required, there may be difficulties in guaranteeing the eventual repayment of the fresh credit if the reorganization fails. While this issue can be addressed under the insolvency law by providing some form of priority for such ongoing lending (see Part two, chapter VI.B), the law will not generally extend to such an arrangement under an informal process.

47. Those creditors who participate in an attempted reorganization, nevertheless, can agree amongst themselves that if one or more of them extends further credit the others will subrogate their claims to enable the new credit to be repaid ahead of their own claims. Thus, as between those creditors, there will be a contractual agreement for the repayment of new money where the reorganization is successful. Where the reorganization fails, however, and the debtor is liquidated, the creditor who has provided the fresh credit may be left with an unsecured claim (unless security was provided) and receive only partial repayment along with other unsecured creditors.

*(vi) Access to complete, accurate information on the debtor*

48. This is essential to enable proper evaluation to be made of the financial position of the debtor and any proposals to be made to relevant creditors. Information concerning the assets, liabilities and business of the debtor should be made available to all relevant creditors but unless already publicly available, may need to be treated as confidential.

*(vii) Dealing with creditors*

49. The complexity of the interests of creditors often presents critical problems for informal processes. Providing for those differing interests, and persuading those creditors that have already commenced recovery or enforcement action against the debtor that they should participate in the informal process may be possible only if there is a prospect of a better result through the informal process or if the threat of formal insolvency proceedings will restrain creditors from pursuing their individual rights.

50. In many cases, however, it will not be possible (or indeed necessary) to involve every creditor in the informal process, either because of their number and diverse interests or because of the inefficiency of involving creditors who are owed only small amounts of money or who do not have the commercial expertise, knowledge or will to participate effectively in the process. While creditors who fall into these categories often may be left out of the process, they cannot be ignored as they may be important to the continued operation of the business (as suppliers of essential goods or services or as participants in essential parts of the debtor's production process) and there are no rules which can compel such creditors to accept the decision of a majority of their number.

51. Often in an informal reorganization, trade and small creditors recover payment in full. Although this suggests unequal treatment, it may make commercial sense to a group of major creditors. An alternative approach is to secure agreement of the main creditors to a reorganization plan and then use the plan as the basis of a formal court supervised reorganization process in which other creditors participate (sometimes referred to as a “pre-packaged” plan—see Part two, chapter V.B). This plan can then bind the other creditors. Without an effective formal insolvency regime, this result could not be achieved.

(c) *Rules and guidelines for informal reorganization*

52. [43] To assist the conduct of informal reorganization, and in particular to address the problems noted above in the context of complex, multinational businesses, a number of organizations have developed non-binding principles and guidelines. One such approach is called the “London Approach” named after the non-binding guidelines issued to commercial banks by the Bank of England. Banks are urged to take a supportive attitude toward their debtors that are in financial difficulties. Decisions about the debtor’s longer-term future should only be made on the basis of comprehensive information, which is shared among all the banks and other parties that would be involved in any agreement as to the future of the debtor. Interim financing is facilitated by a standstill and subordination agreement, and banks work together with other creditors to reach a collective view on whether and on what terms a debtor entity should be given a financial lifeline. Similar guidelines have been developed by the central banks of other countries. [A/CN.9/WP.63/Add.12, para. 365] An international organization which has undertaken work in this area is the International Federation of Insolvency Professionals (INSOL) which has developed Principles for a global approach to multi-creditor workouts. The Principles are designed to expedite informal processes and increase the prospects of success by providing guidance to diverse creditor groups about how to proceed on the basis of some common agreed rules.

**3. *Reorganization processes which include both informal and formal elements***

53. [47] Some countries have adopted what can be described as “pre-insolvency” or “pre-packaged” procedures that are, in effect, a combination of informal reorganization processes and formal reorganization proceedings. Under one insolvency law, for example, regulations have been issued that allow the court to formally approve a reorganization plan that was negotiated informally and approved by creditors through a vote that occurred before the commencement of formal proceedings. Such processes are designed to minimize the cost and delay associated with formal reorganization proceedings while at the same time providing a means by which a reorganization plan negotiated informally nevertheless can be approved in the absence of unanimous support of the creditors. Such a process allows the work undertaken in the informal negotiations to be used to achieve a reorganization that will bind all creditors, whilst at the same time providing the protections of the insolvency law to affected creditors.

54. [48] Another insolvency law provides that in order to facilitate the conclusion of an amicable settlement with its creditors, a debtor may ask the court to appoint a “conciliator”. The conciliator has no particular powers but may request the court to impose a stay of execution against all creditors if, in his or her judgement, a stay would facilitate the conclusion of a settlement agreement. During the stay, the debtor may not make any payments to discharge prior claims (except salaries) or dispose of any assets other than in the regular course of business. The procedure ends when agreement is reached either with all creditors or (subject to

court approval) with the main creditors; in the latter case, the court may continue the stay against non-participating creditors by providing a grace period to the debtor of up to two years.

55. These types of procedures are discussed in more detail in Part two, chapter V.B.

**C. Administrative processes**

56. [44] In recent years a number of crisis-affected jurisdictions have developed semi-official “structured” forms of informal processes, largely inspired by government or central banks, to deal with systemic financial problems within the banking sector. These processes have been developed on a similar pattern. First, each has a facilitating agency to encourage and, in part, coordinate and administer informal reorganization to provide the incentive and motivation necessary for development of the informal processes. Second, each process is underpinned by an agreement between commercial banks in which the participants agree to follow a set of “rules” in respect of corporate debtors who are indebted to one or more of the banks and which may participate in the process. The rules provide the procedures to be followed and the conditions to be imposed in cases where corporate reorganization is attempted. In some of the jurisdictions, a debtor corporation that seeks to negotiate an informal reorganization is required to agree to the application of these rules. Third, time limits are provided for various parts of the procedures and, in some cases, agreements in principle can be referred to the relevant court for a formal reorganization to occur under the law. In addition, one jurisdiction established a special agency which has extremely wide powers under its governing legislation to acquire non-performing loans from the banking and finance sector and then to impose extra-judicial processes upon a defaulting corporate debtor, including a forced or imposed reorganization.

57. Both because these processes are relatively complex and involve the development of special rules and regulations and because they address particular situations of systemic failure they are not discussed in any detail in the Guide.

**D. The structure of the insolvency regime**

58. [52] Although many insolvency laws include both liquidation and reorganization proceedings, approaches differ widely as to the structure of the procedure which leads to the choice of one of these processes. Some insolvency laws provide for a unitary, flexible insolvency proceeding with a single commencement requirement alternatively resulting in liquidation or reorganization depending on the circumstances of the case. Other laws provide for two distinct proceedings, each setting forth its own access and commencement requirements, with different possibilities for conversion between the two proceedings.

59. [53] Those laws that treat liquidation and reorganization procedures as distinct from each other do so on the

basis of different social and commercial policy considerations and with a view to achieving different objectives. However, a significant number of issues are common to both liquidation and reorganization, resulting in considerable overlaps and linkages between them, in terms of both procedural steps and substantive issues, as will become evident from the discussion in Part Two which follows.

60. [54] Where two distinct procedures are provided in the insolvency law, the determination of whether the business of the insolvent debtor is viable should determine, at least in theory, which procedure will be used. As a matter of practice, however, at the time of commencement of either procedure, it is often impossible to make a final evaluation as to the financial viability of the business. Some of the disadvantages of this approach are that it may create an undesirable degree of polarization between liquidation and reorganization and can result in delay, increased expense and inefficiency, especially, for example, where the failure of reorganization requires a new and separate application to be made for liquidation. This inefficiency can be overcome, to some extent, by providing linkages between the two proceedings, with a view to allowing conversion of one type of proceeding to the other in certain specific circumstances, and by including devices designed to prevent the abuse of insolvency process, such as commencing reorganization proceedings as a means of avoiding or delaying liquidation (see ...).

61. [55] As to the question of choice of procedures, some countries provide that the party applying for the insolvency proceedings will have the initial choice between liquidation and reorganization. When liquidation proceedings are initiated by one or more creditors, the law will often provide a mechanism which enables the debtor to request conversion into reorganization proceedings where this is feasible. When the debtor applies for reorganization proceedings, whether on its own motion or as a consequence of an application for liquidation by a creditor, the application for reorganization should logically be decided first. With a view to protecting creditors, however, some insolvency laws will provide a mechanism enabling reorganization to be converted into liquidation upon a determination, either at an early stage of the proceedings or later, that reorganization is not likely to, or cannot, succeed. Another mechanism of protection for creditors may consist of setting forth the maximum period for which reorganization against the will of the creditors may be granted.

62. [56] As a general principle, although usually presented as separate procedures, liquidation and reorganization procedures are normally carried out sequentially, that

is, a liquidation procedure will only run its course if reorganization is unlikely to be successful or if reorganization efforts have failed. In some insolvency systems, the general presumption is that a business should be reorganized and liquidation procedures may be commenced only when all attempts to reorganize the entity have failed. In insolvency systems providing for conversion, a request for reorganization to be converted into liquidation may be made by the debtor, the creditors or the insolvency representative, depending upon the circumstances set forth by the law. These circumstances may include where the debtor is unable to pay post-petition debts as they fall due; where the reorganization plan is not approved by creditors or the court; where the debtor fails to fulfil its obligations under an approved plan; or where the debtor attempts to defraud creditors (see Part two, chapter ..). Whilst it is often possible for reorganization proceedings to be converted to liquidation proceedings, most insolvency systems do not allow reconversion to reorganization once conversion of reorganization to liquidation has already occurred.

63. [57] Difficulties of determining at the very outset whether the debtor should be liquidated rather than reorganized have led some countries to revise their insolvency laws by replacing separate proceedings with "unitary" proceedings.<sup>2</sup> Under the "unitary" approach there is an initial period (usually referred to as an "observation period", which in existing examples of unitary laws may last up to three months) during which no presumption is made as to whether the business will be eventually reorganized or liquidated. The choice between liquidation or reorganization proceedings only occurs once a determination has been made as to whether reorganization is actually possible. The basic advantages offered by this approach are its procedural simplicity, its flexibility and possible cost-efficiency. A simple, unitary procedure, allowing both reorganization and rehabilitation, may also encourage early recourse to the proceedings by debtors facing financial difficulties, thus enhancing the chances of successful rehabilitation. A disadvantage of this procedure, however, may be the delay that occurs between the decision to commence and the decision as to which procedure should be followed, and the consequences for the debtor's business and the value of the debtor's assets that may flow from that delay.

64. However the insolvency law is arranged in terms of liquidation and reorganization, it should ensure that once a debtor is in the system, it cannot exit without some final determination of its future.

<sup>2</sup>Where a unitary system is chosen, some changes will need to be made to the various core elements of the insolvency law. These are identified in Annex ...

## A/CN.9/WP.V/WP.63/Add.16

## Draft legislative guide on insolvency law

## Note by the Secretariat

## CONTENTS

*[The Glossary to the Guide appears in document A/CN.9/WG.V/WP.63/Add.1; Part One, Chapters I and II appear in document A/CN.9/WG.V/WP.63/Add.2; Part Two, Chapter II.A-B in documents A/CN.9/WG.V/WP.63/Add.3-4; Chapter III.A-F in documents A/CN.9/WG.V/WP.63/Add.5-9; Chapter IV.A-D in Add.10-11, Chapter V in Add.12, Chapter VI.A-C in Add.13-14, and Chapter VII.A-B in Add.15]*

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## Part Two (continued)

## IV. PARTICIPANTS AND INSTITUTIONS

## A. The debtor

## 6. Rights of review and appeal

*[This section would be inserted after para. 230 of A/CN.9/WG.V/WP.63/Add.11]*

*Note to the Working Group: in view of the section that follows in respect of creditors, does the debtor have any rights to seek review of decisions made by the insolvency representative or creditors? Can the debtor seek to have the insolvency representative removed and replaced? Can the debtor appeal against decisions made by the court with respect to aspects of the insolvency process? If so, should the Guide address those matters?*

*Under one law, for example, the debtor has a residual interest in the estate and can qualify as an aggrieved person who may seek review by the court of actions or decisions of the insolvency representative (leave of the court is required for actions against the trustee for malicious prosecution or defamation), and may also seek removal of the insolvency representative.*

## C. Creditors

## 3. Rights of review and appeal

*[The following paragraphs may be inserted after para. 295, A/CN.9/WG.V/WP.63/Add.11]*

## (a) Introduction

1. Creditors, collectively, hold the primary economic interest in an insolvent estate. This interest is generally protected by an insolvency representative, who administers the estate with a view to preserving and protecting its assets and value, ultimately for the benefit of creditors.

2. To ensure creditors have confidence in the protection of their interests, it is desirable that an insolvency law provide for the active involvement of creditors in the insolvency proceedings. As is evident from the discussion in chapter IV, the level of that involvement and the roles assigned respectively to creditors, the insolvency representative and the courts in the decision-making process vary considerably between jurisdictions. Most regimes, however, provide creditors, as the primary beneficiaries of the estate, with some ability to scrutinize both the admin-

istration of the estate and the conduct of the insolvency representative in performing its duties. Where decisions relating to administration of the estate are to be made by the courts, those decisions generally may be appealed to a higher court, although some insolvency laws do exempt certain decisions from appeal (e.g. the decision appointing the supervising judge or commencing the proceedings).

3. It should be noted, however, that in considering the extent of the powers to be given to creditors to object to acts or decisions of the insolvency representative some level of disagreement is almost impossible to avoid, particularly as the insolvency representative will be required to act for the benefit of all creditors and to take action that individual creditors may not support or agree with. In the normal course of events, however, such dissatisfaction would not give the court cause to replace the insolvency representative or give the creditor grounds for an action against the insolvency representative.

*(b) Review of acts and omissions of the insolvency representative*

4. Where the insolvency law does provide creditors with the power to object to acts or decisions of the insolvency representative and where the insolvency representative does not agree with or accept such an objection, the course of action available to creditors and the applicable procedural and evidential requirements generally depend largely on the role assigned to creditors in a particular insolvency regime.

5. Where the regime provides for the actions or decisions of the insolvency representative to be supervised or approved by the general body of creditors or the creditor committee, a high level of creditor protection may ensue. Where that supervision or approval adds steps to the administration of the insolvency estate, however, it has the potential to affect the cost and efficiency of the administrative process. For these reasons an insolvency regime will need to balance the extent to which supervision or approval by creditors is required (including defining both the acts and decision that require approval and the procedure for obtaining that approval) against the independence of the insolvency representative and the desirability of speed and cost effectiveness in the conduct of the insolvency proceedings. Regimes vary in the balance reached between these possibly competing factors. Further relevant factors that may need to be taken into account include the extent to which the court plays a role in supervising the proceedings and the insolvency representative, and the manner in which the insolvency regime balances that role against the participation of creditors.

*(c) Grounds for review*

6. The grounds upon which creditors may question either the decisions or administration of an insolvency representative and the decisions that may be subject to such questioning should be expressly stated in an insolvency law. The grounds for creditor action under existing laws can be divided into two main categories.

7. In the first category are those laws under which creditors are given certain rights where the insolvency representative can be shown to have committed some wrong. That wrong may include actual wrongdoing, such as the misappropriation of funds or assets or obtaining creditors' approval by improper means; procedural errors, such as a failure to seek a necessary approval of creditors or a creditors committee, or to undertake another act required by law; or negligence by the insolvency representative in the performance of its duties. Some jurisdictions limit a creditor's right to challenge the insolvency representative to some, if not all, of these situations.

8. In the second category are those laws which provide, normally in addition to the grounds related to specific wrongdoing, that creditors can test (normally in the courts) any decision, act or omission of the insolvency representative which they individually or collectively object to or disapprove of. The basis of a successful action will normally be grounds similar to those already mentioned above, but may also include proof that the decision, act or omission was contrary to the interests of creditors. To prevent unreasonable disruption of the administration of an estate, an insolvency law may adopt appropriate limitations such as adjusting the standard of proof to be met in order for the court to uphold the creditors' appeal or protecting certain aspects of an administration against appeal, e.g. excluding actions concerning commencement of insolvency proceedings.

*(d) Review procedures*

9. Procedural approaches to a creditor's objection to the administration of an estate are largely determined by the rules governing the duties of the insolvency representative and the active role, if any, of creditors in the administration. For example, in those laws which require the insolvency representative to gain the approval of creditors, or their representatives, before undertaking certain acts, direct involvement of creditors in the decision-making process will normally preclude the need for a review procedure with respect to those acts, apart from those situations where the insolvency representative has misled creditors.

10. Where acts of the insolvency representative are not subject to the prior approval of creditors, there may be a need for a formal review procedure.

11. That review procedure may take different forms. Some laws grant creditors, collectively, a review role in the case of a dispute between the insolvency representative and a creditor. Examples of laws which adopt this approach focus on giving creditors the power to require the insolvency representative to call a meeting of all creditors or the creditors committee to attempt to resolve the issue raised.

12. Most insolvency laws, however, require creditors to raise their objection through a court action. Some insolvency laws allow individual creditors to bring an action, while others require the objecting creditor or creditors to represent a certain number of creditors or percentage of the debt to have legal standing to proceed with the action, or even require the action to be brought by the creditors committee or the general body of creditors. Such requirements may depend upon the grounds of the objection raised.



13. Most laws provide the courts, in reviewing an insolvency administration and enforcing the substantive rights of creditors, a number of powers. At one level, a court may direct an insolvency representative to take, or refrain from taking, a particular action related to the creditor's objection. The court may also have powers to confirm, reverse or modify decisions of the insolvency representative or to remove the insolvency representative whether at the direct request of the objecting creditor or on the motion of the court (see Part two, chapter IV.B.9). Many insolvency laws provide that the insolvency representative is personally liable for damages intentionally or negligently caused to creditors through the performance of the insolvency representative's duties (see Part two, chapter IV.B.7). Some insolvency laws also provide that in those circumstances the court may impose a monetary penalty on the insolvency representative.

(e) *Reorganization*

14. In reorganization, the creditors may have, in addition to those discussed above which relate to the insolvency representative, remedies relating specifically to approval of the plan and its implementation. These are discussed in Part two, chapter V, A.8, 10, 13 and 14.

## VI. MANAGEMENT OF PROCEEDINGS

### D. Treatment of corporate groups in insolvency

[The following paragraphs may be inserted after the recommendations following para. 441, A/CN.9/WG.V/WP.63/Add.14]

#### 1. Introduction

15. It is common practice for commercial ventures to operate through groups of companies and for each company in the group to have a separate legal personality. Where a company in a group structure becomes insolvent, treatment of that company as a separate legal personality raises a number of issues which are generally complex and may often be difficult to address. In certain situations, such as where the business activity of a company has been directed or controlled by a related company, the treatment of the group companies as separate legal personalities may operate unfairly. That treatment, for example, may prevent access to the funds of one company for the payment of the debts or liabilities of a related debtor company (except where the debtor company is a shareholder or creditor of the related company), notwithstanding the close relationship between the companies and the fact that the related company may have taken part in the management of the debtor or acted like a director of the debtor and caused it to incur debts and liabilities. Furthermore, where the debtor company belongs to a group of companies, it may be difficult to untangle the specific circumstances of any particular case to determine which group company particular creditors dealt with or to establish the financial dealings between group companies.

16. Two issues of specific concern in insolvency proceedings involving one of a group of companies are:

(a) Whether any other company in the group will be responsible for the external debts of the insolvent company (being all debts owed by the insolvent company except for those owed to related group companies, i.e. "intra-group debts"); and

(b) Treatment of intra-group debts (claims against the debtor company by related group companies).

17. Insolvency laws provide different responses to these issues. Some laws adopt a prescriptive approach which strictly limits the circumstances in which group companies can be treated as other than separate legal personalities, in other words, the circumstances in which a related company can be responsible for the debts of an insolvent group member. Other laws adopt a more expansive approach and give courts broad discretion to evaluate the circumstances of a particular case on the basis of specific guidelines. The range of possible results in the latter case is broader than under those laws adopting a prescriptive approach. In either case, however, it is common for insolvency laws to address these issues of intra-group liability based upon the relationship between the insolvent and related group companies in terms of both shareholding and management control. One possible advantage of addressing these issues in an insolvency law is to provide an incentive for corporate groups to continuously monitor the activities of companies within the group, and take early action in the case of financial distress of a member of that group. Treating companies as other than separate legal entities however, may undermine the capacity of business, investors and creditors to quarantine, and make choices about, risk (which may be particularly important where the group includes a company with special requirements for risk management, such as a financial institution); it may introduce significant uncertainty that affects the cost of credit, particularly when the decision about responsibility for group debts is made by a court after the event of insolvency; and it may involve accounting complexities concerning the manner in which liabilities are treated within the group.

#### 2. Group responsibility for external debts

18. Insolvency regimes look to a number of different circumstances or factors in the assessment of whether a related or group company should bear responsibility for the external debts of an insolvent member of the group.

19. It is common to many jurisdictions for the related company to bear responsibility for the debt where it has given a guarantee in respect of its subsidiaries. Similarly, many regimes infer responsibility to compensate for any loss or damage in cases of fraud in intra-group transactions. Further solutions may be prescribed by other areas of law. In some circumstances, for example, the law may treat the insolvent company as an agent of the related company, which would permit third parties to enforce their rights directly against the related company as a principal.

20. Where the insolvency law grants the courts a wide discretion to determine the liability of one or more group companies for the debts of other group companies, subject

to certain guidelines, those guidelines may include the following considerations: the extent to which management, the business and the finances of the companies are intermingled; the conduct of the related company towards the creditors of the insolvent company; the expectation of those creditors that they were dealing with one economic entity rather than two or more group companies; and, the extent to which the insolvency is attributable to the actions of the related group company. Based on these considerations, a court may decide on the degree to which a corporate group has operated as a single enterprise and, in some jurisdictions, may order that the assets and liabilities of the companies be consolidated or pooled,<sup>1</sup> particularly where that order would assist in a reorganization of the corporate group, or that a related company contribute financially to the insolvent estate, provided that contribution would not affect the solvency of the contributing company. Contribution payments would generally be made to the insolvency representative administering the insolvent estate for the benefit of the estate as a whole.

21. One further and important consideration in insolvency laws that allow such measures is the effect of those measures on creditors. These regimes, in seeking to ensure fairness to creditors as a whole, must reconcile the interests of two (or more) sets of creditors who have dealt with two (or more) separate corporate entities. These collective interests will conflict if the total assets of the combined companies are insufficient to meet all claims. In such a case, creditors of a group company with a significant asset base would have their assets diminished by the claims of creditors of another group company with a low asset base. One approach to this issue is to consider whether the savings to creditors collectively would outweigh the incidental detriment to individual creditors. In the situation where both companies are insolvent, some laws take into account whether the withholding of a consolidation decision, ensuring separate insol-

<sup>1</sup>A decision that a corporate group has operated as one economic entity will give rise to application of other provisions of the insolvency law, for example, the duty of directors to prevent insolvent trading. Some laws also allow, in limited circumstances, companies to voluntarily pool assets and liabilities.

veny proceedings, would increase the cost and length of proceedings and deplete funds which would otherwise be available for creditors, as well as allowing the shareholders of some corporate group companies to receive a return at the expense of creditors in other group companies.<sup>2</sup>

22. The common principle of all regimes with laws of this type is that, for a consolidation order to be granted, the court must be satisfied that creditors would suffer a greater prejudice in the absence of consolidation than the insolvent companies and objecting creditors would from its imposition. In the interests of fairness, some jurisdictions allow for partial consolidation by exempting the claims of specific creditors and satisfying these claims from particular assets (excluded from the consolidation order) of one of the insolvent companies. The difficulties imposed by this reconciliation exercise have resulted in such orders being infrequently made in those countries where they are available.

23. It should be noted that insolvency laws providing for consolidation do not affect the rights of secured creditors, other than possibly the holders of intra-group securities (where the secured creditor is a group company).

### 3. *Intra-group debts*

24. Intra-group debts may be dealt with in a number of ways. As discussed above (see Part two, chapter III.E), intra-group transactions may be subject to avoidance actions. Under some insolvency laws that provide for consolidation, intra-group obligations are terminated by the consolidation order. Other approaches involve classifying intra-group transactions differently from similar transactions conducted between unrelated parties (e.g. a debt may be treated as an equity contribution rather than as an intra-group loan) with the consequence that the intra-group obligation will rank lower in priority than the same obligation between unrelated parties.

<sup>2</sup>Some laws require creditors, as well as assets and liabilities, of each relevant group company to be separately identified before any distribution can be made.

## A/CN.9/WG.V/WP.63/Add.17

### Draft legislative guide on insolvency law

#### Note by the Secretariat

*[The Glossary to the Guide appears in A/CN.9/WG.V/WP.63/Add.1; Part One of the Guide appears in A/CN.9/WG.V/WP.63/Add.2; Part Two of the Guide appears in documents A/CN.9/WG.V/WP.63/Add.3-16]*

#### APPLICABLE LAW GOVERNING IN INSOLVENCY PROCEEDINGS

##### Recommendations

##### *Purpose of legislative provisions*

The purpose of provisions on the applicable law governing in insolvency proceedings is to:

- (a) Promote cross-border financing, commerce and trade;
- (b) Facilitate commercial transactions by providing a clear and transparent basis for predicting the rules of law that will apply to the legal relationships with the debtor;
- (c) Provide courts with clear and predictable rules for the enforcement of choice of law provisions in contracts with a debtor; and

(d) In the absence of a choice of law provision in a contract with the debtor, to provide courts with clear and predictable rules for determining the rules of law applicable to legal relationships with the debtor.

### *Contents of legislative provisions*

#### *Administration of insolvency proceedings*

##### *— Law of the forum*

(1) The general insolvency law [of the State] should [apply] [be the law that applies] to all aspects of the commencement, conduct, administration and termination of insolvency proceedings, [in particular] [including]:

- (a) Eligibility and commencement criteria;
- (b) Creation and scope of the insolvency estate;
- (c) Treatment of property of the estate, including the scope of, exceptions to, and relief from application of a stay;
- (d) Powers of the debtor, insolvency representative, creditors and creditors' committee;
- (e) Costs and expenses;
- (f) Proposal, acceptance, confirmation and enforcement of a plan of reorganization;
- (g) Treatment of legal acts detrimental to creditors;
- (h) Conditions under which set-off can occur after commencement of insolvency proceedings;
- (i) effect of the commencement of the proceedings upon contracts and leases under which both the debtor and its counterparty have not yet fully performed their respective obligations, including the enforceability of automatic termination and anti-assignment provisions in those contracts and leases;
- (j) claims and their treatment; and
- (k) resolution and conclusion of the proceedings.

##### *— Law other than the law of the forum*

*[Note: The Working Group may wish to consider whether recommendations of a general nature should be included here to indicate those cases where the law of another jurisdiction should apply, for example that insolvency proceedings should not affect the validity of a security interest which should be governed by the law applicable to the security interest (which could include a cross-reference to the secured transactions guide); employment contracts and relationships, which should be dealt with in accordance with the law governing those contracts.]*

(2) As an exception to recommendation (1), the [general insolvency] law [of a State] may provide that the law of another State applies to [the avoidability of a transaction or set-off that occurred or an obligation that was incurred before the commencement of those proceedings] [whether or not a transaction or set-off that occurred or an obligation that was incurred before the commencement of those proceedings is avoidable].

*[Note: This recommendation does not state the circumstances in which the law of another State would be recognized with respect to avoidability. The Working Group may wish to consider the circumstances in which such recognition would be accorded or specify the connecting factor between the law of the other State and the transaction in question.]*

(3) [As a further exception to recommendation (1),] the general insolvency law should provide that the [acceleration,] [closeout,] set-off or netting of financial obligations and transactions pursuant to the rules of a payment or settlement system or a financial market, should not be subject to avoidance [except to the extent that recommendation (70)(a) would apply] [or unwinding]. The general insolvency law [of the State] should recognize the [acceleration,] [close-out,] set-off or netting pursuant to similar rules of a payment or settlement system or a financial market in another State.

*[Note: The Working Group may wish to consider whether a recommendation of this nature should be included in this section of the Guide or in chapter III.E or F. In this regard see document A/CN.9/WG.V/WP.63/Add.9 and the reference to possible additional recommendations.]*

#### *Validity of contractual choice of law provisions*

(4) The general insolvency law should recognize contractual provisions in which the debtor and its counterparty expressly agree that the law applicable to their legal relationship under the contract will be the law of a specified jurisdiction without regard to the nexus between the transaction or the parties at issue and the chosen applicable law, except where:

- (a) Consumer or employment transactions are involved;
- (b) Such a provision is viewed as manifestly contrary to a public policy of the jurisdiction whose law would apply in the absence of such a provision; or
- (c) Those provisions pertain to the priority, creation, perfection or enforceability of a security interest as against third parties.

#### *Determining the applicable law*

(5) The general insolvency law should clearly indicate when the rules of the insolvency law would be [subordinate to] [affected by] other laws of the jurisdiction. The insolvency law should recognize and respect rights, claims and other entitlements valid under non-insolvency law except to the extent it may be necessary to modify or postpone those rights, claims and entitlements in order to achieve the specific goals of the insolvency process.

*[Note: The Working Group may wish to consider whether a recommendation to this effect should be included in the Guide, bearing in mind that it reflects several key objectives as well as principles generally agreed and already mentioned in several chapters of the commentary. If such a recommendation is to be included, the Working Group may wish to consider whether it should be located in this section or elsewhere in the guide.]*

(6) Where the general insolvency law or other applicable law [of the State] does not provide the governing legal rule, the insolvency court [before which insolvency proceedings have been commenced] should apply non-insolvency law. Where the law of more than one State is relevant to the application of the non-insolvency law, the insolvency court will need to apply a conflict of laws rule of the forum to determine which State's non-insolvency law should apply. The conflict of laws rules should be clear and predictable and should follow modern conflict of laws rules embodied in international treaties and legislative guides sponsored by international bodies.

*[Note: The Working Group may wish to consider, depending upon its decision with respect to recommendation (4), whether examples of the approaches adopted by modern conflicts of laws rules could be included in recommendation (6), for example, respect for the choice of the parties of the law applicable without undue restriction or without requiring a nexus between the transaction or the parties and the chosen applicable law. Such examples could be helpful in clarifying what is intended by the third sentence of the recommendation.]*

**F. Report of Working Group V (Insolvency Law) and Working Group VI (Security Interests) on the work of their first joint session (Vienna, 16-17 December 2002)**

(A/CN.9/535) [Original: English]

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I. INTRODUCTION

1. At its thirty-fifth session (2002), the Commission noted with particular satisfaction the efforts undertaken by Working Group VI (Security Interests) and Working Group V (Insolvency Law) towards coordinating their work on a subject of common interest such as the treatment of security interests in the case of insolvency proceedings. Strong support was expressed for such coordination, which was generally thought to be of crucial importance for providing States with comprehensive and consistent guidance with respect to the treatment of security interests in insolvency

proceedings. The Commission endorsed a suggestion made to revise chapter X of the draft legislative guide on secured transactions in light of the core principles agreed by Working Groups V and VI (see A/CN.9/511, paras. 126-127 and A/CN.9/512, para. 88). The Commission also endorsed a suggestion for closer coordination of the work of the two working groups, including a suggestion to hold a one-day joint meeting of the two working groups at their upcoming sessions.<sup>1</sup>

<sup>1</sup>Official Records of the General Assembly, Fifty-Fourth Session, Supplement No. 17 (A/54/17), para. 203.

## II. ORGANIZATION OF THE SESSION

2. Working Group V (Insolvency Law) and Working Group VI (Security Interests), which were composed of all States members of the Commission, held their first joint session in Vienna, from 16 to 17 December 2002. The session was attended by representatives of the following States members of the Working Groups: Argentina, Austria, Cameroon, Canada, China, Colombia, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Morocco, Romania, Russian Federation, Rwanda, Singapore, Spain, Sweden, Thailand, The former Yugoslav Republic of Macedonia and United States of America.

3. The session was attended by observers from the following States: Algeria, Australia, Belarus, Bulgaria, Denmark, Indonesia, Lebanon, New Zealand, Philippines, Poland, Republic of Korea, Slovakia, Switzerland, Syrian Arab Republic, Turkey, Ukraine and Venezuela.

4. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: International Monetary Fund (IMF) and the World Bank; (b) intergovernmental organizations: Asian-African Legal Consultative Organisation (AALCO), Common Market for Eastern and Southern Africa (COMESA), European Bank for Reconstruction and Development (EBRD) and International Institute for the Unification of Private Law (UNIDROIT); (c) non-governmental organizations invited by the Commission: American Bar Association (ABA), American Bar Foundation (ABF), Center for International Legal Studies, Center of Legal Competence (CLC), Commercial Finance Association (CFA), Europafactoring, International Bar Association, Committee J (IBA), International Federation of Insolvency Professionals (INSOL), Max-Planck-Institute, Society of European Contract Law (SECOLA), The Association of the Bar of the City of New York and Union of Industrial and Employers' Confederations of Europe (UNICE).

5. The Working Group elected the following officers:

*Chairman:* Mr. Alexander MARKUS  
(Switzerland, in his personal capacity);

*Rapporteur:* Mr. Thammanoon PHITAYAPORN  
(Thailand)

6. The Working Groups had before them the following documents: A/CN.9/WG.V/WP.62 and A/CN.9/WG.VI/WP.5 (provisional agenda), A/CN.9/WG.VI/WP.6/Add.5 (Draft legislative guide on secured transactions, Chapter IX. Insolvency) and A/CN.9/WG.V/WP.64 (Draft legislative guide on insolvency law: Treatment of secured creditors in insolvency).

7. The Working Groups adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Consideration of the treatment of security rights in insolvency proceedings.
4. Other business.
5. Adoption of the report.

## III. DELIBERATIONS AND DECISIONS

8. The Working Groups considered the treatment of security rights in insolvency proceedings on the basis of chapter IX, Insolvency, of the draft legislative guide on secured transactions (A/CN.9/WG.VI/WP.6/Add.5). The deliberations and decisions of the Working Groups are set forth below in part IV. The Working Groups noted with particular satisfaction that, as a result of their fruitful cooperation, their deliberations and decisions were based on principles and policies that were consistent, an approach that was indispensable for providing comprehensive and consistent advice to States with respect to the treatment of security rights in insolvency proceedings. The Secretariat was requested to prepare, on the basis of those deliberations and decisions, a revised version of chapter IX, Insolvency, of the draft legislative guide on secured transactions.

## IV. CONSIDERATION OF THE TREATMENT OF SECURITY RIGHTS IN INSOLVENCY PROCEEDINGS

### A. Introduction (paras. 1-5)

9. With respect to paragraph 2, it was agreed that it should clarify that, while the protection of the economic value of encumbered assets was important to secured transactions regimes, insolvency regimes attached importance to the protection of the value of all assets of the insolvency estate. It was also agreed that the reference to monitoring the activities of debtors should be toned down on the basis that the draft guide should not impose obligations that could not be met and could negatively affect the availability and the cost of credit, or go into a detailed discussion of obligations under the security agreement.

10. With respect to paragraph 4, it was suggested that the distinction between liquidation and reorganization needed some further elaboration to take into consideration other techniques, such as the sale of a business as a going concern, and that that change should be reflected throughout chapter IX.

### B. Key objectives (paras. 6-8)

11. It was agreed that the principle that the effectiveness of a security right should be recognized in an insolvency proceeding subject to avoidance actions should be emphasized. It was noted that that principle was also reflected in the draft insolvency guide (see A/CN.9/WG.V/WP.63/Add.9, para. 170 and recommendation 71). It was also agreed that the reference to priority should be understood as relating to competing claims rather than to a distinction between effectiveness as against the debtor and effectiveness and priority as against third parties. In addition, it was also agreed that reference should be made to the impact of post-commencement financing on the rights of existing secured creditors.

### C. The inclusion of encumbered assets in the insolvency estate (paras. 9-15)

12. It was noted that Working Group V, in defining the property to be included in the estate (for the purposes of both liquidation and reorganization), had agreed that in addition to assets of the debtor, the estate should include rights of the debtor, whether of a proprietary, contractual or other nature (see A/CN.9/529, para. 82 and recommendations 27 and 30.). In agreeing that that formulation should be reflected in the draft guide on secured transactions, the Working Groups noted that rights of the buyer/debtor with respect to retention of title arrangements would be included in the estate, irrespective of whether they were characterized as property or contractual rights or whether the rights of the seller/creditor were treated as security rights or not (an issue that remained to be resolved in the draft guide on secured transactions).

### D. Limitations on the enforcement of security rights (paras. 16-22)

13. It was noted that Working Group V had completed a detailed discussion of the application of the stay and the variety of measures required to protect secured creditors (see A/CN.9/529, paras. 114-124 and recommendations 40-42). After discussion, the Working Groups agreed that the chapter on insolvency in the draft guide on secured transactions should be consistent with the draft insolvency guide on those issues. It was suggested that paragraph 20 should be expanded to indicate the standard against which the safeguards should be assessed (for example, the position the secured creditor would have been in had it enforced its security prior to commencement of proceedings).

14. With respect to the question in paragraph 22 whether the value of the encumbered assets after payment of the secured claim ("surplus") should be part of the estate, it was agreed that reference should be made to the treatment of retention of title arrangements in the various legal systems. It was stated that, in some legal systems, in the case of a sale under a retention of title arrangement, the seller could retain any surplus. In response, it was observed that in other legal systems any surplus, even in retention of title arrangements, would be part of the estate. It was stated that the matter might depend on whether retention of title arrangements were treated as security rights and on whether the relevant contract was continued or terminated by the insolvency representative. As to the discussion of the use and disposition of assets in paragraph 22, it was agreed that it should reflect the thrust of the approach taken with respect to that matter in recommendations 44, 45 and 51 of the draft insolvency guide (see A/CN.9/529, paras. 131 and 139-140).

### E. Participation of secured creditors in insolvency proceedings (paras. 23-24)

15. With respect to paragraph 23, it was agreed that it should be revised to reflect the principle that, as encum-

bered assets were part of the estate, secured creditors were affected and should be allowed to participate effectively in the insolvency proceedings, including in any negotiations aimed at an amicable settlement.

16. As to paragraph 24, it was agreed that it should reflect more accurately recommendation 110 of the draft insolvency guide as to the extent to which secured creditors would be represented in creditor committees (see A/CN.9/WG.V/WP.63/Add.11).

### F. The validity of security rights and avoidance actions (para. 25)

17. It was noted that paragraph 26 reflected a principle contained in the draft insolvency guide (see A/CN.9/WP.63/Add.9, para. 170 and recommendation 171). After discussion, it was agreed that reference should be made to the effectiveness as against the debtor and its creditors, since the notion of "validity" referred to the relationship between the secured creditor and the debtor and implied a contractual right. It was also agreed that with respect to the question whether avoidance actions could be initiated not only by the insolvency representative but also by creditors, reference should be made to the relevant discussion in the draft insolvency guide (see A/CN.9/529, paras. 164-165). In addition, it was agreed that the reference to payment of post-commencement proceeds of encumbered assets should be clarified by adding that that matter related to liquidation proceedings and strengthened to the effect that payment "should be made" and not just "be possible". The suggestion was made that reference should be made to avoidance of a secured transaction for the lack of registration. In response, it was stated that that might not be necessary since the source of ineffectiveness in such a case was secured transactions law rather than insolvency law.

### G. Relative priority of security rights (paras. 26-28)

18. With respect to paragraphs 26 and 27, it was agreed that the principle that pre-commencement priority should be respected subject to limited and clearly prescribed exceptions, should be reflected more clearly. As to the note in italics, various views were expressed. One view was that the note should be deleted as it could be taken as a recommendation to legislators to adopt unnecessary exceptions to the principle in paragraphs 26 and 27 (privileged claims, carve-outs, equitable subordination). Another view was that the note should be retained subject to the clarification that the exceptions referred to in the note were made in some countries only. Yet another view was that the exceptions were examples and should be retained as they were. After discussion, it was agreed that the text in the note should be retained but revised to clarify that any exceptions made were examples of approaches taken in some countries and that their adoption could have a negative impact on the availability and the cost of credit.

19. As to paragraph 28, it was agreed that the principle that costs for the administration of the estate should not be given priority over the claims of secured creditors should

be reflected more clearly. It was also agreed that the exception to that principle (costs of maintaining the encumbered assets) should be further clarified.

#### **H. Post-commencement financing (paras. 29-35)**

20. With respect to paragraph 29, it was agreed that it should make it clearer that post-commencement financing should be considered as an option only where appropriate.

#### **I. Reorganization proceedings (paras. 36-41)**

21. With respect to the discussion of the protection of the economic value of a security right in paragraph 39, it was agreed that the value should be no less than the value of the security right in the case of liquidation proceedings.

#### **J. Expedited reorganization proceedings (paras. 42-45)**

22. The substance of paragraphs 42 to 45 was found to be generally acceptable.

#### **K. Summary and recommendations (paras. 46-53)**

23. It was agreed that paragraphs 46 to 53 should be revised to reflect the above-mentioned decisions of the Working Groups. In particular with respect to retention of title arrangements, it was confirmed that whether they were to be treated as security rights or not (which was a matter of secured transactions law addressed in other chapters of the draft guide on secured transactions), either the assets or the value of the price paid by the buyer would be part of the estate (see para. 12).

### **G. Draft legislative guide on insolvency law (A/CN.9/534) [Original:English]**

#### **Note by Secretariat**

1. This note sets forth the structure of the draft legislative guide as contained in A/CN.9/WG.V/WP/63/Add.1-17. The list of contents shows the scope of the issues addressed by the draft legislative guide and its responsiveness to the mandate given to the Working Group. The final structure will require some revisions as to the numbering of chapters and recommendations; inclusion of the existing Chapter IV.D, Institutional framework, in the opening chapters of Part One; and relocation of Addendum 17 should the Working Group recommend that the material on applicable law governing in insolvency proceedings be retained in the legislative guide.

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#### **Part One. Designing the structure and key objectives of an efficient and effective insolvency regime**

##### **Introduction and glossary (A/CN.9/WG.V/WP.63/Add.1)**

##### **I. INTRODUCTION TO INSOLVENCY PROCEDURES (A/CN.9/WG.V/WP.63/ADD.2)**

##### **A. Key objectives of an effective and efficient insolvency regime**

1. Maximize value of assets
2. Strike a balance between reorganization and liquidation
3. Ensure equitable treatment of similarly situated creditors
4. Provide for timely, efficient and impartial resolution of insolvency
5. Prevent premature dismemberment of the debtor's assets
6. Provide for a procedure that is transparent and predictable and contains incentives for gathering and dispensing information
7. Recognize existing creditor rights and establish clear rules for ranking of priority claims
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**B. Balancing key objectives****C. General features of an insolvency regime****II. TYPES OF INSOLVENCY PROCEEDINGS****A. Liquidation****B. Reorganization**

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<sup>1</sup>Renumbering of the Guide in the last revision resulted in there being no chapter I in Part Two—in the final version of the Guide, Application and Commencement will be chapter I of Part Two.



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*Recommendations (27)-(29)*

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### III. INTERNATIONAL COMMERCIAL ARBITRATION AND CONCILIATION

#### A. Report of the Working Group on Arbitration on the work of its thirty-seventh session

(Vienna, 7-11 October 2002) (A/CN.9/523) [Original: English]

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#### I. INTRODUCTION

1. At its thirty-second session, in 1999, the Commission had before it a note entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985, also referred to in this report as "the Model Law"), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.<sup>1</sup>

2. The Commission entrusted the work to one of its working groups, which it named the Working Group II (Arbitration and Conciliation), and decided that the priority items for the Working Group should be conciliation,<sup>2</sup> requirement of written form for the arbitration agreement,<sup>3</sup> enforceability of interim measures of protection<sup>4</sup> and possible enforceability of an award that had been set aside in the State of origin.<sup>5</sup>

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future

<sup>2</sup>Ibid., paras. 340-343.

<sup>3</sup>Ibid., paras. 344-350.

<sup>4</sup>Ibid., paras. 371-373.

<sup>5</sup>Ibid., paras. 374 and 375.

<sup>1</sup>Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter referred to as “the New York Convention”) (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the 1958 New York Convention (para. 109 (i)); and the power by the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to “online” arbitrations (i.e. arbitrations in which significant parts or even all of arbitral proceedings were conducted by using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.<sup>6</sup>

4. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished so far regarding the three main issues under discussion, namely, the requirement of the written form for the arbitration agreement and the issue of interim measures of protection and the preparation of a model law on conciliation.

5. At its thirty-fifth session, held in New York from 17-28 June 2002, the Commission took note with appreciation of the report of the Working Group on the work of its thirty-sixth session (A/CN.9/508). The Commission commended the Working Group for the progress accomplished so far regarding the issues under discussion, namely the requirement of the written form for the arbitration agreement and the issues of interim measures of protection. At the same session, the Commission also adopted the UNCITRAL Model Law on International Commercial Conciliation.

6. With regard to the issues of interim measures of protection, the Commission noted that the Working Group had considered a draft text for a revision of article 17 of the Model Law (A/CN.9/WG.II/WP.119, para. 74) and that the secretariat had been requested to prepare revised draft provisions, based on the discussion in the Working Group,

for consideration at a future session. It was also noted that a revised draft of a new article prepared by the secretariat for addition to the Model Law regarding the issue of enforcement of interim measures of protection ordered by an arbitral tribunal (para. 83) would be considered by the Working Group at its thirty-seventh session (A/CN.9/508, para. 16).

7. The Working Group is composed of all States members of the Commission. These are:

Argentina, Austria, Benin, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, Fiji, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Morocco, Paraguay, Romania, Russian Federation, Rwanda, Sierra Leone, Singapore, Spain, Sudan, Sweden, Thailand, the Former Yugoslav Republic of Macedonia, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

8. The Working Group at its thirty-seventh session was attended by the following State members: Argentina, Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, Hungary, India, Italy, Japan, Lithuania, Mexico, Russian Federation, Rwanda, Singapore, Spain, Sudan, Sweden, Thailand, the United Kingdom of Great Britain and Northern Ireland and the United States of America.

9. The session was attended by observers from the following States: Algeria, Australia, Croatia, Czech Republic, Denmark, Ecuador, Finland, Greece, Indonesia, Ireland, Lebanon, Peru, Philippines, Poland, Qatar, Republic of Korea, Slovakia, Slovenia, Switzerland, Turkey, Ukraine, Venezuela and Yemen.

10. The session was attended by observers from the following international organizations:

(a) Intergovernmental organizations: Hague Conference on Private International Law, League of Arab States, NAFTA Article 2022 Advisory Committee and the Permanent Court of Arbitration;

(b) Non-governmental organizations invited by the Commission: American Arbitration Association, Cairo Regional Centre for International Commercial Arbitration, *Centre d'Arbitrage et d'Expertise du Rwanda*, Chartered Institute of Arbitrators, Global Center for Dispute Resolution Research, International Chamber of Commerce (ICC), International Council for Commercial Arbitration (ICCA), International Law Institute (ILI), London Court of International Arbitration (LCIA), Moot Alumni Association (MAA) and Lagos Regional Centre for International Commercial Arbitration.

11. The Working Group elected the following officers:

*Chairman:* Mr. José María ABASCAL ZAMORA (Mexico)

*Rapporteur:* Mr. Prem Kumar MALHOTRA (India)

12. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.II/WP.120);

<sup>6</sup>Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 396.

(b) Note by the Secretariat: Preparation of uniform provisions on interim measures of protection (A/CN.9/WG.II/WP.119);

(c) Proposal by the United States of America (A/CN.9/WG.II/WP.121).

13. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of harmonized texts on interim measures of protection.
4. Other business.
5. Adoption of the report.

## II. DELIBERATIONS AND DECISIONS

14. The Working Group discussed agenda item 3 on the basis of the proposal by the United States of America (A/CN.9/WG.II/WP.121) and the document prepared by the Secretariat (A/CN.9/WG.II/WP.119). The deliberations and conclusions of the Working Group with respect to that item are reflected in Chapter III below.

## III. INTERIM MEASURES ORDERED BY THE ARBITRAL TRIBUNAL

15. The Working Group recalled that at its thirty-sixth session it had commenced discussions on the power of a court or arbitral tribunal to order interim measures of protection (A/CN.9/508, paras. 51ff.) and had considered a draft text for a revision of article 17 of the UNCITRAL Model Law on International Commercial Arbitration (A/CN.9/WG.II/WP.119). Due to lack of time, the Working Group had not completed its deliberations on interim measures of protection ordered by an arbitral tribunal at that session. A decision was made that the Working Group would continue its deliberations on the basis of a proposal submitted by the United States of America (A/CN.9/WG.II/WP.121) setting out a revision of draft article 17 of the UNCITRAL Model Law on International Commercial Arbitration, also having regard to the draft text previously prepared as contained in document A/CN.9/508 and document A/CN.9/WG.II/WP.119. The proposed text as considered by the Working Group (A/CN.9/WG.II/WP.21, also referred to in this report as “the proposal”) was as follows:

“(1) Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order another party to take interim measures of protection.

“(2) An interim measure of protection is any temporary measure, whether reflected in an interim award or otherwise, by which, at any time prior to the issuance of the award by which the dispute is finally decided, the arbitral tribunal orders a party to

“(a) maintain or restore the status quo pending determination of the dispute, in order to ensure or facilitate the effectiveness of an eventual award;

“(b) take action that would prevent, or refrain from taking action that would cause, current or imminent harm, in order to ensure or facilitate the effectiveness of an eventual award;

“(c) provide security for the enforcement of an eventual award, including an award of costs; or

“(d) preserve evidence that may be relevant and material to the resolution of the dispute.

“(3) The arbitral tribunal may order an interim measure of protection when the requesting party has demonstrated that

“(a) there is an urgent need for the measure;

“(b) irreparable harm will result if the measure is not ordered, and that harm substantially outweighs the harm that will result to the party opposing the measure if the measure is granted; and

“(c) there is a substantial possibility that the requesting party will succeed on the merits of the dispute.

“(4) (a) The arbitral tribunal may grant an interim measure of protection without notice to the party against whom the measure is directed or before the party against whom the measure is directed has had an opportunity to respond when, in addition to meeting the requirements of paragraph (3), the requesting party demonstrates that it is necessary to proceed in that manner in order to ensure that the measure is effective.

“(b) Any interim measure of protection ordered under this paragraph shall be effective for no more than twenty days, which period cannot be extended. This subparagraph shall not affect the authority of the arbitral tribunal to grant, confirm, extend, or modify an interim measure of protection under paragraph (1) after the party against whom the measure is directed has been given notice and an opportunity to be heard.

“(c) Except to the extent that the arbitral tribunal has determined under paragraph (4)(a) that it is necessary to proceed without notice to the party against whom the interim measure of protection is directed in order to ensure that the measure is effective, that party shall be given notice of the measure and an opportunity to be heard at the earliest practicable time.

“(d) [A party requesting an interim measure of protection under this paragraph shall have an obligation to inform the arbitral tribunal of all circumstances that the arbitral tribunal is likely to find relevant and material to its determination whether the requirements of this paragraph have been met.]

“(5) The arbitral tribunal may require the requesting party to provide appropriate security as a condition to granting an interim measure of protection.

“(6) The requesting party shall, from the time of the request onwards, inform the arbitral tribunal promptly of any material change in the circumstances on the basis of which the party sought or the arbitral tribunal granted the interim measure of protection.

“(7) The arbitral tribunal may modify or terminate an interim measure of protection at any time.”

### A. General remarks on interim measures ordered on an ex parte basis

16. The Working Group was invited to focus its attention on the most contentious issue of the power of an arbitral tribunal to order ex parte interim measures of protection as set forth in paragraph (4) of the proposal.

17. The Working Group recalled that at its thirty-sixth session diverging views were expressed as to whether, as a matter of general policy, it would be suitable for a revision of the Model Law to establish the possibility for interim measures to be ordered ex parte by an arbitral tribunal (A/CN.9/508, paras. 77-94). The Working Group recalled that a number of delegations had expressed the view that this power should be reserved for State courts. That view was reiterated. Other delegations felt that this power should be given to an arbitral tribunal provided that the ex parte order only applied for a limited time period. Other delegations took the view that, given the potential adverse impact of an ex parte order against the affected party, empowering an arbitral tribunal to issue such an order would be acceptable if strict conditions were imposed to ensure that the power was not subject to abuse. A widely shared view was that, even if ex parte measures were eventually dealt with in a revised version of article 17 of the Model Law, they should be so drafted as to indicate that ex parte measures should only be granted in exceptional circumstances.

18. The Working Group heard a presentation on the history and content of the proposal. It was noted that the proposal took the approach that the arbitral tribunal should be granted the authority to issue an ex parte interim measure of protection on a provisional basis and for a limited period. It was stated that there were at least two situations where it would be justified for an arbitral tribunal to order interim measures of protection on an ex parte basis, notwithstanding the fundamental principle of due process and equality of parties in arbitration. The first such situation was where a party applying for the interim measure in a case where it was urgently needed was prepared to provide notice to the other party but, for practical reasons, had not yet been able to give effective notice. The second, and more difficult, circumstance was where a party seeking the interim measures of protection contended it was necessary to withhold notice in order to ensure that the interim measure would be effective or that the other party would not frustrate the measure. It was said that the fundamental question of policy to be decided at the outset was whether the authority to order interim measures of protection on an ex parte basis should be granted to arbitral tribunals in addition to courts.

19. In support of giving such power to arbitral tribunals it was said that if the Working Group agreed that a necessary component of an arbitral tribunal's ability to resolve disputes included the power to order interim measures generally, then it would necessarily follow that an arbitral tribunal should have the discretion to do so on an ex parte basis where circumstances so required. It was suggested that the main argument against granting such power was the concern for the possible abuse of such a power. It was noted that the risk of abuse applied equally whether the ex parte interim measures of protection were sought from a court or from an arbitral tribunal. It was recognized that the

power to order ex parte interim measures of protection would need to work in tandem with the enforcement provisions yet to be considered by the Working Group. Given that the enforcement regime set out in the proposal envisaged that a national court would be permitted to examine the circumstances of the granting of the ex parte order, in some cases a party would have to successfully mislead both an arbitral tribunal and a court for there to be abuse of the measure. It was said that this risk was reduced by the fact that the potential review by a national court provided an appropriate and effective safeguard against abuse. Also, it was stated that the order of an arbitral tribunal could not directly affect third parties and that the party seeking the interim measures of protection could be placed under an obligation to provide security to safeguard against harm to the party against whom the measure was made. It was pointed out that there was some evidence, albeit anecdotal, that the judiciary in some States was in favour of providing arbitral tribunals with the power to address interim measures of protection. However, it was also pointed out that, in certain legal systems, an interim measure rendered on an ex parte basis would be regarded as a procedural decision that could not be enforced by State courts.

20. More specifically, it was explained that the general authority to grant ex parte interim measures of protection in paragraph 4(a) of the proposal included safeguards against potential abuse. Paragraph 4(b) provided that the ex parte interim measures of protection would be effective only for a maximum of twenty days and paragraph 4(c) provided that notice of the measure and an opportunity to be heard should be given to the responding party at the earliest practicable time. Further, paragraph 4(d) set out the obligation of the party seeking the measure to inform the tribunal of all circumstances that were relevant and material to the determination.

21. A number of reservations were expressed in respect of the proposal. First, it was said that such a power could potentially undermine the fundamental principle of agreement of parties upon which arbitration was based. It was suggested that allowing an arbitral tribunal to order ex parte interim measures of protection was contrary to the whole principle of arbitration which was based on the consensus of two parties permitting one or more persons to decide their dispute. It was said that conferring such a power on an arbitral tribunal would run counter to party expectations that arbitration respected party equality and the expectation that the powers of an arbitral tribunal were limited. In this respect, it was said that consensus between the parties and confidence in the arbitrators were fundamental to arbitration as a dispute settlement method. As such, it was said that parallels between national courts and private arbitral tribunals were not appropriate in the context of ex parte interim measures of protection. It was noted that the text as originally drafted referred to a "likelihood of the applicant for the measure succeeding on the merits" (A/CN.9/508, para. 51) whilst the proposal provided in paragraph 3(c) that there be "a substantial possibility that the requesting party will succeed on the merits" (A/CN.9/WG.II/WP.121). It was suggested that the original draft risked inviting the arbitral tribunal to prejudge the case in its examination of the merits and that the language of the proposal increased this risk. It was noted that this could undermine confidence in the arbitral process and create a misleading perception regarding the

impartiality of an arbitral tribunal. A suggestion was made to delete paragraph 3(c) to avoid this problem. Contrary views were expressed, and deletion was objected to on the grounds that such a requirement was generally well established in existing law governing the issuance of ex parte interim measures by State courts, and also amounted to an additional safeguard.

22. A suggestion was made that the power of the arbitral tribunal to order ex parte interim measures should only apply when the parties had expressly agreed to its application, for example in the arbitration agreement, in a set of arbitration rules, or through a determination of the national law that would govern the arbitration. There was some support for that suggestion. However, it was recalled that a similar suggestion had been objected to at the previous session of the Working Group on the grounds that “it was unrealistic to imagine that parties would agree on such a procedural rule either before or after the dispute had arisen” (A/CN.9/508, para. 78). It was pointed out that, particularly where one of the parties to the arbitration was a State or State entity, it might be difficult to elicit such express agreement. However, it was pointed out that a State party to a transaction with a private party might wish to be able to seek protective interim measures. As an alternative to the view that ex parte interim measures of protection should only be permitted if expressly agreed to by the parties, some delegations suggested that the power to order such measures should be subject to an opting out by the parties. In this respect it was suggested that it should be clarified that paragraph (1) of the proposal, which provided that the power to order interim measures of protection was subject to contrary agreement by the parties, should also apply to the power to order ex parte interim measures of protection in paragraph (4) of the proposal.

23. Additional concerns were expressed regarding the suitability of allowing a private arbitral tribunal to order ex parte interim measures. It was stated that determining appropriate safeguards against abuse was a complex matter that could take years to refine. In that respect, it was pointed out that the proposal did not provide that the applicant for the ex parte interim measures of protection should systematically provide a cross-undertaking to pay compensation to the respondent in the event that the ex parte measure was found to be unjustified. It was stated that, in such circumstances, some jurisdictions must allow a party to seek compensation from the arbitrator who ordered the measure. It was pointed out that this issue fell outside the scope of an arbitration law. A second concern was that the proposal did not make it clear whether such compensation for damages would be a matter arbitrable before the same tribunal. A third concern was that the proposal failed to recognize the possibility that third parties, although not party to the arbitration, could be affected by the ex parte measure.

24. In support of the proposal to confer a power on arbitral tribunals to order interim measures of protection on an ex parte basis, it was said that providing such a power would make an important contribution to the development of international arbitration that would make it more effective as a method of dispute settlement. It was stated that whilst traditionally the right to issue ex parte interim measures of protection was restricted to national courts,

there was a trend in a number of national laws to confer such a power on arbitral tribunals. In addition to the safeguards already included in the proposal, it was suggested that there should be a mandatory requirement that security be given by the party applying for the ex parte order to cover possible damages resulting from the measure. It was also suggested that there should be a separate obligation imposed upon the party applying for an ex parte measure to provide compensation in the event that the measure was later shown to have been unjustified.

25. A widely supported view was that provisions on ex parte interim measures could only be included in article 17 if appropriate safeguards were established. Discussion proceeded on that basis. Some delegations indicated that the proposal might become acceptable if the safeguards were further refined, for example by providing for prompt inter partes consideration of the matter by the arbitral tribunal as soon as any objection was raised by the other party. In that respect objections were raised against establishing a blanket time limit of twenty days. It was stated that such a provision might be misread as establishing a rule for the duration of the ex parte measure rather than an outside limit and that, in the commercial world, twenty days could be unduly burdensome, or that in some jurisdictions, twenty days would not provide sufficient time to bring the matter before a national court. It was suggested that a better approach would be to state that the ex parte measure should only be effective for a limited time adjusted according to the circumstances of the case. However, it was said that a mere reference to a reasonable period of time would be too vague. It was suggested that the provision should clarify that a respondent affected by the ex parte measure should not have to wait twenty days before it could challenge it, but that such a challenge could be heard at any time after the decision granting the measure. In addition, it was suggested that the tribunal that ordered the measure should be under an obligation to hear the party challenging the measure on short notice, for example within 48 hours of such a challenge.

26. In response to the concerns expressed, it was pointed out that the draft could be revised to confirm that the power to order ex parte interim measures of protection was subject to contrary agreement by the parties. It was also pointed out that the reference in proposed draft paragraph 3(c) to “a substantial possibility” of success on the merits of the dispute was intended to provide more neutral language than the original reference to “substantial likelihood” so as to guard against the risk that an arbitral tribunal might consider itself invited to prejudge the case in its examination on the merits while deciding on ex parte measures. It was agreed that whilst the language should be revised to further guard against prejudgement, the arbitral tribunal would nevertheless be required to undertake some analysis of the merits of the dispute in determining whether to grant ex parte interim measures of protection.

27. There was wide agreement in the Working Group that, by strengthening and increasing the safeguards, a provision on ex parte interim measures of protection might be more acceptable. In this respect, it was suggested that conditions beyond those listed in paragraph (3) should be fulfilled in seeking an ex parte measure.

### B. Paragraph (4)(a)

28. The Working Group proceeded with a detailed discussion of paragraph 4(a). Whilst a number of delegations continued to oppose the inclusion of the power of tribunals to grant ex parte interim measures of protection, the Working Group nevertheless agreed to continue its examination of the proposal. In addition, questions were raised as to the status of the proposal given that the Working Group had at its thirty-sixth session, revised text on this issue which varied in some significant ways from the proposal under consideration. These questions were noted by the Working Group but it was suggested that a detailed examination of the proposal would be appropriate to develop views on the question of ex parte measures. The Working Group heard that the intention of the proposal had been to take into account the views expressed at its thirty-sixth session.

29. Three issues were raised in respect of paragraph 4(a). First, the manner in which the parties could avoid the application of paragraph (4) altogether by way of an opting-in or an opting-out clause. Second, whether the requirements in paragraph (3) of the proposal should also apply in the case of ex parte measures. It was suggested that each of the conditions that were required to be demonstrated in respect of inter partes interim measures of protection should also be required to be demonstrated in ex parte cases. For example, a suggestion had been made that the requirement in paragraph 3(c) that there be a "substantial possibility of success on the merits" amounted to prejudging the dispute and thus should not be a condition for an ex parte measure. In response, it was said that paragraph 3(c) was intended to be the threshold required for obtaining interim measures of protection, and that any risk regarding prejudgement could be cured through drafting, for example, through the use of language such as requiring a prima facie case. It was further suggested that the need for urgency set out in paragraph 3(a) of the proposal was not needed for the general test for inter partes interim measures of protection, but it should be a necessary requirement for ex parte measures, where the urgency made notice to the other party impracticable. Wide support was expressed for that suggestion.

30. The third issue raised with respect to paragraph 4(a) was which additional requirements were necessary where ex parte relief was sought. In addition to those conditions listed in paragraph 3(c) for inter partes interim measures of protection, it was suggested that five additional conditions should be required in the case of ex parte measures. First, there should be a mandatory requirement that security should be put up by the party requesting the measure to compensate the respondent if the measure was later found to have been unjustified. Second, there should be a duty to compensate the party against whom the measure was taken on a strict liability basis for loss resulting from a measure wrongfully granted. In respect of this second proposed condition it was noted that it would be important that the issue of that liability be arbitrable before the same tribunal that granted the original measure. A problem was noted in respect of this second proposed condition being, whether the tribunal would have the jurisdiction to resolve an issue of compensation for loss due to an ex parte measure, particularly in the case where no such jurisdiction might be implied from a

general arbitration agreement or where the arbitration agreement was narrowly drafted. A third proposed condition was that the party seeking the ex parte measure should be able to demonstrate the non-existence of any other legal remedy and that this was a remedy of last resort. Fourth, although not specifically a condition, it was suggested that paragraph 4(a) should open with words along the lines of "in exceptional circumstances" to emphasize the exceptional nature of ex parte measures. Finally, it was also said that principles of reasonableness and proportionality should apply in the case of ex parte measures.

31. After discussion, the Working Group agreed that a revised text should be prepared taking note of the views and concerns expressed in the Working Group. In particular, the revised text should include a provision recognizing the parties' freedom of contract by allowing them to contract out of a provision giving a tribunal the power to grant an ex parte interim measure of protection. The revised text should also recognize that the conditions that applied to inter partes measures as set out in paragraph 3 of the proposal should also apply to ex parte measures but that the requirement in paragraph 3(c) of "a substantial possibility" of success on the merits, should be softened by using more neutral language. Also the revised draft should ensure that the requirement that the party seeking the measure give security be mandatory and that the requesting party be considered strictly liable for damages caused to the responding party by an unjustified measure. Such strict liability should be the subject of further determination by the same tribunal.

32. A number of delegations volunteered to prepare a revised draft of paragraph (4)(a). The Working Group suspended its deliberations regarding paragraph (4) until such a new draft paragraph (4)(a) could be considered (for continuation of the discussion, see paras. 53-69 below).

33. With respect to subparagraphs (b) to (d), the Working Group took note of the following suggestions: (1) that the draft provisions should clarify the time when the running of the twenty-day period commenced; (2) that the provisions on ex parte measures should mention the continuing obligation of the party seeking the measure to give full and frank disclosure to the tribunal; (3) that the responding party should have an opportunity to challenge the measure within a short time frame; and (4) that further consideration should be given to the possibility of lifting the measure where a responding party provided sufficient security.

### C. Paragraph (1)

34. It was observed that paragraph (1) as redrafted in document A/CN.9/121 was in line with the text previously discussed by the Working Group (A/CN.9/508, paras. 51-54). The Working Group found the substance of the redrafted paragraph generally acceptable. As a matter of drafting, the view was expressed that the words "order another party to take interim measures of protection" might unduly limit the scope of the provision. It was suggested that those words should be replaced by "grant interim measures of protection". The Working Group took note of that suggestion.

#### D. Paragraph (2)

35. It was explained that paragraph (2) as redrafted in document A/CN.9/121 was intended to reflect the discussion at the previous session of the Working Group (A/CN.9/508, paras. 51 and 64-76).

36. The reference to the notion of “interim award” was questioned as contrary to the view that had prevailed at the previous session of the Working Group not to qualify the award as “partial” or “interim” (see A/CN.9/508, para. 66). Doubts were also expressed with respect to the notion of an interim measure being “reflected” in an award. It was suggested that wording previously considered by the Working Group along the lines of “An interim measure of protection is any temporary measure, whether in the form of an award or in another form” was preferable. That suggestion was generally accepted.

37. The discussion focused on subparagraph (c). The view was expressed that subparagraph (c), while it was based on the approach previously taken by the Working Group (“a measure providing a preliminary means of securing or facilitating the enforcement of the award”: see A/CN.9/508, para. 74), extended considerably and possibly unduly the scope of the provision. In particular, the reference to “an award of costs” was criticized on the grounds that it could be misinterpreted as allowing an order for security for costs to be made not only against a claimant or counter-claimant but also against a defendant, which would run counter to established principles of law in a number of countries. It was stated in response that deposits for costs might be requested from any party, for example under article 41 of the UNCITRAL Arbitration Rules. However, it was further objected that a clear distinction should be made between (1) the question as to which party would ultimately bear the costs of the arbitration proceedings; (2) the question as to which party could be required to make deposits for costs, for example under article 41 of the UNCITRAL Arbitration Rules; and (3) the question as to which party should supply a guarantee for costs, for example under article 25.2 of the Arbitration Rules of the London Court of International Arbitration (LCIA Arbitration Rules). It was stated that, while deposits for costs were normally required from both parties to ensure that the arbitral tribunal was in funds to conduct the proceedings, the idea of a guarantee for costs being required was often associated with the claim being apparently frivolous. Such a guarantee could only be required from the claimant and should in no case be imposed on the defendant, who should be under no obligation to provide a guarantee simply to defend itself. A widely shared view was that the provision should not deal in general terms with the costs of arbitration but limit itself to securing the enforcement of the award. Considerable support was expressed for the deletion of the words “including an award for costs”. It was pointed out that under Article 38 of the UNCITRAL Arbitration Rules, and various other rules, an award may include costs. After discussion, the Working Group decided to replace the entire text of subparagraph (c) by wording along the lines of “provide a preliminary means of securing assets out of which an award may be satisfied”.

38. At the close of the discussion, it was recalled that, at its previous session, the Working Group had agreed that it should be made abundantly clear that the list of provisional measures provided in the various subparagraphs was intended to be non-exhaustive (A/CN.9/508, para. 71). It was pointed out that, as redrafted, the list contained in paragraph (2) was exhaustive. It was explained in response that, as redrafted, paragraph (2) no longer provided a list of the individual interim measures that could be granted by a tribunal. Instead, the revised provision mentioned “any temporary measure”, thus offering an open-ended formulation. In addition, the provision listed the various purposes for which a provisional measure could be granted. To the extent that all such purposes were covered by the revised list, it was no longer necessary to make the list non-exhaustive. While that explanation was generally accepted, the Working Group decided to consult further before making a final decision as to whether all conceivable grounds for which an interim measure of protection might need to be granted were covered by the current formulation. It was agreed that the discussion in that regard would be reopened at a future session.

#### E. Paragraph (3)

39. It was explained that paragraph (3) as redrafted in document A/CN.9/121 was intended to reflect the discussion at the previous session of the Working Group (A/CN.9/508, paras. 51 and 55-58).

40. A concern was expressed that the word “demonstrated” in the opening words of the paragraph might connote a high standard of proof. It was recalled that a similar debate had taken place at the previous session of the Working Group and that the verbs “show”, “prove” and “establish” had been suggested together with the verb “demonstrate”, without the Working Group making a decision in that regard (A/CN.9/508, para. 58). The Working Group decided that all those verbs should be retained in square brackets for continuation of the discussion at a later stage.

41. General support was expressed for the deletion of subparagraph (a) from paragraph (3) and its relocation in paragraph (4). It was agreed that the urgency of the need for the measure should not be a general feature of interim measures of protection but rather that it should be made a specific requirement for granting an interim measure *ex parte*.

42. With respect to subparagraph (b), it was suggested that, as a matter of drafting, the words “the party opposing the measure” should be replaced by the words “the party affected by the measure”. Another drafting suggestion was that the words “and that harm” should be replaced by the words “and such harm”. General support was expressed in favour of those suggestions. A view was expressed that the words “irreparable harm” might lend themselves to confusion with the words “current or imminent harm” in subparagraph (b) of paragraph (2), thus creating the risk that the criteria set forth in paragraph (3) might be read as applying only to those measures granted for the purposes of subparagraph (b) of paragraph (2). The Working Group took note of the view.

43. With respect to subparagraph (c), it was generally agreed that the words “there is a substantial possibility” could easily be misinterpreted as requiring the tribunal to make a prejudgement on the merits of the case. It was agreed that the provision should make it abundantly clear that the determination to be made under subparagraph (c) should be limited to a determination regarding the seriousness of the case without in any way prejudicing the findings to be made by the tribunal at a later stage. It was suggested that wording along the lines of “there is a reasonable prospect that the requesting party will succeed on the merits, provided that any determination on this issue shall not prejudice any subsequent determination by the tribunal” might better reflect the threshold function of the provision. Support was expressed in favour of that suggestion.

44. The Secretariat was requested to take the above suggestions, views and concerns into consideration when preparing a future draft of the provision.

#### F. Paragraph (5)

45. In the context of the discussion of paragraph (5), a suggestion was made regarding the structure of the article. It was pointed out that, to the extent that paragraphs (5), (6) and (7) were intended to apply to interim measures in general and not only to those measures that might be granted *ex parte* under paragraph (4), paragraphs (5) to (7) should be relocated before paragraph (4). The Working Group generally found that suggested restructuring to be reasonable.

46. Against the background of the generally accepted view that, in respect of *ex parte* measures, security should be mandatory, the Working Group discussed the interplay between paragraph (5) and paragraph (4). A concern was expressed that, as currently drafted, paragraph (5) might create a possibility to avoid supplying mandatory security under paragraph (4), since paragraph (4) was based on the idea that in respect of *inter partes* measures, the requirement for security should be within the discretion of the arbitral tribunal. To alleviate that concern, it was suggested that paragraph (5) should be made subject to paragraph (4). Another suggestion was that paragraph (5) and the relevant provision intended for addition in paragraph (4) might be merged into a single paragraph. The Working Group took note of those suggestions.

47. A suggestion was made that paragraph (5) should create the possibility for the party affected by an interim measure (whether granted *ex parte* or *inter partes*) to obtain the lifting of the interim measure against payment of an adequate counter-security. The following wording was suggested for inclusion in paragraph (5): “The party against whom an interim measure is directed may opt to provide an equivalent security when appropriate, provided that this substitution does not imply a substantial modification of the purpose for which the interim measure was granted”. That suggestion did not appear to receive sufficient support in the Working Group. The Working Group was reminded that paragraph (7) gave the tribunal broad discretion to modify or terminate interim measures of pro-

tection at any time so that the suggestion with respect to counter-security might in fact be dealt with under that paragraph.

48. A suggestion was made that the words “the requesting party” should be changed to “any party” in paragraph (5) for reasons of consistency with the language used in article 17 of the Model Law. In response it was said that the general principle should be that the requesting party should be required to provide security for the interim measure. It was suggested that the words “the requesting party or any other party, except the party against whom the interim measure is being granted” should be used. However, it was observed that, even if the words “any party” were used, the text of paragraph (5) would still refer to security being provided “as a condition to granting an interim measure of protection”, thus avoiding any risk that the security would be required from the defendant. In support of the proposal to include the term “any party”, it was said that this would provide the tribunal with a discretion that would accommodate certain situations in multiparty arbitration, for example the situation where there were numerous claimants, each of whom would benefit from the interim measure, but the request for interim measures was made by only one claimant having no assets. In that situation, the tribunal would have the discretion to request security from the other claimants. In addition, the reference to “any party” could accommodate the situation where a party provided counter-security. The Working Group expressed preference for using the words “the requesting party and any other party”.

#### G. Paragraph (6)

49. A suggestion was made that, if it were agreed to include the term “or any other party” in paragraph (5), then this phrase should also be added to paragraph (6). The view was expressed that this could however invite additional argument between the parties. A suggestion was made that whilst there was a duty to inform the arbitral tribunal of any material changes in the circumstances affecting the granting of the interim measure, there was no sanction if this duty was breached. In response it was agreed that this matter could adequately be dealt with under paragraph (7). On that basis, no decision was made to change the text of paragraph (6).

#### H. Paragraph (7)

50. Some support was expressed for the draft provision on the ground that it was drafted in general terms and did not overregulate the matter. A question was raised whether the provision was also intended to include an interim measure of protection that had previously been enforced by a court. Further questions were raised whether the provision should be amended to clarify that the arbitral tribunal would have the power to modify or terminate an interim measure of protection either upon its own motion or upon request by any other party. It was said that if the arbitral tribunal could act upon its own motion, it might need to be further clarified that the tribunal would be required to inform the requesting party of its modification or termination of the measure.



51. Further, it was said that it was not clear whether the power to modify or terminate an interim measure should only be recognized when the conditions for granting an interim measure were no longer met or whether the tribunal should have full discretion in this regard. Some opposition was expressed to allowing the arbitral tribunal to act without a request by the parties and without hearing from the parties. In this respect it was recalled that in the event that a modification or termination of a measure caused damage to a party, it was not clear who would be liable for such damages. For this reason it was said that the discretion to modify or terminate a measure should be subject to a request by the parties. Some opposition was expressed on the basis that it appeared to complicate the matter as it was not clear whether such a request would need to be made by one or all parties. A suggestion was also made that the power to modify or terminate a measure should be limited to situations where there had been a change in the circumstances.

52. Taking account of the above discussion the following text was proposed for addition at the end of paragraph (7): “upon application by any party or of its own motion, after hearing from the parties”. However, it was suggested that the discretion to modify or terminate an interim measure should not be limited. It was observed that, given the extraordinary nature of such measures, if a tribunal had the power to grant such measures then it should also have the power to modify or terminate them. It was further said that, given that the intention in paragraph (7) appeared to be to also cover *ex parte* measures, the circumstances in which the arbitrator might wish to terminate or change could occur during the *ex parte* period and that therefore the requirement to inform parties could frustrate the measure. It was suggested that further consideration might be necessary to examine whether a distinction should be made depending upon whether the interim measure was *inter partes* or *ex parte*, in which case a separate provision might need to be prepared to deal with *ex parte* measures. No decision was made to change the text of paragraph (7).

### I. Paragraph (4)(a) (continued)

53. With a view to facilitating continuation of the discussion on paragraph (4), a number of delegations prepared a revised draft for consideration by the Working Group. The revised draft was aimed at reflecting the views and concerns expressed in the context of the earlier discussion of paragraph (4)(a) (see above, paras. 28-32). The Working Group resumed its deliberations on paragraph (4)(a) based on the following draft text (hereinafter “paragraph (4)(a) redraft”):

“(4) (a) Unless otherwise agreed, the arbitral tribunal may grant an interim measure of protection without notice to the party against whom the measure is directed or before the party against whom the measure is directed has had an opportunity to respond provided that:

“(i) the requesting party demonstrates that it is necessary to proceed without notice, [in order to ensure that the measure is effective] [because the measure would be defeated if notice is given]; and

“(ii) there is an urgent need for the measure; and  
“(iii) irreparable harm will result if the measure is not ordered, and that such harm substantially outweighs the harm that will result to the party affected by the measure if the measure is granted; and

“(iv) there is a [substantial possibility] [reasonable prospect] that the requesting party will succeed on the merits], [provided that any determination on this issue shall not prejudice any subsequent determinations by the Tribunal]; and

“(v) the requesting party shall be [strictly] liable for any costs and losses caused by the measure to the party against whom it is directed [in light of the final disposition of the claims on the merits]; and

“(vi) the requesting party provides [a guarantee] [a cross-indemnity itself secured in such manner as the arbitral tribunal considers appropriate] [security in such form as the arbitral tribunal may determine], [for any costs and losses that the party against whom the measure is directed may suffer in complying with the order] [for any costs and losses pursuant to subparagraph (v) above]

“Additional paragraph

“The arbitral tribunal shall have jurisdiction, *inter alia*, to determine all issues arising out of or relating to subparagraphs (v) and (vi) above”.

### *Chapeau of paragraph (4)(a) redraft*

54. As a matter of drafting, it was suggested that after the opening phrase “Unless otherwise agreed”, the phrase “by the parties” should be included. Another suggestion was that the word “and” should be deleted after each subparagraph of paragraph (4)(a) redraft, except for the penultimate subparagraph. No objection was made to those suggestions.

55. Regarding substance, the view was expressed that the chapeau of paragraph (4)(a) redraft raised an anomaly since it referred not only to the situation where an interim measure of protection was sought without notice but also where notice was given but the responding party had not had the opportunity to respond, yet subparagraph (4)(a)(i) did not appear to encompass the second situation.

### *Paragraph (4)(a)(i) and (ii) redraft*

56. It was noted that, as redrafted, the provision required that the requesting party “demonstrate” that it was necessary to proceed without notice. It was suggested that, to allay concerns regarding the standard of proof to be met, subparagraph (i) should be redrafted as follows: “the tribunal is satisfied that it is necessary to proceed on an *ex parte* basis”. Some support was expressed for this approach. However, it was recalled that, at its previous session, the Working Group had agreed to consider expressions such as “establish”, “demonstrate” or “show”, which were considered as preferable alternatives to requiring “proof” of the necessity to proceed without notice (A/CN.9/508, para. 55). The Working Group agreed that all of the above

suggestions should be reflected in the revised draft to be prepared by the Secretariat for continuation of the discussion at a later stage.

57. In respect of the two bracketed alternatives in paragraph (4)(a)(i) redraft, support for the first alternative text was expressed on the basis that it established a broad standard and that the language was consistent with other provisions. A suggestion based on the first alternative text was that using the words “necessarily ineffective” might be more appropriate. Overall preference was expressed for a formulation based on the second bracketed alternative. However, concern was expressed over the use of the word “defeated”, which might be appropriately replaced by the word “frustrated”.

58. It was submitted that paragraph (4)(a)(i) redraft could be deleted in its entirety since the notion of urgency in paragraph (4)(a)(ii) redraft was a sufficient basis upon which the tribunal could act. However, it was argued that both the need for urgency in paragraph (4)(a)(ii) redraft and the principle of avoiding the frustration of the measure in paragraph (4)(a)(i) redraft should be required for an ex parte measure. Broad support was expressed for the inclusion of both these elements. It was noted that merely requiring urgency of the measure would not properly indicate why the application must be made ex parte. It was said that subparagraph (i) expressed the real reason for an ex parte request, namely that providing notice would thwart the entire purpose of the measure.

59. In light of the comments made, it was suggested that the chapeau and subparagraphs (i) and (ii) of paragraph (4)(a) redraft should be revised as follows:

“(4) (a) Unless otherwise agreed by the parties, the arbitral tribunal may grant an interim measure of protection without notice to the party against whom the measure is directed or before the party against whom the measure is directed has had an opportunity to respond when the requesting party shows that it is necessary to proceed in that manner in order to ensure that the [measure is effective] [purpose of the measure is not frustrated before the order is granted], provided that:

(i) there is an urgent need for the measure; and”.

60. A widely shared view was that the first part of the newly revised chapeau appropriately dealt with a genuine ex parte situation, namely when an arbitral tribunal decided to grant the measure without notice to the other party. However, the words “or before the party against whom the measure is directed has had an opportunity to respond” was not a genuine ex parte scenario, since in that case, notice had already been provided to the responding party. It was suggested that the chapeau should only deal with the circumstance where it was appropriate to proceed without notice. It was said that if the Working Group intended to cover the second scenario, further thought should be given to the structure of the paragraph. It was acknowledged that the phrase “or before the party against whom the measure is directed has had an opportunity to respond” was intended to cover the situation where notice had been given to the responding party but that it either did not have time or was unable to respond or that it did not want to respond and could thereby frustrate the

granting of an interim measure. Support was expressed for the view that that situation was in fact adequately covered by the words “may grant an interim measure of protection without notice to the party against whom the measure is directed” as well as by the rules on default. It was agreed that the words “or before the party against whom the measure is directed has had an opportunity to respond” should be deleted on the assumption that the text sufficiently covered the situation where notice was given but the responding party either could not or had not responded to that notice.

61. Whilst some support was expressed for the first bracketed text in the revised chapeau (“[measure is effective]”), strong preference was expressed for the second bracketed text (“[the purpose of the measure is not frustrated before the order is granted]”) on the ground that it more appropriately addressed the condition that should be satisfied in the granting of an ex parte measure.

#### *Paragraph (4)(a)(iii) redraft*

62. It was agreed that subparagraph (iii) should be deleted on the basis that it was adequately covered by paragraph (3)(c) because the subparagraph set out conditions that should apply to both inter partes and ex parte measures. The Working Group was reminded that reference to meeting the requirements of paragraph (3) should be added to the chapeau in the paragraph (4)(a) redraft.

63. A proposal that the chapeau be redrafted using conditional language, such as, “if the arbitral tribunal grants an interim measure of protection” to more closely reflect the exceptional situation wherein an interim measure would be sought ex parte, did not receive support.

#### *Paragraph (4)(a)(iv) redraft*

64. The Working Group considered the two bracketed texts appearing in subparagraph (iv), i.e. “[substantial possibility]” or “[reasonable prospect]” that the requesting party will succeed on the merits. Whilst some support was expressed for each of these alternative texts, the prevailing view was that neither text adequately addressed the concerns expressed earlier (see paragraph 26, above) that these words appeared to invite the arbitral tribunal to prejudge the dispute at a time which might be very early in the arbitral proceedings, and could thus compromise the neutrality of the arbitrators or the perception of that neutrality by the parties. It was suggested that the Working Group should consider text that would guard against frivolous claims for ex parte measures being made, but that would not require the arbitral tribunal to make a judgement on the merits. One proposal to achieve this was that the subparagraph simply require the arbitral tribunal to decide, in the light of all the available facts, that an interim measure of protection was appropriate. An alternative proposal was that the subparagraph be revised to state that “there is a reasonable possibility that the requesting party will succeed on the merits provided that any determination in this connection shall not affect any subsequent determinations by the arbitral tribunal”. A further proposal was that more

neutral and objective language could be used, employing illustrative examples, which would not require prejudice, along the lines of “that there be a substantial issue for determination”. It was further suggested that the opening phrase of the subparagraph read “there is at least a reasonable possibility” rather than “there is a reasonable possibility” and also that the language “will succeed on the merits” be replaced by “may succeed on the merits”. After discussion, it was suggested that the text be revised to read as follows: “there is a reasonable possibility that the requesting party may succeed on the merits, provided that any determination in this connection shall not affect any subsequent determinations by the arbitral tribunal.” The Secretariat was requested to prepare the revised text as a new paragraph (3)(b) to follow the renumbering due to the fact that paragraph (3)(a) had been subsumed into paragraph 4(a).

#### *Paragraph (4)(a)(v) redraft*

65. It was observed that subparagraph (v) provided an additional safeguard for the responding party for costs and losses arising from an ex parte measure. Such a safeguard would operate following the final decision on the merits of the case. It was recalled that the liability of the requesting party for an inter partes interim measure of protection was agreed not to be covered by the provision as this would be left to other law. A widely shared view was that it was more logical to refer to “damages and costs” than to “costs and losses”. It was suggested that the reference to “costs” should be clarified so as to cover “costs of arbitration caused by the interim measure”. Concern was expressed as to any draft which suggested that costs and losses arising from an ex parte interim measure should depend on the final outcome of the dispute. It was said that the question whether a requesting party should be liable for such losses or damages should be a question left to the discretion of the arbitral tribunal but disassociated from the final decision on the merits of the case. In this respect it was said that, even if a requesting party ultimately received an award in its favour in the arbitration, it might still be liable for losses or damages in respect of an ex parte interim measure of protection that was found to be unjustified. It was suggested that to ensure flexibility and a broad discretion for the arbitral tribunal, words such as “to the extent appropriate, taking into account all of the circumstances of the case, including the final disposition of the claim on the merits” should be considered for a future revision of the provision. Alternatively, it was suggested that the revision should take account of the approach taken in paragraph 17.1.3 of the Draft Fundamental Principles and Rules of Transnational Civil Procedure prepared by the American Law Institute and UNIDROIT, as reflected in paragraph 69 of document A/CN.9/WG.II/WP.119.

66. It was suggested that, given that the notion of “strict liability” was a term of art that was not understood in all jurisdictions, and in the interests of creating a flexible provision, the term “strictly” should be deleted from the provision. Another suggestion was that the verb “shall” be replaced by “may”. Whilst the first suggestion was found to be generally acceptable, the Working Group agreed to

retain the verb “shall”. The Working Group was reminded that the purpose of the provision should be borne in mind in any redraft. It was said that the provision should be assessed against the objective to impose liability on a requesting party for damages caused by an ex parte measure where that measure was found to be unjustified. It was said that further thought might need to be given to determining what the trigger for liability was, namely whether the provision was intended to cover the situation where the requesting party had acted negligently or fraudulently, or whether it also covered the situation where an arbitral tribunal had acted in error.

67. It was agreed that the words “to the extent appropriate, taking into account all of the circumstances of the case, in light of the final disposition of the claim on the merits” should be included in square brackets in a future revision of the provision for continuation of the discussion.

#### *Paragraph (4)(a)(vi) redraft*

68. Questions were raised regarding the different shades of meaning attached to the words “guarantee”, “cross-indemnity” and “security”, which were offered as alternatives in paragraph (4)(a)(vi) redraft. While support was expressed for retaining the word “guarantee”, it was observed that the word “security” had been used in article 17 of the Model Law and translated as “guarantee” in certain language versions. A widely shared view was that the new provision should not unnecessarily deviate from the language used in the Model Law. Preference was expressed for wording along the following lines: “security in such form as the arbitral tribunal considers appropriate”.

69. With respect to the words “costs and losses” a widely shared view was that subparagraph (vi) should mirror the language used in subparagraph (v). It was pointed out that both provisions should make it clear that they dealt only with those costs of the arbitration related to the interim measure and with those damages suffered in complying with the interim measure. Overall preference was expressed for using language in subparagraph (vi) along the lines of: “for any damages and any costs of the arbitration referred to in subparagraph (v) above”.

#### *Additional paragraph*

70. A suggestion was made that the words “For the avoidance of doubt” should be inserted at the beginning of the proposed additional subparagraph. While some support was expressed for that suggestion, it was pointed out that such wording was generally inappropriate in a legislative text. In addition, it was pointed out that in many countries, the effect of the subparagraph would not be to dispel a doubt but to create jurisdiction for the arbitral tribunal beyond the confines of the jurisdiction conferred upon the arbitral tribunal by the parties in the arbitration agreement. A decision was made to introduce the words “For the avoidance of doubt” in square brackets as the opening words of the additional paragraph for continuation of the discussion at a future session.

71. The view was expressed that in formulating a provision extending the jurisdiction of the arbitral tribunal in connection with interim measures of protection ordered on an *ex parte* basis, the Working Group should avoid suggesting that such a provision should be interpreted a *contrario* in the context of those interim measures that were ordered *inter partes*.

72. While it was generally agreed that the cross-reference to subparagraph (v) was appropriate, a question was raised as to whether a cross-reference to subparagraph (vi) was necessary. It was pointed out that paragraph (5) already conferred jurisdiction upon the arbitral tribunal regarding the issues of securities. The working group took note of that point. The cross-references to both subparagraphs (v) and (vi) were placed between square brackets for continuation of the discussion at a future session.

#### J. Paragraph (4)(b)

73. The Working Group proceeded to consider para. (4)(b) as it appeared in document A/CN.9/WG.II/WP.121. It was recalled that concerns had been expressed earlier (see paragraph 25 above) that a reference to a period of time, such as twenty days, could become a default rule rather than a maximum period during which the respondent should have an opportunity to be heard. Earlier objections to the establishment of a fixed period were reiterated. It was pointed out that as currently drafted the provision might not avoid a situation where the interim measure could in practice be prolonged through a new application for a measure of the same kind after expiry of the twenty-day period. A widely shared view was that the purpose of the paragraph was to provide a rebalancing of the arbitral procedure following the granting of an *ex parte* measure by providing the responding party with an opportunity to be heard and have that measure reviewed as soon as possible. Concern was expressed that, as currently drafted, paragraph (4)(b) did not achieve that purpose as it concentrated on restricting the duration of the *ex parte* measure to twenty days. It was stated that the objective of restoring the balance of the arbitral procedure was dealt with under paragraph (c). In that connection, it was generally felt that the order of paragraphs (b) and (c) could be reversed. The Secretariat was invited to bear the above discussion in mind when preparing a revised draft of the provision. A request was also made to clarify whether paragraph (4)(b) related solely to *ex parte* interim measures, or to all interim measures, because this paragraph contained a general reference to paragraph (1).

#### K. Paragraph (4)(c)

74. Based on earlier comments (see above, para. 33) the Working Group proceeded to consider a newly redrafted version of subparagraph (c) as follows: "The party against whom the interim measure is directed shall be given notice of the measure and an opportunity to be heard as soon as it is no longer necessary to proceed on an *ex parte* basis in order to ensure that the measure is effective."

75. Various views were expressed regarding the substance of the proposal. One view was that the words "an opportunity to be heard", should be replaced by a reference to the "right" of the party to be heard in order to make it clear that an arbitral tribunal having issued an *ex parte* measure of protection should stand ready to be activated on short notice by the affected party. Another view was that the reference to the measure being "effective" might need to be reviewed to take into account earlier deliberations regarding paragraph 4(a)(i) (see above, paras. 56-61). Yet another view was that the provision should specify a time frame within which the arbitral tribunal should hear the party affected by the interim measure. The following wording was suggested for inclusion in paragraph 4(c): "that party shall be given notice of the measure and [an opportunity] [the right] to be heard by the arbitral tribunal [as soon as it is no longer necessary to proceed on an *ex parte* basis in order to ensure that the measure is effective] [within forty-eight hours of the notice, or on such other date and time as is appropriate in the circumstances]". The Secretariat was invited to consider the above discussion when redrafting the provision. It was suggested that future consideration should be given to determining whether paragraph 4(c) should apply only in the context of interim measures ordered on an *ex parte* basis or more generally to all types of interim measures.

#### L. Paragraph (4)(d)

76. The Working Group proceeded to consider paragraph (4)(d) as contained in document A/CN.9/WG.II/WP.121. The view was expressed that, as currently drafted, this paragraph did not serve any purpose and should be deleted. In that connection, the view was expressed that it would be essential for the provision to provide a time limit within which the party requesting an interim measure should disclose a change in circumstances to the arbitral tribunal. Another view was that the provision should impose a sanction for failure to perform the obligation set forth in paragraph (4)(d). It was further suggested that a future redraft of the provision should establish a clear link between the obligation to disclose change in circumstances and the liability regime applicable to the party requesting the interim measure. The Secretariat was requested to bear the above suggestions in mind when preparing a revised provision for continuation of the discussion at the next session.

### IV. INTERIM MEASURES ORDERED BY COURTS

77. The Working Group heard a brief exchange of views on the possible treatment of interim measures of protection ordered by state courts in the context of the revision of article 17 of the Model Law (A/CN.9/WG.II/WP.119). Support was expressed for the general principle that the rules governing court-ordered measures should parallel as much as possible the rules applicable to interim measures ordered by the arbitral tribunal. However, it was widely felt that it would be overly ambitious to attempt to harmonize, by way of an international instrument the rules applicable to interim measures of protection ordered by courts in support

of arbitration. By way of illustration, it was stated that it would be extremely difficult to reconcile rules regarding interim measures ordered by a state court in support of an arbitration with the principle applicable in some jurisdictions that the jurisdiction of courts to decide on interim measures was conditional upon the existence of proceedings on the merits of the case pending before the same court. It was agreed that the discussion would need to be continued at a future session.

## V. RECOGNITION AND ENFORCEMENT OF INTERIM MEASURES

78. The Working Group had a brief discussion on the issue of recognition and enforcement of interim measures based on the text contained in the Note by the Secretariat (A/CN.9/WG.II/WP.119). That text read as follows:

“Enforcement of interim measures of protection

“(1) Upon an application by an interested party, made with the approval of the arbitral tribunal, the competent court shall refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if: \*

(a) party against whom the measure is invoked furnishes proof that:

(i) *[Variant 1]* The arbitration agreement referred to in article 7 is not valid. *[Variant 2]* The arbitration agreement referred to in article 7 appears to not be valid, in which case the court may refer the issue of the [jurisdiction of the arbitral tribunal] [validity of the arbitration agreement] to be decided by the arbitral tribunal in accordance with article 16 of this Law];

(ii) The party against whom the interim measure is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or

(iii) The party against whom the interim measure is invoked was unable to present its case with respect to the interim measure [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or

(iv) The interim measure has been terminated, suspended or amended by the arbitral tribunal.

(b) The court finds that:

(i) The measure requested is incompatible with the powers conferred upon the court by its procedural laws, unless the court decides to reformulate the measure to the

extent necessary to adapt it to its own powers and procedures for the purpose of enforcing the measure; or

(ii) The recognition or enforcement of the interim measure would be contrary to the public policy of this State.

“(2) Upon application by an interested party, made with the approval of the arbitral tribunal, the competent court may, in its discretion, refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if the party against whom the measure is invoked furnishes proof that application for the same or similar interim measure has been made to a court in this State, regardless of whether the court has taken a decision on the application.

“(3) The party who is seeking enforcement of an interim measure shall promptly inform the court of any termination, suspension or amendment of that measure.

“(4) In reformulating the measure under paragraph (1)(b)(i), the court shall not modify the substance of the interim measure.

“(5) Paragraph (1)(a)(iii) does not apply.

*[Variant 1]* to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that the measure was ordered to be effective for a period not exceeding [30] days and the enforcement of the measure is requested before the expiry of that period.

*[Variant 2]* to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that such interim measure is confirmed by the arbitral tribunal after the other party has been able to present its case with respect to the interim measure.

*[Variant 3]* if the arbitral tribunal, in its discretion, determines that, in light of the circumstances referred to in article 17(2), the interim measure of protection can be effective only if the enforcement order is issued by the court without notice to the party against whom the measure is invoked.”

“The conditions set forth in this article are intended to limit the number of circumstances in which the court must refuse to enforce interim measures. It would not be contrary to the level of harmonization sought to be achieved by these model provisions if a State were to adopt fewer circumstances in which enforcement must be refused.

79. With a view to providing a simpler version of a possible provision on recognition and enforcement of interim measures, the following text was proposed by one delegation:

“(1) Interim measures of protection issued and in effect in accordance with article 17, irrespective of the country in which they were issued, and whether reflected in an interim award or otherwise, shall be recognized as binding and, upon application in writing to the competent court, be enforced subject to the provisions of articles 35

and 36, except as otherwise provided in this article. Any determination made on any ground set forth in Article 36 in ruling on such an application shall be effective only for purposes of that application.

“(2) (a) Recognition or enforcement of interim measures of protection shall not be refused on the ground that the party against whom the measures are directed did not have notice of the proceedings on the request for the interim measures or an opportunity to be heard if

- (i) the arbitral tribunal has determined that it is necessary to proceed in that manner in order to ensure that the measure is effective, and
- (ii) the court makes the same determination.

(b) The court may condition the continued recognition or enforcement of an interim measure issued without notice or an opportunity to be heard on any conditions of notice or hearing that it may prescribe.

“(3) A court may reformulate the interim measure to the extent necessary to conform the measure to its procedural law, provided that the court does not modify the substance of the interim measure.

“(4) While an application for recognition or enforcement of an interim measure is pending, or an order recognizing or enforcing the interim measures is in effect,

the party who is seeking or has obtained enforcement of an interim measure shall promptly inform the court of any modification, suspension, or termination of that measure.”

80. It was explained by its proponents that this proposal was based on the following five principles: (1) the legal framework for enforcement of interim measures should be similar to that existing for the enforcement of arbitral awards; (2) the decision regarding the enforcement of an interim measure should have no binding effect on the subsequent process in the arbitration; (3) where an ex parte measure has been issued, the courts should have full opportunity to verify that it was appropriate to issue such a measure; (4) parties should be under no obligation to obtain permission from the arbitral tribunal before they could seek enforcement of the interim measure before a court; and (5) in cases where an application for enforcement was made before several courts, those courts should be free to evaluate the best way to proceed. At the close of the discussion it was pointed out that it would be essential for the Working Group to make a decision regarding the form in which an interim measure could be issued. In particular, it should be decided whether an interim measure was issued in the form of an arbitral award or in the form of a procedural order. It was decided that the discussion would be continued at a future session on the basis of both proposed texts.

## **B. Working paper submitted to the Working Group on Arbitration at its thirty-seventh session: Arbitration: interim measures of protection**

### **Proposal by the United States of America**

(A/CN.9/WG.II/WP.121) [Original:English]

### **Note by the Secretariat**

In preparation for the thirty-seventh session of Working Group II (Arbitration and conciliation), during which the Working Group is expected to proceed with its review of a revised draft article 17 of the UNCITRAL Model Law on International Commercial Arbitration (see the report of the thirty-sixth session, A/CN.9/508, paras. 51-94), the Government of the United States of America, on 23 September 2002, submitted the text of a proposed revised version of article 17 for consideration by the Working Group. The text of that proposal is reproduced as an annex to this note in the form in which it was received by the Secretariat.

## Annex. Proposal by the United States of America

1. The Report of the Working Group on Arbitration on the work of its thirty-sixth session (New York, 4-8 March 2002) (A/CN.9/508) sets forth in paragraph 88 the text of a proposal for a redraft of paragraph (5) and the remainder of the draft article 17. As noted in paragraph 90 of the Report, discussion of this text and other suggestions was not completed for lack of sufficient time.

2. At the Congress of the International Council for Commercial Arbitration (ICCA) in May 2002, a proposal to refine the text in paragraph 88 was discussed. The text discussed at ICCA is as follows:

### *Power of arbitral tribunal to order interim measures*

(1) Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order another party to take interim measures of protection.

(2) An interim measure of protection is any temporary measure, whether reflected in an interim award or otherwise, by which, at any time prior to the issuance of the award by which the dispute is finally decided, the arbitral tribunal orders a party to

(a) maintain or restore the status quo pending determination of the dispute, in order to ensure or facilitate the effectiveness of an eventual award;

(b) take action that would prevent, or refrain from taking action that would cause, current or imminent harm, in order to ensure or facilitate the effectiveness of an eventual award;

(c) provide security for the enforcement of an eventual award, including an award of costs; or

(d) preserve evidence that may be relevant and material to the resolution of the dispute.

(3) The arbitral tribunal may order an interim measure of protection when the requesting party has demonstrated that

(a) there is an urgent need for the measure;

(b) irreparable harm will result if the measure is not ordered, and that harm substantially outweighs the harm that will result to the party opposing the measure if the measure is granted; and

(c) there is a substantial possibility that the requesting party will succeed on the merits of the dispute.

(4) (a) The arbitral tribunal may grant an interim measure of protection without notice to the party against whom the measure is directed or before the party against whom the measure is directed has had an opportunity to respond when, in addition to meeting the requirements of paragraph (3), the requesting party demonstrates that it is necessary to proceed in that manner in order to ensure that the measure is effective.

(b) Any interim measure of protection ordered under this paragraph shall be effective for no more than twenty days, which period cannot be extended. This subparagraph shall not affect the authority of the arbitral tribunal to grant, confirm, extend, or modify an interim measure of protection under paragraph (1) after the party against whom the measure is directed has been given notice and an opportunity to be heard.

(c) Except to the extent that the arbitral tribunal has determined under paragraph (4)(a) that it is necessary to proceed without notice to the party against whom the interim measure of protection is directed in order to ensure that the measure is effective, that party shall be given notice of the measure and an opportunity to be heard at the earliest practicable time.

(d) [A party requesting an interim measure of protection under this paragraph shall have an obligation to inform the arbitral tribunal of all circumstances that the arbitral tribunal is likely to find relevant and material to its determination whether the requirements of this paragraph have been met.]

(5) The arbitral tribunal may require the requesting party to provide appropriate security as a condition to granting an interim measure of protection.

(6) The requesting party shall, from the time of the request onwards, inform the arbitral tribunal promptly of any material change in the circumstances on the basis of which the party sought or the arbitral tribunal granted the interim measure of protection.

(7) The arbitral tribunal may modify or terminate an interim measure of protection at any time.

## C. Report of the Working Group on Arbitration on the work of its thirty-eighth session (New York, 12-16 May 2003)

(A/CN.9/524) [Original: English]

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## I. INTRODUCTION

1. At its thirty-second session, in 1999, the Commission had before it a note entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985) (hereafter referred to as "the Model Law"), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.<sup>1</sup>

2. The Commission entrusted the work to one of its working groups, which it named the Working Group on Arbitration, and decided that the priority items for the Working Group should be conciliation,<sup>2</sup> requirement of written form for the arbitration agreement,<sup>3</sup> enforceability of interim measures of protection<sup>4</sup> and possible enforceability of an award that had been set aside in the State of origin.<sup>5</sup>

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding

the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter referred to as "the New York Convention") (A/CN.9/468, para. 109 (*k*)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (*ibid.*, para. 107 (*g*)); freedom of parties to be represented in arbitral proceedings by persons of their choice (*ibid.*, para. 108 (*c*)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the 1958 New York Convention (*ibid.*, para. 109 (*i*)); and the power by the arbitral tribunal to award interest (*ibid.*, para. 107 (*j*)). It was noted with approval that, with respect to "online" arbitrations (i.e. arbitrations in which significant parts or even all of arbitral proceedings were conducted by using electronic means of communication) (*ibid.*, para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (*ibid.*, para. 107 (*m*)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.<sup>6</sup>

4. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished so far regarding the three main issues under discussion, namely, the requirement of the

<sup>1</sup>*Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, para. 337.

<sup>2</sup>*Ibid.*, paras. 340-343.

<sup>3</sup>*Ibid.*, paras. 344-350.

<sup>4</sup>*Ibid.*, paras. 371-373.

<sup>5</sup>*Ibid.*, paras. 374 and 375.

<sup>6</sup>*Ibid.*, *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, para. 396.



written form for the arbitration agreement, the issues of interim measures of protection and the preparation of a model law on conciliation.

5. At its thirty-fifth session, in 2002, the Commission took note with appreciation of the report of the Working Group on the work of its thirty-sixth session (A/CN.9/508). The Commission commended the Working Group for the progress accomplished so far regarding the issues under discussion, namely, the requirement of the written form for the arbitration agreement and the issues of interim measures of protection.

6. With regard to the requirement of written form for the arbitration agreement, the Commission noted that the Working Group had considered the draft model legislative provision revising article 7, paragraph (2), of the Model Law (see A/CN.9/WG.II/WP.118, para. 9) and discussed a draft interpretative instrument regarding article II, paragraph 2, of the New York Convention (*ibid.*, paras. 25-26). The Commission noted that the Working Group had not reached consensus on whether to prepare an amending protocol or an interpretative instrument to the New York Convention and that both options should be kept open for consideration by the Working Group or the Commission at a later stage. The Commission noted the decision of the Working Group to offer guidance on interpretation and application of the writing requirements in the New York Convention with a view to achieving a higher degree of uniformity. A valuable contribution to that end could be made in the guide to enactment of the draft new article 7 of the Model Law, which the Secretariat was requested to prepare for future consideration by the Working Group, by establishing a “friendly bridge” between the new provisions and the New York Convention, pending a final decision by the Working Group on how best to deal with the application of article II(2) of the New York Convention (A/CN.9/508, para. 15). The Commission was of the view that member and observer States participating in the Working Group’s deliberations should have ample time for consultations on those important issues, including the possibility of examining further the meaning and effect of the more-favourable-right provision of article VII of the New York Convention, as noted by the Commission at its thirty-fourth session.<sup>7</sup> For that purpose, the Commission considered that it might be preferable for the Working Group to postpone its discussions regarding the requirement of written form for the arbitration agreement and the New York Convention until its thirty-eighth session, in 2003.

7. With regard to the issues of interim measures of protection, the Commission noted that the Working Group had considered a draft text for a revision of article 17 of the Model Law (A/CN.9/WG.II/WP.119, para. 74) and that the Secretariat had been requested to prepare revised draft provisions, based on the discussion in the Working Group, for consideration at a future session. It was also noted that a revised draft of a new article prepared by the Secretariat for addition to the Model Law regarding the issue of enforcement of interim measures of protection ordered by an arbitral tribunal (*ibid.*, para. 83) would be considered by the Working Group at its thirty-seventh session (A/CN.9/508, para. 16).

8. At its thirty-seventh session, held in Vienna from 7 to 11 October 2002, the Working Group discussed the issue of interim measures ordered by the arbitral tribunal on the basis of a proposal by the United States of America (A/CN.9/WG.II/WP.121) and a note prepared by the Secretariat (A/CN.9/WG.II/WP.119).

9. The Working Group on Arbitration, which was composed of all States members of the Commission, held its thirty-eighth session in New York, from 12 to 16 May 2003. The session was attended by the following States members of the Working Group: Austria, Burkina Faso, Cameroon, Canada, China, Colombia, Fiji, France, Germany, India, Iran (Islamic Republic of), Japan, Lithuania, Mexico, Morocco, Paraguay, Russian Federation, Rwanda, Singapore, Spain, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

10. The session was attended by observers from the following States: Australia, Cambodia, Czech Republic, Denmark, Finland, Ireland, Kuwait, Libyan Arab Jamahiriya, Madagascar, Monaco, Pakistan, Panama, Peru, Philippines, Poland, Republic of Korea, Syrian Arab Republic, Switzerland, Turkey and Venezuela.

11. The session was also attended by observers from the following international organizations: (a) intergovernmental organizations; International Cotton Advisory Committee (ICAC), the NAFTA Article 2022 Advisory Committee and the Permanent Court of Arbitration; (b) non-governmental organizations invited by the Commission: the Arab Union of International Arbitration, Center for International Legal Studies, Club of Arbitrators, Global Center for Dispute Resolution Research, Inter-American Bar Association (IABA), International Chamber of Commerce (ICC), International Council for Commercial Arbitration (ICCA), International Law Institute (ILI), the Regional Centre for International Commercial Arbitration, School of International Arbitration, the American Bar Association, the Cairo Regional Centre for International Commercial Arbitration, the Chartered Institute of Arbitrators, the European Law Students Association (ELSA), the Gulf Cooperation Council, the International Federation for Commercial Arbitration, the London Court of International Arbitration (LCIA), the National Law Center for Inter American Free Trade and the Union des avocats européens.

12. The Working Group elected the following officers:

*Chairman:* Mr. José María ABASCAL  
ZAMORA (Mexico)

*Rapporteur:* Ms. Pakvipa AHVIPHAN (Thailand)

13. The Working Group had before it the following documents: (a) provisional agenda (A/CN.9/WG.II/WP.122); (b) a note by the Secretariat containing the text on recognition and enforcement of interim measures of protection (A/CN.9/WG.II/WP.119); (c) the report of the Working Group on its thirty-seventh session (A/CN.9/523); (d) a note by the Secretariat containing a revised text of the power of an arbitral tribunal to order interim measures (A/CN.9/WG.II/WP.123).

<sup>7</sup>*Ibid.*, para. 313.

14. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of harmonized texts on interim measures of protection.
4. Other business.
5. Adoption of the report.

## II. SUMMARY OF DELIBERATIONS AND DECISIONS

15. The Working Group discussed agenda item 3 on the basis of the text contained in paragraph 78 of A/CN.9/523. The deliberations and conclusions of the Working Group with respect to that item are reflected in chapters III and IV below.

## III. RECOGNITION AND ENFORCEMENT OF INTERIM MEASURES ISSUED BY THE ARBITRAL TRIBUNAL

### A. General discussion

16. The Working Group recalled that, at its thirty-fourth session (2001), it had discussed the question of enforcement of interim measures of protection issued by an arbitral tribunal under article 17 on the basis of draft provisions that had been prepared by the Secretariat. The considerations of the Working Group were reflected in the report of that session (A/CN.9.487, paras. 76-87) but for lack of time, the Working Group did not complete its consideration on the enforcement provisions.

17. The Working Group also recalled that it had had a brief discussion at its thirty-seventh session (2002) on the issue of recognition and enforcement of interim measures of protection based on the note prepared by the Secretariat (A/CN.9/WG.II/WP.119, para. 83) and draft text (also reproduced in A/CN.9/523, para. 78) as follows (“the draft enforcement provision”):

#### Enforcement of interim measures of protection

“(1) Upon an application by an interested party, made with the approval of the arbitral tribunal, the competent court shall refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if:\*

(a) The party against whom the measure is invoked furnishes proof that:

- (i) [Variant 1] The arbitration agreement referred to in article 7 is not valid [Variant 2] The arbitration agreement referred

to in article 7 appears to not be valid, in which case the court may refer the issue of the [jurisdiction of the arbitral tribunal] [validity of the arbitration agreement] to be decided by the arbitral tribunal in accordance with article 16 of this Law];

- (ii) The party against whom the interim measure is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or
  - (iii) The party against whom the interim measure is invoked was unable to present its case with respect to the interim measure [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or
  - (iv) The interim measure has been terminated, suspended or amended by the arbitral tribunal;
- (b) The court finds that:
- (i) The measure requested is incompatible with the powers conferred upon the court by its procedural laws, unless the court decides to reformulate the measure to the extent necessary to adapt it to its own powers and procedures for the purpose of enforcing the measure; or
  - (ii) The recognition or enforcement of the interim measure would be contrary to the public policy of this State.

“(2) Upon application by an interested party, made with the approval of the arbitral tribunal, the competent court may, in its discretion, refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if the party against whom the measure is invoked furnishes proof that application for the same or similar interim measure has been made to a court in this State, regardless of whether the court has taken a decision on the application.

“(3) The party who is seeking enforcement of an interim measure shall promptly inform the court of any termination, suspension or amendment of that measure.

“(4) In reformulating the measure under paragraph (1) (b)(i), the court shall not modify the substance of the interim measure.

“(5) Paragraph (1) (a)(iii) does not apply

[Variant 1] to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that the measure was ordered to be effective for a period not exceeding [30] days and the enforcement of the measure is requested before the expiry of that period.

\*The conditions set forth in this article are intended to limit the number of circumstances in which the court must refuse to enforce interim measures. It would not be contrary to the level of harmonization sought to be achieved by these model provisions if a State were to adopt fewer circumstances in which enforcement must be refused.

[*Variant 2*] to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that such interim measure is confirmed by the arbitral tribunal after the other party has been able to present its case with respect to the interim measure.

[*Variant 3*] if the arbitral tribunal, in its discretion, determines that, in light of the circumstances referred to in article 17 (2), the interim measure of protection can be effective only if the enforcement order is issued by the court without notice to the party against whom the measure is invoked.”

18. The Working Group also recalled that another drafting proposal had been made by one delegation at its thirty-seventh session (A/CN.9/523, para. 79). That text (“the alternative proposal”) was as follows:

“(1) Interim measures of protection issued and in effect in accordance with article 17, irrespective of the country in which they were issued, and whether reflected in an interim award or otherwise, shall be recognized as binding and, upon application in writing to the competent court, be enforced subject to the provisions of articles 35 and 36, except as otherwise provided in this article. Any determination made on any grounds set forth in article 36 in ruling on such an application shall be effective only for purposes of that application.

“(2) (a) Recognition or enforcement of interim measures of protection shall not be refused on the ground that the party against whom the measures are directed did not have notice of the proceedings on the request for the interim measures or an opportunity to be heard if

(i) The arbitral tribunal has determined that it is necessary to proceed in that manner in order to ensure that the measure is effective, and

(ii) The court makes the same determination

(b) The court may condition the continued recognition or enforcement of an interim measure issued without notice or an opportunity to be heard on any conditions of notice or hearing that it may prescribe.

“(3) A court may reformulate the interim measure to the extent necessary to conform the measure to its procedural law, provided that the court does not modify the substance of the interim measure.

“(4) While an application for recognition or enforcement of an interim measure is pending, or an order recognizing or enforcing the interim measures is in effect, the party who is seeking or has obtained enforcement of an interim measure shall promptly inform the court of any modification, suspension, or termination of that measure.”

19. Pursuant to its earlier agreement, the Working Group agreed to discuss the provision on recognition and enforce-

ment of interim measures before it reverted back to the provision on interim measures of protection ordered by an arbitral tribunal.

20. At the thirty-seventh session (2002) it was decided that the discussion would be continued at a future session on the basis of both prepared texts. At the thirty-eighth session, the discussion focused initially on the text of the draft enforcement provision. It was suggested that a provision on recognition and enforcement of interim measures should reflect four principles. First, that the legal framework for enforcement of interim measures should be similar to that existing for the enforcement of arbitral awards under articles 35 and 36 of the Model Law, in particular, with some specific changes needed to adapt these grounds to interim measures. In this respect, it was said that, whilst the draft enforcement provision took account of most of the grounds listed in article 36, it had excluded some of the grounds. For example, it was noted that, as currently drafted, that provision did not include the grounds that the party to the arbitration agreement was under some incapacity as was provided in article 36 (1) (a)(i) of the Model Law or that the decision on the interim measure was beyond the scope of the submission to arbitration (article 36 (1) (a)(iii)).

21. Second, it was suggested that the right to seek recognition and enforcement of an interim measure should not, as was currently the case under paragraph (1) of the draft enforcement provision, be conditional upon the approval of the arbitral tribunal. Third, it was said paragraph (2) of the draft enforcement provision, which gave a court the discretion to refuse to recognize or enforce an interim measure solely on the ground that a similar application had been made in another court in that State was too broad. It was suggested that, where an application for enforcement was made before several courts, these courts should be free to evaluate the best way to proceed. It was said that the mere fact that a party had sought enforcement in two different State courts should not of itself be a ground for non-enforcement as there could be legitimate grounds why the application would be made in different State courts. For example, the applicant could have assets in more than one jurisdiction in a State or it could be unclear which court was the proper court in which to make that application.

22. Fourth, it was suggested that it was crucial that the arbitral tribunal’s power to decide its own jurisdiction should be preserved. It was said that variant 1 in subparagraph (a)(i) of paragraph (1) of the draft enforcement provision held the risk that a court could rule on an arbitral tribunal’s jurisdiction and thereby pre-empt that determination by an arbitral tribunal. Therefore, the policy sought to be achieved by variant 2, namely that it was for the arbitral tribunal to determine in the first instance its jurisdiction, was broadly supported.

23. As to the drafting of variant 2, various observations were made. It was said that the language was too narrow because it referred only to one type of jurisdictional issue, namely the validity of an agreement, and did not cover other jurisdictional issues that could arise and were contemplated by article 36 of the Model Law, such as, for example, the possibility that the interim measure was out-

side the scope of a valid arbitration agreement. It was also said that the wording in variant 2 did not appropriately cover all instances, such as when the tribunal had already ruled on its jurisdiction and the instance where jurisdiction was disputed but the arbitral tribunal had not yet determined the matter. To the extent that, as currently drafted, variant 2 allowed the court to make a determination as regards the jurisdiction of the arbitral tribunal (for example, by refusing enforcement on the basis that the arbitral tribunal did not have jurisdiction) it was said that such a determination should have effect only in respect of the enforcement of the interim measure of protection, and in particular should not prevent the arbitral tribunal from continuing with the arbitral proceedings.

24. It was noted that the words “made with the approval of the arbitral tribunal”, which appeared in both paragraphs (1) and (2) of the draft enforcement provision, meant that recognition and enforcement was conditional upon the approval of the arbitral tribunal. The Working Group undertook a careful examination of the question whether an arbitral tribunal’s approval should be sought before an application for recognition and enforcement of an interim measure could be sought. It was said that the chapeau, as currently drafted, did not make it clear that that approval referred to the application for recognition and enforcement of an interim measure of protection. In order to clarify this point it was suggested that the chapeau be redrafted to provide that: “Upon an application by an interested party, made with the approval of the arbitral tribunal to recognize and enforce an interim measure of protection issued pursuant to article 17, irrespective of the country in which it was ordered, the competent court shall”.

25. Two conflicting views were expressed as to the necessity for obtaining the approval of an arbitral tribunal before seeking recognition and enforcement of an interim measure. Against its inclusion it was said that such an approval was implicit from the fact that the arbitral tribunal had granted such a measure and thus expressly requiring such approval was unnecessary. It was also said that imposing such a condition could have a detrimental effect on the timing of enforcement of an interim measure. It was suggested that, if such approval could not be implied, then the text could provide that the arbitral tribunal should expressly state that the interim measure was enforceable at the time that it made the interim measure. Whilst support was expressed for that suggestion, it was not ultimately accepted for the reason that it was considered unnecessarily time-consuming and unduly burdensome on the tribunal. Another suggestion was that a distinction might be introduced in the draft provision according to whether the interim measure of protection was made in the form of an award or a procedural order. That suggestion was objected to on the ground that practice might vary as to whether a given type of interim measure would be granted in the form of an award or a procedural order. The view was expressed that strictly speaking no interim measure could be regarded as an award in the sense that it would not bring a final solution to any part of the dispute.

26. In support of requiring approval by the arbitral tribunal before court enforcement could be sought, it was said that, given the different nature of interim measures that

could be made by an arbitral tribunal ranging from interim awards to mere procedural orders and in order not to restrict a tribunal’s discretion to amend its interim measures, it would be advisable to condition an application for recognition or enforcement of interim measures upon the approval of the arbitral tribunal. It was further said that it was not implicit in the making of an interim measure that it could be recognized and enforced in a court. In this respect it was said that, in some cases, an interim measure might be granted without its enforcement by courts being envisaged by the arbitral tribunal. It was said that, in such cases, what was implicit was that the interim measure would be complied with by a party against whom it was made or that the arbitral tribunal had available to it the means to make compliance likely, such as the power to draw adverse inferences, if the measure was not complied with. In other words, whilst it could be implied that an interim measure was binding on the parties and would be complied with, it was not implicit that court enforcement would always be needed. It was suggested that the words “made with the approval of the arbitral tribunal” in paragraph (1) of the draft enforcement provision be substituted by words along the lines of “where the interim measure so permits” or “unless otherwise provided by the arbitral tribunal”.

27. In support of including a precondition that an arbitral tribunal approve an application for recognition and enforcement of an interim measure it was also stated that the arbitral tribunal was often more informed than a court as to the circumstances of the arbitral matter both in substance and in its procedural history. For this reason it was said that consideration should be given to ensuring that an arbitral tribunal would have the discretion to determine if an interim measure was enforceable or not. It was suggested that draft article 17 could be amended to define an interim measure either as an order that was enforceable or as an expression of a provisional intention of an arbitral tribunal that was not enforceable. It was said that this did not mean that some interim measures were enforceable and others were not, but merely indicated that the sanctions available for non-compliance with an interim measure of protection depended on the subject of the interim measure.

28. It was generally agreed that the title to the draft article was too narrow and, to properly reflect the scope of the provision, reference should be made to recognition as well as enforcement of interim measures of protection. Following on from this suggestion, it was suggested that, given that this draft article was aimed at recognition and enforcement, instead of using the negative statement “the competent court shall refuse to recognize” in the chapeau of draft article (1), it would be preferable to use a positive statement. One delegation proposed the following text to address the various concerns that had been expressed: “Unless otherwise provided by the arbitral tribunal an order or award for interim measures issued by the arbitral tribunal shall be recognized as binding and, upon application in writing to the competent court, shall be enforced, subject to the provisions of this article. The court may refuse to recognize and enforce an interim measure if ...”. Some support was expressed for this text. However, it was suggested that the words “recognized as binding” should be deleted. Alternatively, it was suggested that the text could

be redrafted along the lines of “an order or award for interim measures issued by the arbitral tribunal shall be recognized and, unless otherwise provided by the arbitral tribunal upon application in writing to the competent court, shall be enforced, subject to the provisions of this article”. It was agreed that the Secretariat should revise the text bearing in mind the above suggestions.

29. Concern was expressed that the reference to an application “by an interested party” (which appeared in both paragraphs (1) and (2) of the draft enforcement provision) could be too broad and could include a party other than a party to the dispute. It was suggested that consideration be given to a narrower term such as the party that was the beneficiary of the interim measure being sought. In this respect, it was noted by one delegation that the alternative proposal offered one solution as it did not include a reference to the term “interested party” and did not require approval by the arbitral tribunal before recognition and enforcement was sought. No decision was made on the point and it was widely felt that the discussion be resumed at a later point.

#### **B. Discussion of specific provisions on the basis of a revised draft**

30. With a view to accommodating various concerns expressed in respect of the draft article, a revised draft prepared by a number of delegations was presented. It was said that the intention of the revised draft was to encapsulate the conclusions that had been reached in respect of the chapeau to draft article (1) and subparagraph (a)(i). It was explained that the revised draft had been divided into four paragraphs to provide clarification. The revised draft was as follows:

- “(1) An order or award for interim measures issued by an arbitral tribunal, that satisfies the requirements of Article 17, shall be recognized as binding.
- “(2) Unless otherwise provided by the arbitral tribunal, such interim measure shall be recognized and enforced upon application in writing to a competent court subject to the provisions of this article.
- “(3) The court may refuse to recognize and enforce an interim measure if:
  - (a) The court is satisfied that there is a substantial issue as to the jurisdiction of the tribunal;
  - (b) ...
  - (c) ...
  - (d) ...
- “(4) Any determination made on any ground in (3) above shall be effective only for the purposes of the application to recognize and enforce the interim measure.”

31. The Working Group proceeded to examine the revised draft. General support was expressed for the overall approach taken in the revised draft although some concerns were expressed both as to substance and drafting.

#### **1. Paragraph (1) of the revised draft**

32. It was stated that paragraph (1) of the revised draft included a broader formulation than that used in the draft enforcement provision by replacing the words “interim measure of protection referred to in article 17” with “An order or award for interim measures issued by an arbitral tribunal, that satisfies the requirements of Article 17”. It was said that the intention behind the formulation in the revised draft was to ensure that an interim measure that was sought to be enforced would have to comply with the safeguards that had been established in draft article 17, irrespective of whether that measure was ordered in a country that had adopted the Model Law or in another country. It was pointed out that the reference to “an order or award” in paragraph (1) was unnecessary, particularly given that draft paragraph 17 (2) did not prejudge the form that an interim measure should take. That proposal was accepted.

33. It was generally agreed that paragraph (1) of the revised draft should include the words “irrespective of the country in which it was ordered” as provided for in draft paragraph (1) of the draft enforcement provision.

#### **2. Paragraph (2) of the revised draft**

34. In respect of paragraph (2), it was stated that the reformulation reflected the decision of the Working Group made earlier (see para. 28, above) that the provision should first provide a positive statement that an interim measure should be recognized and enforced and then set out the grounds upon which recognition or enforcement could be refused. It was also stated that the words “Unless otherwise provided” had been included to reflect the decision that an arbitral tribunal should be able to provide at the time of ordering the interim measure that that measure was not to be the subject of an application for court enforcement (see para. 26, above). The substance of paragraph (2) of the revised draft was said to be generally acceptable. As a matter of drafting it was suggested that paragraph (2) of the revised draft could omit the words “recognized and” since recognition was implied in enforcement. However, concern was expressed that both these terms should be included for the sake of consistency with other draft provisions as well as the Model Law. The Secretariat was requested to bear those concerns in mind when preparing a newly revised draft for continuation of the discussion at a later session. A view was expressed that the word “recognition” in paragraph (2) was not appropriate since it was very unlikely that the arbitral tribunal would provide that its decision should not be recognized as binding contrary to the general principle established in paragraph (1). The words “recognition and enforcement” were considered appropriate in paragraphs (3) and (4) of the revised draft.

#### **3. Paragraph (3) of the revised draft**

35. In respect of paragraph (3), it was pointed out that, unlike paragraph (1) (a) of the draft enforcement provision which provided that the “party against whom the interim

measure is invoked furnishes proof that”, the revised draft did not make such a reference. It was said that the revised draft had been formulated more broadly so as to avoid dealing with the requirements of the burden of proof. In addition, it was said that the draft further emphasized that the circumstances in which refusal could occur were limited. To emphasize that point, it was suggested that the word “only” should be included in draft paragraph (3) of the revised draft after the word “may”. That suggestion was generally accepted.

36. It was recalled that the Working Group had had a lengthy discussion on the question of who had the burden of proof in satisfying the court of the requirements needed for enforcement of an interim measure. While it was generally acknowledged that in most practical situations it would be for the party against whom the measure was invoked to establish the grounds on which enforcement should be refused, it was widely felt that no reference to the burden of proof was needed in that paragraph. It was recalled that the prevailing view had been reached (see para. 35, above) that this was not an issue that should necessarily be dealt with in the Model Law but that it should be left to the law of the forum. It was pointed out that the revised draft had the advantage of eliminating the need to address the issue. A view was expressed, however, that a lack of such a reference in this article in comparison with articles 34 and 36 contained in the same law might be interpreted as imposing a burden of proof on the party asking for enforcement or implying that it was for the arbitral tribunal to verify these requisites *ex officio*.

37. In respect of paragraph (3) (a) of the revised draft, which included the requirement that “there is a substantial issue as to the jurisdiction of the tribunal”, it was explained that the intention was to simplify the manner in which the draft article dealt with the issue of possible court interference with the jurisdiction of the arbitral tribunal in respect of the enforcement of the interim measure. The specific criteria set out under paragraph (1) (a)(i) of the draft enforcement provision were replaced by a broad reference to the discretion of a court to decide whether there existed a substantial issue as to the jurisdiction of the tribunal. It was further explained that the intention of the revised draft was that, in order for a court to have discretion to refuse to recognize and enforce an interim measure, the court should not only be satisfied that there was a substantial issue but also that that issue was an appropriate basis on which to refuse enforcement and recognition. It was suggested that, if that intention was not clear, a newly revised draft could expand upon this point by either noting expressly that the substantial issue should be of such a nature as to make recognition or enforcement inappropriate or that the existence of that issue was such that the interim measure was unenforceable. It was pointed out that the draft text differed from the narrower approach taken with respect to jurisdiction in the draft enforcement provision which relied on the invalidity of the arbitration agreement as a ground to refuse recognition and enforcement. That broader approach (which was said to encompass the narrower validity test) dealing, for example, with issues such as whether the arbitration exceeded the terms of reference of a valid arbitration agreement, was widely supported.

38. It was suggested that, instead of listing the grounds on which recognition and enforcement could be refused, reference could instead be made to a general ground based on a violation of public policy. Whilst some support was expressed for that suggestion, concern was expressed that that ground could provide too low a threshold for refusal. It was noted that the notion of public policy was a very vague term, described as insusceptible to definition in a number of countries. It was stated that there existed at least three different types of public policy: (1) domestic public policy understood as covering all mandatory provisions of domestic legislation; (2) public policy rules specifically established in domestic legislation for international relationships; and (3) the very limited set of rules established at the transnational level and sometimes referred to as international public policy. If the latter interpretation was to be retained, a reference to public policy might also be regarded as establishing too high a threshold for refusal of enforcement. In view of the different interpretations given by different state courts on the notion of public policy, inclusion of that as the only ground could introduce an unnecessary complication in the draft provision. It was also noted that some of the grounds upon which enforcement could be refused might not be covered by a public policy ground, in particular subparagraph (iv) which referred to the situation where an interim measure had been terminated, suspended or amended by the arbitral tribunal.

39. It was also noted that any revision of subparagraph (a) of the revised draft should also take account of earlier discussions regarding the requirement that security ought to be provided when an interim measure was granted.

#### 4. Paragraph (4) of the revised draft

40. In respect of paragraph (4), it was said that the intention of the revised draft took account of the concern expressed in the Working Group’s earlier discussion on the risk that a court, in considering a request for enforcement of an interim measure, could hinder the arbitral tribunal’s right to determine its own competence (see para. 22, above). It was said that paragraph (4) expressly provided that, whatever determination was made in respect of an application for recognition and enforcement of an interim measure under paragraph (3), that determination had no impact on the competence of the arbitral tribunal. It was said that the formulation in paragraph (4) did not interfere with the notion that the final determination on the jurisdiction of the arbitral tribunal would be in the hands of the courts that recognized and enforced the final award. It was suggested that the reference to “any determination” could be ambiguous and it should be made clear that what was intended to be covered was any determination by a court. However, it was widely accepted that paragraph (4) would have to be revisited when subparagraphs (3) (a), (b), (c) and (d) had been discussed.

41. Having completed its initial review of the revised draft, the Working Group proceeded to consider the remainder of paragraph (1) of the draft enforcement provision.

### 5. *Subparagraph 1 (a)(ii) of the draft enforcement provision*

42. It was stated that for the same reasons outlined in respect of subparagraph (a)(i), it was not necessary to expressly introduce language on the burden of proof because it was apparent that it was for the party against whom the interim measure was sought to show that it was not given proper notice of the appointment of the arbitrator or of the arbitral tribunal.

43. A concern was raised that subparagraph (a)(ii) dealt in effect with ex parte interim measures which the Working Group had agreed to set aside for future consideration. It was suggested that to continue work on that provision might create a provision which would run counter to any ex parte measures that might later be formulated. On that basis, a proposal was made to delete that subparagraph.

44. However, opposition was expressed to the deletion of that subparagraph. It was observed that, should the Working Group ultimately agree to include provisions dealing with ex parte interim measures, then the question of inclusion of subparagraph (a)(ii) could be revisited. However, it was pointed out that that subparagraph was not primarily intended to deal with ex parte interim measures. It was stated that a distinction should be drawn between, on the one hand, the situation where a conscious decision had been made to exclude a party from the debate that resulted in the issuance of an interim measure, a situation that was accurately described as an ex parte interim measure, and on the other hand, the situation where no such decision had been made, the situation more directly covered by subparagraph (ii). It was said that, for example, subparagraph (a)(ii) should be retained because it safeguarded a party in the situation where an arbitral tribunal might take a decision on an interim measure in the absence of one of the parties erroneously believing that that party had been properly notified. It was also said that the ground for refusal set forth in subparagraph (a)(ii) appeared in both article V of the New York Convention and in article 36 of the Model Law and, on that basis, its omission here could be interpreted to mean that proper notification of the appointment of an arbitrator or of the arbitral tribunal was not as important in the context of enforcement of interim measures as it was in the context of enforcement of awards. It was also said that the bracketed text in subparagraph (a)(ii) should be retained as its intention went beyond merely preserving the competence-competence principle. It was said that, in view of the expeditious nature of the proceedings for the issuance of the interim measures, a problem could arise with the notification of the other party and if that issue came before a court it may want to refer that issue back to the arbitral tribunal or it may want to remain seized of the matter in the interests of saving time.

45. The Working Group proceeded to discuss the bracketed text in subparagraph (a)(ii). It was stated that that text could be omitted on the basis that it sought to guard against a court encroaching upon the right of the arbitral tribunal to determine its own jurisdiction which was adequately dealt with under the proposed paragraph (4) of the revised draft. In support of retaining the bracketed text it

was stated that that language might provide a level of flexibility by allowing the court to stay proceedings, for example where there was a dispute as to whether a party had been properly notified. Suggestions were made for improving the drafting of the bracketed language. One suggestion was to add language to the effect that the court might suspend the enforcement proceedings until the parties had had an opportunity to be heard by the arbitral tribunal. Another suggestion was that the court might suspend the enforcement proceedings until all parties had been properly notified. The Working Group took note of those suggestions which the Secretariat was requested to bear in mind when preparing a newly revised draft to be considered at a later stage.

### 6. *Subparagraph (a)(iii) of the draft enforcement provision*

46. It was stated that subparagraph (a)(iii), in line with article V of the New York Convention and article 36 of the Model Law, was not intended to refer to the exceptional situation where an ex parte measure had been issued but more generally to the situation where, for a variety of reasons, a party had been unable to present its case. The substance of the subparagraph was found to be generally acceptable. The usefulness of the language in square brackets at the end of the subparagraph was questioned. It was stated that the bracketed language described only one among many options which would normally be open to a state court under domestic law where a party had not been given full opportunity to present its case under article 18 of the Model Law. From that perspective the bracketed language would only prove useful in the unlikely situation where the domestic rules of procedural law would not allow a court to order suspension of the proceedings. The Working Group took note of that view and agreed that the discussion should be continued at a later stage. In response to a suggestion that the words “the court may suspend the court proceedings” should be replaced by the phrase “the court shall suspend the court proceedings” it was pointed out that, should the bracketed language be ultimately retained, it would be essential to preserve the broadest possible discretion for the court, a result that would be better achieved by using the verb “may”.

### 7. *Subparagraph (a)(iv) of the draft enforcement provision*

47. The substance of subparagraph (a)(iv) was found to be generally acceptable. Various views were expressed as to how its formulation might be improved. One suggestion was that the draft provision should address the situation where the interim measure, particularly if it had been issued in the form of an award, had been set aside by a court in the country of the seat of the arbitration. It was suggested that wording along the lines of article 36 (1) (a) (v) of the Model Law might need to be added to the draft provision. Another suggestion was that the Working Group should study the implications of an

interim measure being issued in the form of an award on the applicability of other provisions of the Model Law, for example article 31. In response it was stated that, irrespective of whether an interim measure had been labelled as an award, it should not be treated as an award for the purposes of applying the Model Law. In the view of various delegations, strictly speaking, no interim measure should be regarded as an arbitral award, since it was ephemeral in nature and did not attempt to solve definitively all or part of the dispute (see para. 25, above). It was observed that such an interpretation of the notion of "arbitral award" might create the need to revisit the text of draft article 17. A note of caution was struck about dealing with the situation where an interim measure had been set aside by a foreign court. It was stated that opening that discussion might create the difficult situation where standards would need to be established to assist courts in establishing an acceptable policy regarding the setting aside of interim measures and regarding the cases where an interim measure would have to be enforced even if it had been set aside by a court in another country. With a view to avoiding some of the above concerns, it was suggested that the words "or by order of a competent court" should be added at the end of subparagraph (iv). It was agreed that the Secretariat should bear those suggestions in mind when preparing a newly revised draft for a continuation of discussions at a later stage.

#### **8. Subparagraph (b)(i) of the draft enforcement provision**

48. It was suggested that the term "procedural" should be omitted from subparagraph (b)(i) for the reason that it might be too narrow given that there could be circumstances where the court may wish to refuse to recognize and enforce an interim measure for the reason that it was incompatible with the powers conferred upon the court by its substantive laws. Further support was given to the deletion of the term "procedural" given that there were substantial differences between the content of procedural laws in different jurisdictions. While reservations were expressed about the suggestion, it was ultimately agreed that the term "procedural" could be omitted in a revised draft.

49. A question was raised whether the omission of the term "procedural" would impact negatively on draft paragraph (4) of the draft enforcement provision which prohibited a court from modifying the substance of the interim measure. In this respect it was suggested that paragraph (4) should be combined with subparagraph (b)(i). It was agreed that the Secretariat should seek to combine subparagraph (b)(i) and paragraph (4) in a revised text to be discussed at a future session.

#### **9. Subparagraph (b)(ii) of the draft enforcement provision**

50. It was suggested that the phrase "this State" should be omitted from the draft paragraph. It was noted that, even

though the term "this State" was mentioned in paragraph 36 (1) (b)(i) of the Model Law, that reference was in connection with a reference to "the law of this State" and, as that phrase was not mentioned here, it was considered that it was not necessary to refer to "this State" in subparagraph (b)(ii) of the draft enforcement provision.

51. It was also suggested that, if the intention of the Working Group was to cover all three meanings of public policy (being domestic public policy, public policy forming part of the international private law and true public policy of a transnational character as discussed earlier (see para. 38), it would be unnecessarily restrictive to refer to the public policy "of this State". In this respect it was suggested that a reference ought to be made to international public policy. However, this suggestion did not receive support for the reasons that the notion of international public policy was still a vague term which was not uniformly understood; it was suggested that to include the expression "international" in that context could introduce complexities into the text which were unwarranted. It was observed that the Working Group was not legislating in a vacuum but against a wealth of authority in every State. It was also observed that the jurisprudence on public policy was complex and that the debate of the Working Group had only touched upon the various differences between domestic public policy, transnational public policy and international public policy that was recognized by courts in different States. It was further observed that debate on the distinctions and content of each of these terms was not settled, and by departing from the language used in article V of the New York Convention and article 36 (1) (b)(ii) of the Model Law the new model legislative provision could undermine the position established thereunder and would have the potential of broadening the concept of public policy. It was said in response that, notwithstanding the wording that existed in both the Model Law and the New York Convention, the Working Group could take the opportunity in drafting the model provision to recognize that there had been jurisprudential development of the term "international public policy" since the time that the Model Law was finalized. It was also said that, since the intention of the Working Group had been expressed to create a sui generis system for enforcement of interim measures of protection, it would be helpful to refer to international public policy to recognize the developments in jurisprudence that had occurred.

52. Following discussion, the prevailing view that emerged was that the term "international public policy" was not a sufficiently clear notion since it was susceptible to different interpretations. It was suggested that the term "international public policy" could be encompassed within the "public policy of this State". It was suggested that, insofar as it might be considered that the phrase "public policy of this State" might create an impression that it only referred to domestic public policy, it may be helpful to include the words "public policy recognized by the court". It was suggested that that formulation could encompass international public policy where it was so recognized by courts in a particular State.

#### **10. Paragraph (2) of the draft enforcement provision**

53. The view was expressed that the provision contained in paragraph (2) of the draft enforcement provision should



be considered for possible inclusion in paragraph (1), as another ground for a state court to refuse enforcement of an interim measure ordered by an arbitral tribunal. On the assumption that paragraphs (1) and (2) would later be combined, the Working Group proceeded with a review of the substance of paragraph (2).

54. Lack of clarity was evident regarding the contents of paragraph (2). A number of delegations were of the view that the provision dealt with a situation where a party applied for enforcement of a single interim measure issued by an arbitral tribunal before a number of courts, located either in the same State or in different States. It was pointed out that, in and of itself, the application for enforcement of a given interim measure before several state courts should not be sufficient ground to refuse enforcement. It was stated that such an application for enforcement might be justified, for example, where assets of the defendant were located in different court jurisdictions. Other delegations observed that paragraph (2), in fact, was intended to deal with the option that might be recognized to the parties to apply for an interim measure of protection both before a court of the enacting State and before the arbitral tribunal (with subsequent application before a court of the enacting State for enforcement of the interim measure granted by the arbitral tribunal). It was widely recognized that the latter situation was the situation that was intended to be covered by paragraph (2). Limited support was expressed for introducing in the Model Law a provision that gave the court the discretion to coordinate the relief so as to avoid conflict between several interim measures. It was pointed out that, should such a provision be retained, extensive redrafting would be necessary to clarify the scope and purpose of that provision. The widely prevailing view, however, was that it would be unnecessary to include a provision dealing with such an infrequent situation at such a level of detail. It was generally agreed that the matter of a possible conflict between interim measures requested from an arbitral tribunal and interim measures requested from state courts should be left to applicable law. After discussion, the working Group decided that paragraph (2) should be deleted.

#### **11. Paragraph (4) of the revised draft (continued)**

55. The Working Group reverted to a consideration of paragraph (4) of the revised draft as contained in paragraph 30, above (for earlier discussion, see para. 40, above).

56. It was recalled that the Working Group had earlier agreed to add the words "by the court" following the word "made" to provide greater clarity that the paragraph was addressed to a court and not to an arbitral tribunal and to provide a clearer link of that paragraph with paragraph (3) of the revised draft. The Secretariat was requested to revise the text accordingly when preparing a newly revised draft for a later session.

#### **12. Possible restructuring of paragraph (1) of the draft enforcement provision**

57. At the close of the discussion regarding the individual grounds for refusing enforcement of an interim measure issued by an arbitral tribunal, it was observed that one of the results achieved by the Working Group had been to bring those various grounds somewhat closer to the grounds listed in articles 35 and 36 of the Model Law and in article V of the New York Convention. It was thus suggested that, instead of formulating each of those individual grounds, the paragraph could be recast in the form of a general reference to "the provisions of articles 35 and 36", with exceptions, as appropriate, where the paragraph was intended to deviate from the provisions of articles 35 and 36. In addition to offering more concise drafting, the suggestion was said to limit the risk that might arise from lack of parallelism between the grounds for refusing enforcement of an interim measure issued by an arbitral tribunal and the grounds for refusing enforcement of an arbitral award under articles 35 and 36. It was stated that, for example, the suggested redrafting would avoid any doubt as to whether a general reference to the jurisdiction of the arbitral tribunal in the draft enforcement provision was intended to cover the non-arbitrability of the dispute alongside other jurisdiction-related grounds for refusing enforcement. Some support was expressed for that suggestion. Others held the view, however, that it was preferable to spell out in the Model Law the provisions applicable to the enforcement of interim measures issued by an arbitral tribunal since the policy and legal considerations governing the enforcement of those measures were sufficiently different from those governing the enforcement of an arbitral award. It was generally agreed that, in drafting that provision, unnecessary deviation from the text of articles 35 and 36 should be avoided. Another view was that a reference to article 35 and 36 of the Model Law should be avoided to facilitate the use of the draft enforcement provision by those States that might not have already enacted the Model Law. After discussion, the Secretariat was requested to prepare a newly revised provision and, in doing so, to consider both of the above views and suggestions and to consider the possibility of drafting alternative variants so that the Working Group would have concrete texts before it when discussing the matter further at a future session.

58. The discussion also focused on the question whether, parallel to article 36 of the Model Law, the draft enforcement provision should distinguish between, on the one hand, the situation covered by article 36 (1) (a), where grounds for refusing enforcement were examined by the court "at the request of the party against whom" the interim measure had been issued and that party would "furnish sufficient proof" that enforcement should be refused, and, on the other hand, the situation covered by article 36 (1) (b), where the court, of its own motion, would "find" that there existed a ground for refusing enforcement. It was recalled that, in its earlier discussion, the Working Group, with a view to avoiding the complexities that might arise from the allocation of the burden of proof, had decided that all grounds for refusing enforcement of an interim measure of protection should be introduced in the draft enforcement provision by the wording "the court is satisfied that" (see above, paras. 35 and 36).

59. It was suggested that, in considering the possible need for a differentiated treatment of the various grounds under paragraph (1), the three following questions should be borne in mind: (1) which party should bear the burden of proof; (2) what would be the applicable standard of proof; and (3) upon whose initiative or request would a court examine a possible ground for refusing enforcement.

60. As to which party should bear the burden of proof, the view was expressed that the allocation should follow the pattern established in article 36 of the Model Law. It was pointed out, however, that article 36 (1) (a) (ii) of the Model Law, for example, should not be interpreted as requiring the party against whom the award was invoked to bear the burden of proving the negative fact that it had not received proper notice. After discussion, the Working Group reiterated the conclusion that no provision should be made in the draft enforcement provision regarding the allocation of the burden of proof and that the matter should be left to applicable law. In the context of that discussion, doubts were expressed as to whether leaving the issue of the burden of proof to domestic law would favour the wider use of arbitration. It was recalled that the Convention on the Execution of Foreign Arbitral Awards (Geneva, 1927) was unclear on that issue. By contrast, the approach taken in the New York Convention had been to allocate the burden of proof to the party resisting enforcement (an approach often referred to as the “pro-enforcement bias”). It was suggested that the same approach should be followed in the draft enforcement provision. In response, it was pointed out that a “pro-enforcement bias” might not be as justified in the case of an interim measure issued without a full appreciation of all facts of the dispute, at an early stage of the proceedings, as it was regarding an award on the merits of the case.

61. Regarding the standard of proof, a widely shared opinion was that the urgent need for enforcement and the ephemeral character of an interim measure would seem to indicate that the court should apply a prima facie standard when examining the issue of enforcement of such a measure, as opposed to the more stringent standard of proof that would typically be required when considering the enforcement of an arbitral award on the merits of the case. The prevailing view, however, was that the issue of the standard of proof should not be dealt with in any detail in the draft enforcement provision and would better be left to applicable law.

62. As to whether grounds for refusing enforcement should be considered only at the request of the party or whether such grounds could be raised by the court of its own motion, it was suggested that a distinction should be drawn along the lines of subparagraphs (a) and (b) of paragraph (1) of article 36 of the Model Law. The following text was proposed:

“Recognition or enforcement of an arbitral award may be refused only:

(a) At the request of the party when the court is satisfied that ...

[all subparagraphs in subparagraph (1) (a) of the draft enforcement provision]; or

(b) If the court [finds][is satisfied] that ...

[all subparagraphs in subparagraph (1) (b) of the draft enforcement provision].”

63. The Secretariat was requested to bear that proposal in mind when preparing a newly revised draft of the enforcement provision, with possible variants, for continuation of the discussion at a future session.

### **13. Footnote to paragraph (1) of the draft enforcement provision**

64. The Working Group proceeded to consider the text contained in the footnote to paragraph (1). It was observed that the text therein closely followed the sentiment expressed in the footnote to article 35 (2) of the Model Law. General support was expressed for the inclusion of the footnote although it was suggested that the word “must”, which appeared two times in the footnote should be replaced by the word “may”. That suggestion received support.

65. Another view expressed was that, in the context of enforcement of interim measures, a different approach than that provided for enforcement of arbitral awards might be warranted. Given that interim measures were often issued without a complete appreciation by the arbitral tribunal of the circumstances of the dispute and that the grounds listed in paragraph (1) of the draft enforcement provision were to protect the party against whom the interim measure was ordered, it was suggested that it might not be appropriate to encourage States to remove these safeguards. Against this view, it was said that since the current provision was dealing with the enforcement of inter partes interim measures the footnote was comparable to the footnote in article 35 (2) of the Model Law and that therefore it should be retained. It was also said that, in determining whether or not to retain the footnote, the Working Group should balance the need for harmonization between the Model Law and the risk of abuse and where that risk was low should refrain from departing from the Model Law.

66. Noting the reservations expressed as to the inclusion of such a footnote in the context of enforcement of interim measures, the Working Group agreed to retain the footnote with the amendment to replace “must”, where it appeared in the footnote, with the word “may”.

### **14. Paragraph (3) of the draft enforcement provision**

67. In respect of paragraph (3), it was observed that the paragraph was based on the principle that a party seeking enforcement of an interim measure should be obliged to inform the court of any termination, suspension or amendment of that measure. Broad support was expressed for that principle.

68. It was stated that, since the provision reflected the principle of good faith, both parties might be subject to that obligation. It was observed that the paragraph could operate in two distinct circumstances. The first was where there was no opposition from the other party to enforce-

ment of the interim measure. In that case, the onus of showing that that interim measure was in line with what had been ordered by the arbitral tribunal properly fell on the party seeking enforcement. The second circumstance was where there was opposition to enforcement in which case it was said that the onus should be on both parties. However, the prevailing view was the obligation to notify should properly apply only to the party seeking enforcement of the interim measure in view of the fact that the decisions to enforce interim measures were often taken *ex parte* and that enforcement orders often carried with them sanctions such as penalties, fines or being found to be in contempt of court.

69. It was suggested, and the Working Group agreed, that the obligation to notify extended also to the period after an enforcement order had been granted. In order to express that idea it was decided to replace the expression “the party who is seeking enforcement” with “the party who is seeking or has obtained enforcement”.

70. It was suggested that the provision was not complete, as it did not deal with the consequences, such as liability for damages, where a party failed to fulfil that obligation. However, the prevailing view was that it was more prudent to leave such a liability regime to the applicable national law.

71. It was observed that the purpose of notifying the court under paragraph (3) was to enable it to take a corrective measure such as to terminate, suspend or amend its own enforcement order. According to one opinion, it would be useful to state expressly that the court had the power to take such corrective measures in the light of changed circumstances about which it was notified. However, the prevailing view was that courts already had sufficient possibilities to take appropriate action in accordance with the national procedural rules and that, therefore, there was no need to formulate a unified provision on that matter. In that context, it was said that for a court to modify its enforcement order it was not sufficient that a court be notified of a change in circumstance and that a request by a party was necessary. On this point too, the Working Group considered that it should be left to be governed by the applicable procedural law.

#### ***15. Proposal for a new provision on security for requests for enforcement***

72. The Working Group then turned to the question whether a court, when faced with an application to enforce an interim measure, ought to be able to order the applicant to provide security. It was suggested that the question whether security ought to be mandatory when seeking enforcement of an interim measure ought to be left to domestic law. It was observed that, given that draft article 17 conferred a power on an arbitral tribunal to order security when ordering interim measures, it was appropriate that such a power be conferred on a court when enforcing an interim measure. It was suggested that the power to order security should be expressed as a discretion and not be mandatory. It was suggested that such a power was particu-

larly important to bind third parties, which could not be affected by an interim measure issued by an arbitral tribunal.

73. A widely held view was that a court should have the power to order security where no order regarding security had been made by an arbitral tribunal at the time of ordering the interim measure. However, concern was expressed about extending that power to the circumstance where an arbitral tribunal had made such an order given the potential for inconsistency between such orders. It was also said that there was a risk that an applicant could be disadvantaged for making an application for enforcement if a request imposed by a court was in addition to one already required by an arbitral tribunal. In that connection, it was suggested that the situation where security was requested by a court in the context of an application for enforcement of an interim measure issued by an arbitral tribunal should be distinguished from the situation where the application for an interim measure was presented directly to the court. The view emerged that any possible conflict between security granted by an arbitral tribunal and that granted by a court could be dealt with by the court and thus the provision should simply reflect that a court had the discretion to order security when enforcing an interim measure.

74. However, concern was expressed that such a power could run the risk that a court would review the tribunal’s decision as to the appropriate level of security. It was suggested that one way to reduce that risk was to circumscribe the power of a court to order security by including a text that recognized that the court had the power to order security insofar as security had not already been determined by the arbitral tribunal. It was said that that would cover any decision taken by an arbitral tribunal in respect of security whether affirmative or negative as well as allowing orders for security in respect of third parties.

75. Following that discussion, the Secretariat was requested to prepare a revised text setting out the various options discussed by the Working Group. It was clarified that these options should include a provision setting out that a court had the power to order security with bracketed text that limited such a power to the circumstance where a tribunal had not made an order with respect to security. Another option would extend this power to include a power to order security where an arbitral tribunal had made an order but the court found that order to be inappropriate or insufficient in the circumstances. A further suggested option was that the provision simply provide that a court had the discretion to order security for costs, and that the scope of the power, as well as any potential conflict with an earlier determination by an arbitral tribunal on security, would be dealt with by the court under a law other than the Model Law. A related proposal that was agreed should be reflected as another option was that the provision limit the power of the court to the question whether or not to enforce an interim measure. In that respect an analogy was drawn to the situation where a court was requested to determine enforcement of a foreign judgement in *exequatur* proceedings. Yet another option suggested was that the power of the court to order security should be limited to dealing with third party rights.

#### IV. COURT-ORDERED INTERIM MEASURES

76. The Working Group considered a possible draft provision expressing the power of the court to order interim measures of protection in support of arbitration on the basis of the Note by the secretariat (A/CN.9/WG.II/WP.119, paras. 75-81 and, in particular, the draft provision which read as follows:

“The court shall have the same power of issuing interim measures of protection for the purposes of and in relation to arbitration proceedings as it has for the purposes of and in relation to proceedings in the courts.”

77. General support was expressed in favour of a provision that would give a court power to issue interim measures of protection, irrespective of the country where the

arbitration took place. As to the criteria and standards for the issuing of such measures, different views were expressed. One view was that the court should apply its own rules of procedures and standards. Another view favoured the criteria and standards set forth in article 17. It was generally recognized that any reference to existing standards would have to provide flexibility for the court to adapt to the specific features of international arbitration.

78. The secretariat was requested to prepare a revised draft with variants reflecting the views expressed above. It was pointed out that the scope of the provision was not in line with the rule on territoriality expressed in the Model Law. It was generally agreed that in preparing the revised draft, attention should be given to the possible need of adapting article 1 (2) to extend the exception to the territorial application of the Model Law.

#### **D. Working paper submitted to the Working Group on Arbitration at its thirty-eighth session: Settlement of commercial disputes: Interim measures of protection**

(A/CN.9/WG.II/WP.123) [Original: English]

#### NOTE BY THE SECRETARIAT

1. At its thirty-sixth session in March 2002, the Working Group resumed discussions on the power of a court or arbitral tribunal to order interim measures of protection (A/CN.9/508, paras. 51-94; for earlier discussions, see A/CN.9/468, paras. 60-87, A/CN.9/485, paras. 78-106, A/CN.9/487, paras. 64-87) and considered a draft text for a revision of article 17 of the UNCITRAL Model Law on International Commercial Arbitration (A/CN.9/WG.II/WP.119, para. 74) (hereinafter referred to as “the secretariat proposal”).

2. At the start of its thirty-seventh session in October 2002, a decision was made that the Working Group would continue its deliberations on the basis of a proposal submitted by the United States of America (A/CN.9/WG.II/WP.121) (hereinafter referred to as “the United States proposal”) setting out a revision of draft article 17 of the UNCITRAL Model Law on International Commercial Arbitration, also having regard to the secretariat proposal.

3. This note has been prepared on the basis of discussions and decisions of the thirty-seventh session of the Working Group. To facilitate the resumption of discussions, the following text (hereinafter referred to as “the revised draft”), sets out a newly revised version of article 17 of the UNCITRAL Model Law on International Commercial Arbitration, taking account of discussions and decisions made at the thirty-seventh session of the Working Group.

#### REVISED DRAFT OF ARTICLE 17 OF THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION REGARDING THE POWER OF AN ARBITRAL TRIBUNAL TO GRANT INTERIM MEASURES OF PROTECTION

- (1) Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, grant interim measures of protection.
- (2) An interim measure of protection is any temporary measure, whether in the form of an award

or in another form, by which, at any time prior to the issuance of the award by which the dispute is finally decided, the arbitral tribunal orders a party to:

- (a) Maintain or restore the status quo pending determination of the dispute [, in order to ensure or facilitate the effectiveness of a subsequent award];
- (b) Take action that would prevent, or refrain from taking action that would cause, current or imminent harm [, in order to ensure or facilitate the effectiveness of a subsequent award];

- (c) Provide a preliminary means of securing assets out of which a subsequent award may be satisfied; or
- [(d) Preserve evidence that may be relevant and material to the resolution of the dispute.]
- (3) The party requesting the interim measure of protection shall [demonstrate] [show] [prove] [establish] that:
- (a) Irreparable harm will result if the measure is not ordered, and such harm substantially outweighs the harm that will result to the party affected by the measure if the measure is granted; and
- (b) There is a reasonable possibility that the requesting party will succeed on the merits, provided that any determination on this possibility shall not affect the discretion of the arbitral tribunal in making any subsequent determinations.
- (4) [Subject to paragraph (7) (b) (ii),] [except where the provision of a security is mandatory under paragraph (7) (b) (ii),] the arbitral tribunal may require the requesting party and any other party to provide appropriate security as a condition to granting an interim measure of protection.
- (5) The arbitral tribunal may modify or terminate an interim measure of protection at any time [in light of additional information or a change of circumstances].
- (6) The requesting party shall, from the time of the request onwards, inform the arbitral tribunal promptly of any material change in the circumstances on the basis of which the party sought or the arbitral tribunal granted the interim measure of protection.
- (7) (a) Unless otherwise agreed by the parties, the arbitral tribunal may [, in exceptional circumstances,] grant an interim measure of protection, without notice to the party [against whom the measure is directed] [affected by the measure], when:
- (i) There is an urgent need for the measure;
- (ii) The circumstances set out in paragraph (3) are met; and
- (iii) The requesting party shows that it is necessary to proceed in that manner in order to ensure that the purpose of the measure is not frustrated before it is granted.
- (b) The requesting party shall:
- (i) Be liable for any costs and damages caused by the measure to the party [against whom it is directed] [affected by the measure] [to the extent appropriate, taking into account all of the circumstances of the case, in light of the final disposition of the claims on the merits]; and
- (ii) Provide security in such form as the arbitral tribunal considers appropriate [, for any costs and damages referred to under subparagraph (i),] [as a condition to granting a measure under this paragraph];
- [(c) [For the avoidance of doubt,] the arbitral tribunal shall have jurisdiction, inter alia, to determine all issues arising out of or relating to [subparagraph (b)] above;]
- [(d) The party [against whom the interim measure of protection is directed] [affected by the measure granted] under this paragraph shall be given notice of the measure and an opportunity to be heard by the arbitral tribunal [as soon as it is no longer necessary to proceed on an ex parte basis in order to ensure that the measure is effective] [within forty-eight hours of the notice, or on such other date and time as is appropriate in the circumstances];]
- [(e) Any interim measure of protection ordered under this paragraph shall be effective for no more than twenty days [from the date on which the arbitral tribunal orders the measure] [from the date on which the measure takes effect against the other party], which period cannot be extended. This subparagraph shall not affect the authority of the arbitral tribunal to grant, confirm, extend, or modify an interim measure of protection under paragraph (1) after the party [against whom the measure is directed] [affected by the measure] has been given notice and an opportunity to be heard;]
- [(f) A party requesting an interim measure of protection under this paragraph shall have an obligation to inform the arbitral tribunal of all circumstances that the arbitral tribunal is likely to find relevant and material to its determination whether the requirements of this paragraph have been met;]

## NOTES

### *Paragraph (1)*

4. At its thirty-seventh session, the Working Group observed that paragraph (1) of the United States proposal was in line with the text previously discussed by the Working Group. The Working Group found the substance of the redrafted paragraph generally acceptable but suggested that the words “order another party to take interim measures of protection” might unduly limit the scope of the provision and suggested that these words be replaced by “grant interim measures of protection” (A/CN.9/523 para. 34). The revised draft takes account of this suggestion.

### *Paragraph (2)*

#### *Placement of paragraph (2) and general remark*

5. The text currently contained in paragraph (2) of the revised draft (formerly paragraph (4) of the secretariat proposal) was discussed at the thirty-sixth session of the Working Group and it was agreed that it be placed imme-



diately after paragraph (1) (A/CN.9/508, para. 64). The substance of this paragraph was, in part, inspired by the draft Convention on Jurisdiction and Foreign Judgements in Civil and Commercial Matters, interim text 2001 of the Hague Conference on Private International Law (reproduced in part in A/CN.9/WG.II/WP.119, para. 71).

*Chapeau—Notion of “interim measure of protection”*

6. At its thirty-seventh session, the Working Group heard that paragraph (2) of the United States proposal was intended to reflect the discussion at the thirty-sixth session of the Working Group (A/CN.9/508, paras. 64-76). The reference to an “interim award” was said to be contrary to the view that had prevailed at that session not to qualify an award as “partial” or “interim” (see A/CN.9/508, para. 66 and A/CN.9/523, para. 36). Doubts were also expressed with respect to the notion of an interim measure being “reflected” in an award. In line with the decision taken at the thirty-seventh session of the Working Group, paragraph (2) of the revised draft includes the following words: “An interim measure of protection is any temporary measure, whether in the form of an award or in another form” (A/CN.9/523, para. 36).

*Subparagraphs (a) and (b)—“in order to ensure or facilitate the effectiveness of a subsequent award”*

7. The words “in order to ensure or facilitate the effectiveness of a subsequent award” in both subparagraphs (a) and (b) of the revised draft were introduced into the text by the United States proposal. The wording appears to incorporate language used in a variant considered by the Working Group at its thirty-sixth session as a separate paragraph to describe an interim measure (see para. 4 (b) of Variant 2, A/CN.9/WG.II/WP.119, para. 74 and reproduced in A/CN.9/508, para. 51). However, these words, as incorporated within subparagraphs (a) and (b) of the revised draft were not fully discussed and the Working Group may wish to consider whether this wording unduly restricts the scope of these provisions.

*Subparagraphs (a), (b) and (c)—“a subsequent award”*

8. In order to avoid the difficulty of defining the term “eventual award”, as contained in the text of the United States proposal under paragraphs 2 (a), (b) and (c), more neutral language has been used (“subsequent award”) in paragraphs 2 (a), (b) and (c) of the revised draft to indicate any award that might be ordered at a subsequent point in time.

*Subparagraph (b)—Scope of the provision*

9. At its thirty-sixth session, the Working Group generally felt that the ambit of subparagraph (b) of the revised draft (formerly para. (4) (c) of Variant 1, A/CN.9/WG.II/WP.119, para. 74) should be broadened to cover also cases where the purpose of the interim measure was not to restrain but to order affirmative conduct (A/CN.9/508, para. 75). Along the same lines, it was felt that the scope of the provision should not cover only measures ordered against the defendant but also measures addressed to other parties to the arbitration. The Working Group may wish to con-

sider whether the text in the revised draft appropriately addresses these suggestions.

*Subparagraph (c)*

10. At its thirty-seventh session, the Working Group agreed to replace the entire text of subparagraph (c) of the United States proposal being, “provide security for the enforcement of an eventual award, including an award of costs”, by wording along the lines, “provide a preliminary means of securing assets out of which an award may be satisfied” (A/CN.9/523, para. 37). That decision restored the language used in the secretariat proposal (formerly para. (4) (b) of Variant 1 in A/CN.9/WG.II/WP.119, para. 74 and reproduced in A/CN.9/508, para. 51).

*Subparagraph (d)*

11. At its thirty-sixth session, the Working Group agreed that, to facilitate the issuance of interim measures aimed at preventing destruction of evidence, paragraph (2) should also refer to “a measure intended to provide a preliminary means of preserving evidence” (A/CN.9/508, para. 76). Subparagraph (d) of the revised draft, which refers to “preserve evidence that may be relevant and material to the resolution of the dispute” was not discussed at the thirty-seventh session of the Working Group. The Working Group may wish to consider if that wording is appropriate.

*Non-exhaustive nature of list of provisional measures*

12. At the close of the discussion at the thirty-seventh session of the Working Group, it was recalled that, at its thirty-sixth session, the Working Group had agreed that it should be made abundantly clear that the list of provisional measures provided in the various subparagraphs was intended to be non-exhaustive (A/CN.9/508, para. 71). It was pointed out that, as redrafted, the list was exhaustive. It was explained in response that, as redrafted, paragraph (2) no longer provided a list of the individual interim measures that could be granted by a tribunal. Instead, the revised provision mentioned “any temporary measure”, thus offering an open-ended formulation. In addition, the provision listed the various purposes for which a provisional measure could be granted. To the extent that all such purposes were covered by the revised list, it was no longer necessary to make the list non-exhaustive. While that explanation was generally accepted, the Working Group decided to consult further before making a final decision as to whether all conceivable grounds for which an interim measure of protection might need to be granted were covered by the current formulation. It was agreed that the discussion, in that regard, would be reopened at a future session (A/CN.9/523, para. 38).

*Paragraph (3)*

*Chapeau*

13. The chapeau of paragraph (3) of the revised draft has been simplified to avoid unnecessarily repeating the content of paragraph (1) and now reflects the original text as contained in paragraph (2) of the secretariat proposal.

Paragraph (3) has also been revised to include a number of other verbs other than the word “demonstrate” because concern was expressed that this term might connote a high standard of proof (A/CN.9/523, para. 40; for earlier discussion, see A/CN.9/508, para. 55).

*Deletion of the reference to the “urgent need for the measure”*

14. At its thirty-seventh session, the Working Group agreed that the urgency of the need for the measure should not be a general feature of interim measures of protection but rather it should be made a specific requirement for granting an interim measure *ex parte* where urgency made notice to the other party impracticable (A/CN.9/523, paras. 29 and 41). The reference to the urgency of a measure has been relocated into paragraph (7) (a) (i) of the revised draft (formerly paragraph 4 of the United States proposal) which deals with *ex parte* interim measures.

*Subparagraph (a)*

15. Paragraph 3 (a) of the revised draft (formerly paragraph 3 (b) of the United States proposal) has been revised to take account of the suggestion that the words “the party opposing the measure” be replaced by “the party affected by the measure” and that the words “and that harm” should be replaced by the words “and such harm” (A/CN.9/523, para. 42). A view was expressed that the words “irreparable harm” might lend themselves to confusion with the words “current or imminent harm” in paragraph (2) (b) thus creating the risk that the criteria set forth in paragraph (3) might be read as applying only to those measures granted for the purposes of paragraph (2) (b). The Working Group took note of that view (A/CN.9/523, para. 42). It should be recalled that, at the thirty-sixth session of the Working Group, it was widely felt that the provision should be based on a “balance of convenience” under which the assessment of the degree of harm suffered by the applicant if the interim measure was not granted should be balanced against an evaluation of the harm suffered by the party opposing the measure if that measure was granted. In addition, it was felt that the quantitative approach reflected in the words “a significant degree of harm” might create uncertainties as to how a degree of harm should be considered to be sufficiently “significant” to justify certain provisional measures. It was suggested that a reference to the more qualitative notion of “irreparable harm” should be used (A/CN.9/508, para. 56). The text in the revised draft mirrors this earlier decision of the Working Group. It is submitted that the broad definition of interim measures under paragraph (2) does not conflict with the need for the party requesting the interim measure to show evidence of irreparable harm.

*Subparagraph (b)*

16. Consistent with a suggestion made at the thirty-seventh session of the Working Group, paragraph (3) (b) of the revised draft (formerly paragraph (3) (c) of the United States proposal) has been revised to replace the words “there is a substantial possibility that the requesting party will succeed on the merits of the dispute” with “there is a reasonable possibility that the requesting party will succeed on the merits, provided that any determination on this

possibility shall not affect the discretion of the arbitral tribunal in making any subsequent determinations” (A/CN.9/523, para. 64; for earlier discussion, see para. 43 and A/CN.9/508, para. 57).

*Paragraph (4)*

*Placement of paragraph (4)*

17. Paragraph (4) of the revised draft (formerly paragraph (5) of the United States proposal) has been relocated in the text to reflect the fact that it is intended to apply to interim measures in general and not only to those measures that might be granted *ex parte* under paragraph (7) of the revised draft (A/CN.9/523, para. 45). The Working Group also agreed that paragraphs (6) and (7) of the United States proposal (paragraphs (5) and (6) of the revised draft) be relocated to appear before the paragraph dealing with the *ex parte* interim measures (A/CN.9/523, para. 45).

*Interplay between paragraph (4) and paragraph (7) (b) (ii)*

18. At the thirty-seventh session of the Working Group, concern was expressed that, as previously drafted, this text might create a possibility to avoid supplying mandatory security in respect of *ex parte* interim measures of protection (A/CN.9/523, para. 46). It was agreed that this text was based on the idea that, in respect of *inter partes* measures, the requirement for security should be within the discretion of the arbitral tribunal (A/CN.9/523, para. 46). To meet this concern, two alternative texts, namely, “Subject to paragraph (7) (b) (ii)” or “Except where a provision of security is required under paragraph (7) (b) (ii)” have been included in the revised draft in square brackets. These alternatives seek to clarify the decision of the Working Group that paragraph (4) be subject to paragraph (7) (b) (ii) and to distinguish between the situation where the granting of security results from the exercise of a discretion of the arbitral tribunal and the situation where the arbitral tribunal is obliged to require security from the party requesting the *ex parte* interim measure of protection.

*“and any other party”*

19. At its thirty-seventh session, the Working Group also agreed to include the words “and any other party” after the words “the requesting party” to provide the arbitral tribunal with a discretion that would accommodate certain situations in a multiparty arbitration, for example, the situation where there were numerous claimants, each of whom would benefit from the interim measure, but the request was made by only one claimant having no assets. In that situation the tribunal would have the discretion to request security from the other claimants. In addition, the reference to “any party” could accommodate the situation where a party provided counter-security (A/CN.9/523, para. 48).

*Paragraph (5)*

*“in light of additional information or a change of circumstances”*

20. At the thirty-seventh session of the Working Group, it was said that the discretion to modify or terminate an

interim measure should not be limited. It was observed that, given the extraordinary nature of such measures, if a tribunal had the power to grant such measures then it should also have the power to modify or terminate them. The Working Group may wish to consider whether the text currently included in square brackets being “in light of additional information or a change of circumstances”, originally used in the secretariat proposal (see A/CN.9/508, paras. 88-89) should be included to avoid establishing an arbitrary discretion.

#### *Application to ex parte measures*

21. It was further said that, given that the intention in paragraph (5) appeared to also cover ex parte measures, the circumstances in which the arbitral tribunal might wish to modify or terminate an interim measure could occur during the ex parte period and that therefore the requirement to inform the party affected by the measure as required under paragraph (7) (e) could frustrate the measure. It was suggested that further consideration might be necessary to examine whether a distinction should be made depending upon whether the interim measure was inter partes or ex parte, in which case a separate provision might need to be prepared to deal with ex parte measures (A/CN.9/523, para. 52).

#### *Sanction*

22. The Working Group may wish to consider whether paragraph (5) should be revised to provide a clear sanction if the duty under paragraph (6) is not complied with (A/CN.9/523, para. 49; see also para. 24 below).

#### *Paragraph (6)*

“or any other party”

23. A suggestion was made at the thirty-seventh session of the Working Group that, if the term “or any other party” was included in paragraph (4), then this phrase should also be added to the text now contained in paragraph (6) (A/CN.9/523, para. 49). The view was expressed that this could however invite additional argument between the parties. The Working Group may wish to give further consideration to this issue.

#### *Sanction*

24. A suggestion was made that whilst there was a duty to inform the arbitral tribunal of any material changes in the circumstances affecting the granting of the interim measure, there was no sanction if this duty was breached. In response, it was agreed that this matter could be adequately dealt with under paragraph (5) (A/CN.9/523, para. 49). On that basis, no decision was made, at the thirty-seventh session of the Working Group, to change the text of paragraph (6). If the Working Group agrees that paragraph (5) should provide a sanction in the event that paragraph (6) is breached, the Working Group may also wish to consider whether the order of these paragraphs should be reversed.

25. The Working Group may wish to consider whether

the language used in paragraph (6), which refers to “any material change”, as compared to the language used in paragraph (5), which refers to “a change of circumstances”, is appropriate.

#### *Paragraph (7)*

##### *General remark*

26. The issue of the power of an arbitral tribunal to order ex parte interim measures of protection was the subject of extensive discussion at the thirty-seventh session of the Working Group (A/CN.9/523, paras. 16-27). The view stated at the thirty-sixth session of the Working Group, that the power to order ex parte interim measures of protection should be reserved for State courts, was reiterated at the thirty-seventh session of the Working Group (A/CN.9/523, para. 17). Whilst a number of delegations continued to oppose the inclusion of the power of arbitral tribunals to grant ex parte interim measures of protection, the Working Group nevertheless agreed to continue its examination of the United States proposal (A/CN.9/523, para. 28).

##### *Subparagraph (a)*

27. The text contained in paragraph (7) (a) of the revised draft (formerly paragraph (5) of the secretariat proposal and paragraph (4) (a) of the United States proposal) received considerable attention at the thirty-seventh session of the Working Group (A/CN.9/523, paras. 28-33). At that session, the Working Group took note, inter alia, of the suggestion that further consideration be given to the possibility of lifting the ex parte interim measure of protection where a responding party provided sufficient security (A/CN.9/523, para. 33). The revised draft does not address this point.

28. The Working Group may wish to consider whether, in the interests of consistency, the language used in paragraph 3 (a) namely “the party affected by the measure” should also be reflected in paragraphs 7 (a), (b) (i), (d) and (e), to replace the phrase “the party against whom the measure is directed”. Both alternatives are included in square brackets in the revised draft.

29. A widely shared view of the Working Group at its thirty-seventh session was that, if ex parte measures were included, then the provision should indicate that such measures only be granted in exceptional circumstances (A/CN.9/523, para. 17). The words “in exceptional circumstances” have been included after the words “the arbitral tribunal may”. The Working Group agreed that paragraph (4) (a) of the United States proposal should be revised to take account of the views and concerns expressed by the Working Group and, in particular, to recognize the parties’ freedom of contract by allowing them to contract out of the provision giving the tribunal the power to grant an ex parte interim measure of protection (A/CN.9/523, para. 31). To give effect to this decision, paragraph (7) (a) of the revised draft includes the phrase “by the parties” after the opening phrase, “Unless otherwise agreed” as suggested at the thirty-seventh session of the Working Group (A/CN.9/523, para. 54).



30. At the thirty-seventh session of the Working Group, a revised draft of paragraph (4) (a) of the United States proposal was prepared (A/CN.9/523, paras. 32 and 53-69) (hereinafter referred to as “the paragraph (4) (a) redraft”) and the following decisions and suggestions made at that session have been included in the revised draft:

Preference was expressed for the second bracketed alternative in the paragraph (4) (a) (i) redraft (paragraph (7) (a) (iii) of the revised draft), with the term “defeated” being replaced by the term “frustrated” (A/CN.9/523, paras. 57 and 61);

Paragraph (7) (a) (ii) of the revised draft (formerly subparagraph (iv) of the paragraph (4) (a) redraft) was revised in accordance with the suggestions made at the thirty-seventh session of the Working Group (A/CN.9/523, para. 64);

The words “or before the party against whom the measure is directed has had an opportunity to respond” were deleted on the assumption that the text sufficiently covered the situation where notice was given but the responding party either could not or had not responded to the notice (A/CN.9/523, para. 60);

It was agreed that the conditions that applied to inter partes measures as set out in paragraph (3) of the United States proposal should also apply to ex parte measures but that the requirement in paragraph 3 (c) of a “substantial possibility” of success on the merits should be softened by using more neutral language (A/CN.9/523, para. 31); a reference to meeting the requirements of paragraph (3) has been added to paragraph (7) (a) of the revised draft (A/CN.9/523, para. 62);

Subparagraph (a) now lists the conditions to be satisfied by the party requesting the ex parte interim measure and subparagraph (b) refers to obligations to be complied with by the party requesting the ex parte interim measure; the Working Group may wish to consider if this new structure is appropriate;

Other suggestions made included that there be a mandatory requirement that security be provided by the party requesting the measure to compensate the respondent if the measure is later found to have been unjustified; that the person seeking the ex parte measure be able to demonstrate the non-existence of any other legal remedy and that this is a remedy of last resort; and that reasonableness and proportionality apply in the case of ex parte measures (A/CN.9/523, para. 30). The Working Group may wish to consider further these suggestions.

#### *Subparagraph (b)*

31. The text in paragraph (7) (b) (i) of the revised draft (formerly subparagraph (v) of the paragraph (4) (a) redraft) has been redrafted to delete the reference to “strictly” and to include, in square brackets, the words “to the extent appropriate, taking into account all of the circumstances of the case, in light of the final disposition of the claim on the merits” (A/CN.9/523, paras. 31 and 66-67).

32. The text in paragraph (7) (b) (ii) of the revised draft (formerly paragraph (4) (a) (vi) redraft) was redrafted to take account of the preference expressed at the thirty-

seventh session of the Working Group for the words “security in such form as the arbitral tribunal considers appropriate”. Also, preference was expressed for the use of language along the following lines “for any damages and any costs of arbitration referred to in subparagraph (i)” (A/CN.9/523, paras. 68-69). For the sake of consistency with the wording of paragraph 4 of the revised draft, paragraph 7 (b) (ii) refers to providing security “as a condition to granting a measure under this paragraph”. It was a generally accepted view of the Working Group at its thirty-seventh session that the security to be provided in respect of ex parte interim measures be mandatory (A/CN.9/523, para. 46). The Working Group may wish to consider whether this subparagraph adequately reflects this view.

#### *Subparagraph (c)*

33. The Working Group agreed to place the cross-reference to subparagraph (b) of the revised draft (formerly a cross reference to paragraph (4) (a) (v) and (vi) redraft) between square brackets following the concern that a cross reference to subparagraph (b) (ii) (formerly subparagraph (vi) of the paragraph 4 (a) redraft) was necessary (A/CN.9/523, para. 72). The Working Group may wish to continue its discussion on this matter at its thirty-eighth session.

34. The words “For the avoidance of doubt” have been included as the opening words of subparagraph (c) of the revised draft for continuation of discussion at a future session (A/CN.9/523, para. 70). At the thirty-seventh session of the Working Group, some support was expressed for this suggestion but it was pointed out that such wording was generally inappropriate in a legislative text and, in many countries, the effect of the subparagraph would not be to dispel a doubt but to create jurisdiction for the arbitral tribunal beyond the confines of the jurisdiction conferred upon the arbitral tribunal by the parties in the arbitration agreement (A/CN.9/523, para. 70). The view was expressed that, in formulating a provision extending the jurisdiction of the arbitral tribunal in connection with interim measures of protection ordered on an ex parte basis, the Working Group should avoid suggesting that such a provision should be interpreted a contrario in the context of those interim measures that were ordered inter partes (A/CN.9/523, para. 71).

#### *Subparagraph (d)*

35. Paragraph (7) (d) of the revised draft (formerly paragraph 4 (c) of the United States proposal) has been redrafted taking account of comments and suggestions set out in paragraphs 74-75 of A/CN.9/523. This redrafting includes reversing the order of subparagraphs (b) and (c) of paragraph (4) of the United States proposal as requested by the Working Group (A/CN.9/523, para. 73). It should be noted that paragraph 7 (d) refers to “an opportunity” for the responding party to be heard either “as soon as it is no longer necessary to proceed on an ex parte basis in order to ensure that the measure is effective” or “within forty-eight hours of the notice, or on such other date and time as is appropriate in the circumstances”. The first option provides some flexibility. However, if the Working Group prefers the second option, it should be noted that it will

then be necessary to revert back to the question when notice should be given. As currently drafted, paragraph (7) (d) applies only to ex parte measures. However, at the thirty-seventh session of the Working Group, it was suggested that future consideration should be given to determining whether this paragraph should apply only in the context of the interim measures ordered on an ex parte basis or more generally to all interim measures (A/CN.9/523, para. 75).

*Subparagraph (e)*

36. The text of paragraph (7) (e) of the revised draft (formerly paragraph (4) (b) of the United States proposal) has been redrafted taking account of the discussion of the Working Group at its thirty-seventh session (A/CN.9/523, para. 73). Paragraph (7) (e) provides that an interim measure of protection shall be effective for no more than twenty days and provides two options for determining the commencement of this twenty-day period. At the thirty-seventh session of the Working Group, concerns were expressed about the inclusion of a blanket period of effectiveness of an interim measure, such as twenty days (A/CN.9/523, paras. 20, 25 and 73). Concern was expressed that, as drafted, the paragraph did not meet its purpose of providing a rebalancing of the arbitral procedure following the granting of an ex parte measure by giving the responding party an opportunity to be heard and having that measure reviewed as soon as possible. It was stated that the objective of restoring the balance of the arbitral procedure was dealt with under paragraph (4) (c) of the United States proposal (paragraph (7) (d) of the revised draft) which gave the responding party an opportunity to be heard (A/CN.9/523, para. 73). The Working Group may wish to consider whether the text as currently drafted meets these concerns. The Working Group should note that the words "This subparagraph shall not affect the authority of the arbitral tribunal to grant, confirm, extend or modify an interim measure of protection under paragraph (1) after the party against whom the measure is directed has been given notice and an opportunity to be heard" differ from the text that appeared in paragraph (7) at the secretariat proposal, which provided "A measure

granted under paragraph (5) may be extended or modified after the party to whom it is directed has been given notice and an opportunity to respond". It should be noted that, whilst the secretariat proposal was directed at extending or modifying the ex parte interim measure after the responding party had been heard, the current text refers to interim measures in general and includes granting or confirming either the ex parte interim measure or a new interim measure altogether.

*Subparagraph (f)*

37. In respect of paragraph (7) (f) of the revised draft (formerly paragraph (4) (d) of the United States proposal), it was suggested that a further redraft of the provision should establish a clear link between the obligation to disclose a change in circumstances and the liability regime applicable to the party requesting the interim measure (A/CN.9/523, paras. 49 and 76). The Working Group may wish to consider further this suggestion.

38. The Working Group should note that paragraph (7) (f) provides a similar obligation to that imposed under paragraph (6), although paragraph (7) (f) appears to impose a slightly broader obligation to inform. At the thirty-seventh session of the Working Group, it was suggested that, if maintained, the text contained in paragraph (7) (f) should provide a time limit within which the party requesting the interim measure should disclose a change in circumstances to the arbitral tribunal. As noted above (para. 24), the Working Group may consider whether an express sanction should be included for the breach of paragraph (6). If the Working Group does decide to include such a sanction, it will be also necessary to decide if the duty to disclose under paragraph (6) should apply to both inter partes and ex parte measures or, if paragraph (7) (f) should be maintained, a separate sanction should be provided where it is breached. It is submitted that the result expected from paragraph (7) (f) (namely to impose a strict obligation to inform upon the party requesting an ex parte measure) is already achieved by the application of paragraph (6) and that duplication of this obligation would affect the readability and internal logic of the text.

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