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**United Nations Commission on  
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**Draft text on a simplified insolvency regime****Note by the Secretariat**

## Contents

	<i>Page</i>
I. Introduction . . . . .	2
II. Draft glossary . . . . .	2
III. Draft recommendations on a simplified insolvency regime . . . . .	4
IV. Draft commentary . . . . .	31



## I. Introduction

1. The background to the project of the Working Group on insolvency of micro and small enterprises (MSEs) may be found in the provisional agenda of the fifty-seventh session of the Working Group ([A/CN.9/WG.V/WP.169/Rev.1](#)). This note was prepared pursuant to the request of the Working Group at its fifty-sixth session to the secretariat to prepare a revised text on a simplified insolvency regime for consideration by the Working Group at its fifty-seventh session ([A/CN.9/1006](#), para. 11).

2. The original note ([A/CN.9/WG.V/WP.170](#)), which was expected to be considered by the Working Group at its fifty-seventh session, scheduled to be held from 11 to 15 May 2020 but postponed due to the measures put in place by States and the United Nations to contain the spread of the coronavirus disease (COVID-19) pandemic, reflected the deliberations at the fifty-sixth session of the Working Group and results of the informal consultations held on 16, 23, 30 and 31 January and 6 February 2020 in preparation for the May 2020 session. The current draft builds on that version, reflecting also the results of the informal consultations on document [A/CN.9/WG.V/WP.170](#) held by the Working Group from 11 to 15 May 2020 and on 3 and 4 September 2020 as well as written communications received from States and organizations on document [A/CN.9/WG.V/WP.170](#) subsequent to those consultations (see annotations in bold in the footnotes; non-substantive changes in the commentary were not annotated).

## II. Draft glossary

3. The Working Group may wish to consider the following proposed explanations of certain expressions that appear frequently in the draft recommendations and commentary but not found in the glossary of the UNCITRAL Legislative Guide on Insolvency Law (the “Guide”):

(a) “Competent authority”: an administrative or judicial authority that is responsible for conduct and/or oversight of simplified insolvency proceedings[. The competent authority may appoint one or more persons, including independent professionals, to assist it in the performance of its functions];<sup>1</sup>

(b) “Independent professional(s)”: an individual or entity of appropriate qualifications, independent from the debtor, creditors and other parties in interest, appointed by the competent authority to perform one or more tasks related to a simplified insolvency proceeding, subject to appropriate clearances as regards ethical, professional and other requirements and the absence of conflicts of interest. In the performance of any tasks assigned to it by the competent authority, the independent professional(s) remains accountable to the competent authority and is expected to adhere to any applicable instructions or guidance that may be issued by the competent authority with respect to a task assigned to the independent professional;<sup>2</sup>

*Option 1 for subparagraphs (c) to (f) [as in A/CN.9/WG.V/WP.170]*

(c) “Individual entrepreneurs”: natural persons exercising a trade, business, craft or profession in the form of a sole proprietorship or self-employed activity or as

<sup>1</sup> Revised further to the changes agreed to be made during the May 2020 informal consultations. In particular, the adjective “administrative” was put before “judicial” and the conjunction “and/or” was included although it was noted that it was not UNCITRAL practice to use that conjunction in its texts. Different views were expressed on the appropriateness of including the second sentence in the definition. Views also differed on whether the definition should be supplemented by a list of functions that can be delegated by the competent authority to independent professionals and a list of functions that cannot be so delegated. See subsequently proposed draft recommendations 5 bis and 5 ter below.

<sup>2</sup> During the May 2020 informal consultations, the view was expressed that the second sentence should be removed from the definition and put in the commentary. No support was expressed for that view.

a founder, owner or member of unlimited liability MSEs. For avoidance of doubt, the term intends to encompass business income earners as opposed to wage earners (i.e., employees);

(d) “Unlimited liability MSEs”: micro and small-sized enterprises with or without separate legal personality and without limited liability protection of their founders, owners or members (e.g., proprietorships, partnerships and other unlimited liability entities);

(e) “Limited liability MSEs”: micro and small-sized enterprises with or without separate legal personality and with limited liability of their founders, owners or members;

(f) “MSEs”: individual entrepreneurs, unlimited liability MSEs and limited liability MSEs referred to collectively in this [text];<sup>3</sup>

*Option 2 for subparagraphs (c) to (f)*<sup>4</sup>

(c) “MSEs”: micro and small-sized enterprises in any legal form, including individual entrepreneurs and unincorporated or incorporated, limited or unlimited liability entities, qualified as micro and small-sized enterprises under their domestic law;<sup>5</sup>

(i) “Individual entrepreneurs”: natural persons exercising a trade, business, craft or profession in the form of a sole proprietorship or self-employed activity or as a founder, owner or member of [unlimited/limited liability]<sup>6</sup> MSEs if qualified as individual entrepreneurs under domestic law. For avoidance of doubt, the term intends to encompass business income earners as opposed to wage earners (i.e., employees);

(ii) [“Unlimited liability MSEs”: micro and small-sized enterprises with or without separate legal personality and without limited liability protection of their founders, owners or members (e.g., proprietorships, partnerships and other unlimited liability entities);

(iii) “Limited liability MSEs”: micro and small-sized enterprises with or without separate legal personality and with limited liability of their founders, owners or members;]<sup>7</sup>

(d) “MSE debtor”: an MSE with respect to which simplified insolvency proceedings have been commenced or initiated. The term “debtor” used in this [text] intends to convey the same meaning unless the specific context suggests otherwise;

<sup>3</sup> It is left to policymakers of each State to define persons (natural and legal) that would qualify as MSEs under their domestic law. In that context, States may wish to take into account the UNCITRAL Legislative Guide on [simplified corporate structure for MSMEs]. [*The final title of the cross-referred text is to be inserted in due course*].

<sup>4</sup> Suggested further to the comments made during the May 2020 informal consultations.

<sup>5</sup> The definition may be accompanied by a footnote explaining that: “It is left to policymakers of each State to identify parameters that persons must fulfil in order to qualify as MSEs under their domestic law. In that context, States may wish to take into account the UNCITRAL Legislative Guide on [simplified corporate structure for MSMEs]. [*The final title of the cross-referred text is to be inserted in due course*].”

<sup>6</sup> During the May 2020 informal consultations, reference to only unlimited liability MSEs in that context was questioned. Different views were expressed on whether reference should be made also to limited liability MSEs. In the light of the addition of the phrase “if qualified as individual entrepreneurs under domestic law” in that definition, the Working Group may wish to consider deleting the words in square brackets.

<sup>7</sup> During the May 2020 informal consultations, different views were expressed on the need to retain the definitions “Unlimited liability MSEs” and “Limited liability MSEs”. Including them was considered desirable in the light of draft recommendations 74 and 75 and the definition of “Individual entrepreneurs” (unless it is amended by deleting reference to [unlimited/limited liability]). See also draft recommendation 2 (option 1) where both terms are used.

(h) “Simplified insolvency proceedings”: include both simplified reorganization and simplified liquidation proceedings.<sup>8</sup>

### III. Draft recommendations on a simplified insolvency regime

4. The Working Group may wish to consider the following draft recommendations (the cross-referred recommendations of the Guide address the same or similar issue):

#### A. Key objectives of a simplified insolvency regime

1. States should provide for a simplified insolvency regime and for that purpose consider the following key objectives:

(a) Putting in place expeditious, simple, flexible and low-cost insolvency proceedings (henceforth referred to as “simplified insolvency proceedings”);

(b) Making simplified insolvency proceedings easily available and accessible to MSEs;

(c) Promoting the MSE debtor’s fresh start by enabling expedient liquidation of non-viable MSEs and reorganization of viable MSEs through simplified insolvency proceedings;

(d) Ensuring protection of persons affected by simplified insolvency proceedings (henceforth referred to as “parties in interest”<sup>9</sup>) throughout simplified insolvency proceedings;

(e) Providing for effective measures to facilitate creditor participation and address creditor disengagement in simplified insolvency proceedings;

(f) Implementing an effective sanctions regime to prevent abuse or improper use of the simplified insolvency regime and to impose appropriate penalties for misconduct; and

(g) Addressing concerns over stigmatization because of insolvency.

Those objectives are in addition to the objectives of an effective insolvency law as set out in recommendations 1–5 of the UNCITRAL Legislative Guide on Insolvency Law (the “Guide”), such as the provision of certainty in the market to promote economic stability and growth, maximization of value of assets, preservation of the insolvency estate to allow equitable distribution to creditors, equitable treatment of similarly situated creditors, ensuring transparency and predictability, recognition of existing creditor rights and establishment of clear rules for ranking of priority.

#### B. Scope of a simplified insolvency regime

##### Application to all MSEs

*Option 1 [as in A/CN.9/WG.V/WP.170]*

2. States should ensure that a simplified insolvency regime applies to all MSEs, but may provide for different treatment of individual entrepreneurs, unlimited liability MSEs and limited liability MSEs. (*See recommendation 8 of the Guide.*)

<sup>8</sup> Revised further to the changes agreed to be made during the May 2020 informal consultations, in particular by mentioning “simplified reorganization” first.

<sup>9</sup> Defined in (dd) of the glossary in the introduction to the Guide as “any party whose rights, obligations or interests are affected by insolvency proceedings or particular matters in the insolvency proceedings, including the debtor, the insolvency representative, a creditor, an equity holder, a creditor committee, a government authority or any other person so affected. It is not intended that persons with remote or diffuse interests affected by the insolvency proceedings would be considered to be a party in interest.”

*Option 2*<sup>10</sup>

2. States should ensure that a simplified insolvency regime applies to all MSEs. Aspects of the regime may differ depending on the type of MSE. (*See recommendation 8 of the Guide.*)

**Comprehensive treatment of all debts of individual entrepreneurs**

3. States should ensure that all debts of an individual entrepreneur are addressed in a single simplified insolvency proceeding unless the State decides to subject some debts of individual entrepreneurs to other insolvency regimes, in which case procedural consolidation or coordination of linked insolvency proceedings should be ensured.

**Types of simplified insolvency proceedings**

4. States should ensure that a simplified insolvency regime provides for simplified liquidation and simplified reorganization. (*See recommendation 2 of the Guide.*)

**C. Institutional framework****Competent authority**

5. The insolvency law providing for a simplified insolvency regime should:

(a) Clearly indicate the competent authority; (*See recommendation 13 of the Guide.*)

(b) Specify the functions of the competent authority [and any independent professional used in the administration of simplified insolvency];<sup>11</sup> and

(c) Specify mechanisms for review of the competent authority's decisions.

[5 bis. Some of the functions of the competent authority may include, by way of example:

(a) Verification of eligibility requirements for commencement of a simplified insolvency proceeding;

(b) Verification of accuracy of information provided to the competent authority by the debtor, creditors and other parties in interest, including as regards the debtor's assets, liabilities and recent transactions;

(c) Resolution of disputes concerning the type of proceeding to commence;

(d) Conversion of one proceeding to another;

(e) Exercise of control over the insolvency estate;

(f) Verification and review of the reorganization plan and the liquidation procedures for compliance with law;

(g) Supervision of the implementation of a debt repayment or reorganization plan and verification of the implementation of the plan;

<sup>10</sup> Option 2 was proposed during the May 2020 informal consultations in the light of the new definition of MSEs (see option 2 for subparagraphs (c) to (f) of that definition above). The view was also expressed at that time that the old wording might suggest that different types of MSEs could be subjected to discriminatory treatment.

<sup>11</sup> The addition of the words in square brackets was proposed during the May 2020 informal consultations. Views differed about the desirability of including them and also generally on whether section C (Institutional framework) should contain any specific mention of, or a separate recommendation on, an independent professional.

(h) Decisions related to the stay of proceedings, relief from the stay, creditors' objections or opposition, disputes and approval or confirmation of a liquidation [schedule] [report]<sup>12</sup> or reorganization plan; and

(i) Oversight of the parties' compliance with their obligations under the simplified insolvency regime.]<sup>13</sup>

[5 ter. If using an independent professional in the administration of a simplified insolvency regime, the insolvency law providing for a simplified insolvency regime should allocate the functions of the competent authority, such as those illustrated in recommendation [5 bis], between the competent authority and the independent professional. That law may provide for such allocation to be determined by the competent authority itself.]<sup>14</sup>

#### **Support with the use of a simplified insolvency regime**

6. The insolvency law providing for a simplified insolvency regime should specify measures to make assistance and support with the use of a simplified insolvency regime readily available and easily accessible. Such measures may include services of an independent professional;<sup>15</sup> templates, schedules and standard forms; and an enabling framework for the use of electronic means where information and communications technology of the State so permits and in accordance with other applicable law of that State.<sup>16</sup>

#### **Mechanisms for covering costs of administering simplified insolvency proceedings**

7. The insolvency law providing for a simplified insolvency regime should specify mechanisms for covering the costs of administering simplified insolvency proceedings where assets and sources of revenue of the debtor are insufficient to meet those costs. (*See recommendation 26 of the Guide.*)

### **D. Main features of a simplified insolvency regime**

#### **Default procedures and treatment**

8. The insolvency law providing for a simplified insolvency regime should specify default procedures and treatment that apply unless any party in interest objects or intervenes with a request for a different procedure or treatment or other circumstances exist that justify a different procedure or treatment.

#### **Short time periods**

9. The insolvency law providing for a simplified insolvency regime should specify short time periods for all procedural steps in simplified insolvency proceedings, narrow grounds for their extension and the maximum number, if any, of permitted extensions.

<sup>12</sup> During the May 2020 informal consultations, views differed on whether any reference to the liquidation schedule, report, plan or another document of this kind should be made in the text and, if so, which term should be used.

<sup>13</sup> Draft recommendation 5 bis was proposed during the May 2020 informal consultations. Support was expressed for adding a recommendation that would illustrate functions of the competent authority.

<sup>14</sup> Draft recommendation 5 ter was proposed during the May 2020 informal consultations. Views differed about the desirability of including it and also generally on whether section C (Institutional framework) should contain any specific mention of, or a separate recommendation on, an independent professional.

<sup>15</sup> During the May 2020 informal consultations, no support was expressed for deleting reference to "services of an independent professional" in this provision.

<sup>16</sup> During the May 2020 informal consultations, it was suggested to delete the phrase "where information and communications technology of the State so permits and in accordance with other applicable law of that State". It was explained that a similar qualifier appeared in other UNCITRAL texts. For further information, see para. 49 bis of the draft commentary.

**Reduced formalities [and ensuring cost-effectiveness]<sup>17</sup>**

10. The insolvency law providing for a simplified insolvency regime should reduce formalities [and ensure cost-effectiveness] for all procedural steps in simplified insolvency proceedings, including for submission of claims, for obtaining approvals and for serving notices and notifications.

**Debtor-in-possession***Option 1 [as in A/CN.9/WG.V/WP.170]*

11. The insolvency law providing for a simplified insolvency regime should specify that the debtor continues to operate the business during a simplified [insolvency] [reorganization] proceeding with appropriate control and assistance of the competent authority. It should require the competent authority to clearly specify the rights and obligations of the debtor-in-possession, in particular as regards the use and disposal of assets,<sup>18</sup> post-commencement finance<sup>19</sup> and treatment of contracts.<sup>20</sup> It should also clearly set out circumstances requiring limited or total displacement of the debtor-in-possession. (See recommendations 112 and 113 of the Guide.)

*Option 2<sup>21</sup>*

11. The insolvency law providing for a simplified insolvency regime should specify that the debtor continues to remain in control of its assets and the day-to-day operation of its business during a simplified reorganization proceeding<sup>22</sup> with appropriate control and assistance of the competent authority. Circumstances justifying limited or total displacement of the debtor-in-possession in simplified reorganization should be clearly set out in the law and be assessed by the competent authority on a case-by-case basis. The law should clearly identify persons who may displace totally or partially the debtor-in-possession in simplified reorganization.<sup>23</sup> (See recommendations 112 and 113 of the Guide.)

11 bis. The insolvency law providing for a simplified insolvency regime may specify circumstances under which the competent authority may allow the debtor's involvement in the liquidation of the insolvency estate and the extent of such involvement.<sup>24</sup>

11 ter. The insolvency law providing for a simplified insolvency regime should clearly specify the rights and obligations of the debtor-in-possession, in particular as regards

<sup>17</sup> The words in square brackets were added by the secretariat further to the comments made during the informal consultations in May 2020 that the need to ensure cost-effectiveness of procedures should be emphasized in the text. Those comments were made in the context of procedures for serving notices and notifications but the Working Group may wish to consider that the consideration of cost-effectiveness is generally applicable to all stages of simplified insolvency proceedings.

<sup>18</sup> See recommendations 52–62 of the Guide that will be applicable mutatis mutandis in a simplified insolvency regime. References to the insolvency representative in those recommendations should be read as references to the debtor-in-possession unless limited or total displacement of the debtor from the operation of the business takes place.

<sup>19</sup> Id., but with reference to recommendations 63–68 of the Guide.

<sup>20</sup> Id., but with reference to recommendations 69–86 and 100–107 of the Guide.

<sup>21</sup> Option 2 for draft recommendation 11, and draft recommendations 11 bis and 11 ter were included by the secretariat in response to the comments made during the May 2020 informal consultations on draft recommendation 11 contained in document A/CN.9/WG.V/WP.170.

<sup>22</sup> During the May 2020 informal consultations, it was agreed that debtor-in-possession would be the default only in simplified reorganization proceedings.

<sup>23</sup> During the May 2020 informal consultations, it was suggested to specify by whom the debtor could be displaced (e.g., an independent professional) in simplified reorganization.

<sup>24</sup> During the informal consultations in May 2020, it was agreed that the text should envisage that the debtor might be involved in the liquidation of the insolvency estate to some extent in some cases, although this would not be the norm.

the use and disposal of assets,<sup>25</sup> post-commencement finance<sup>26</sup> and treatment of contracts,<sup>27</sup> and allow the competent authority to specify them on a case-by-case basis.<sup>28</sup>

### **Deemed approval**

12. The insolvency law providing for a simplified insolvency regime should specify the matters which require approval of creditors and establish the relevant approval requirements. (*See recommendation 127 of the Guide.*) It should also specify that approvals on those matters are deemed to be obtained where:

(a) Those matters have been notified by the competent authority to relevant creditors in accordance with procedures and time periods established for such purpose in the insolvency law providing for a simplified insolvency regime or by the competent authority; and

(b) Neither objection nor sufficient opposition as regards those matters is communicated to the competent authority in accordance with procedures and time periods established for such purpose in the insolvency law providing for a simplified insolvency regime or by the competent authority.<sup>29</sup>

## **E. Participants**

### **Rights and obligations of parties in interest**

13. The insolvency law providing for a simplified insolvency regime should specify rights and obligations of the MSE debtor, of the creditors and of other parties in interest, including:

(a) The right to be heard and request review on any issue in the simplified insolvency proceedings that affects their rights, obligations or interests; (*See recommendations 137 and 138 of the Guide.*)

(b) The right to participate in the simplified insolvency proceedings and to obtain information relating to the proceeding from the competent authority subject to appropriate protection of information that is commercially sensitive, confidential or private; (*See recommendations 108, 111 and 126 of the Guide.*)

(c) Where the debtor is an individual entrepreneur, the right of the debtor to retain the assets excluded from the insolvency estate by law. (*See recommendation 109 of the Guide.*)

<sup>25</sup> See recommendations 52–62 of the Guide that will be applicable mutatis mutandis in a simplified insolvency regime. References to the insolvency representative in those recommendations should be read as references to the debtor-in-possession unless limited or total displacement of the debtor from the operation of the business takes place.

<sup>26</sup> *Idem*, but with reference to recommendations 63–68 of the Guide.

<sup>27</sup> *Idem*, but with reference to recommendations 69–86 and 100–107 of the Guide.

<sup>28</sup> **During the May 2020 informal consultations it was agreed to convey in the text the point that the insolvency law itself, not the competent authority, will specify the rights and obligations of the debtor-in-possession although the competent authority may specify those rights and obligations on a case-by-case basis.**

<sup>29</sup> **During the May 2020 informal consultations, concerns were expressed about introducing the concept of “deemed approval” in the text since such simplified way of decision-taking was considered undermining creditors’ rights, including their right to vote. Those concerns were not widely shared and no support was expressed for changing the provision, including by replacing the word “should” with the word “may” in the second sentence of the chapeau provisions. It was agreed to consider concerns raised in relation to the terms “objection” and “sufficient opposition” in the context of draft recommendations 57 and 58 (see annotations to draft recommendation 57 for the comments made on that subject during the September 2020 informal consultations).**

**Obligations of the debtor**

14. The insolvency law providing for a simplified insolvency regime should specify the obligations of the MSE debtor that should arise on the commencement of, and continue throughout, the proceedings. The obligations should include the following:

(a) To cooperate with and assist the competent authority to perform its functions, including where applicable to take effective control of the estate, wherever located, and of business records, and to facilitate or cooperate in the recovery of the assets;

*Option 1 [as in A/CN.9/WG.V/WP.170]*

(b) To provide accurate, reliable and complete information relating to its financial position and business affairs, subject to allowing the debtor the time necessary to collect the relevant information, with the assistance of the competent authority [or an independent professional] where required, and subject to appropriate protection of commercially sensitive, confidential and private information;

*Option 2<sup>30</sup>*

(b) To provide accurate, reliable and complete information relating to its financial position and business affairs, subject to allowing the debtor the time necessary to collect the relevant information, with the assistance of the competent authority where required [including an independent professional where appointed,] and subject to appropriate protection of commercially sensitive, confidential and private information.

*Option 3<sup>31</sup>*

(b) To provide accurate, reliable and complete information relating to its financial position and business affairs, subject to allowing the debtor the time necessary to collect the relevant information, and subject to appropriate protection of commercially sensitive, confidential and private information;

(c) To provide notice of the change of a habitual place of residence or place of business;

(d) To adhere to the terms of the liquidation [schedule] [report] or reorganization plan; and

(e) In the day-to-day operation of the business, to have otherwise due regard to the interests of creditors and other parties in interest.<sup>32</sup>

*(See recommendations 110 and 111 of the Guide.)*

**F. Eligibility, application and commencement****Eligibility**

15. The insolvency law providing for a simplified insolvency regime should establish the criteria that debtors must meet in order to be eligible for simplified insolvency proceedings, minimizing the number of such criteria, and specify under what conditions creditors of the eligible debtors may also apply for commencement of simplified insolvency proceedings with respect to those debtors.

<sup>30</sup> Option 2 was proposed during the May 2020 informal consultations.

<sup>31</sup> Option 3 was considered during the May 2020 informal consultations in writing and was communicated to the UNCITRAL secretariat by email.

<sup>32</sup> During the May 2020 informal consultations, it was agreed to retain reference to “other parties in interest” in this provision.

**Commencement procedures**

16. The insolvency law providing for a simplified insolvency regime should:

- (a) Establish transparent, certain and simple criteria and procedures for commencement of simplified insolvency proceedings;
- (b) Enable applications for simplified insolvency proceedings to be made and dealt with in a speedy, efficient and cost-effective manner; and
- (c) Establish safeguards to protect both debtors and creditors from improper use of the application procedure.

**Commencement on debtor application***Application*

17. The insolvency law providing for a simplified insolvency regime should allow eligible debtors to apply for commencement of a simplified insolvency proceeding at an early stage of financial distress without the need to prove insolvency. (*See recommendation 18 of the Guide.*)

*Information to be included in the application*

18. The insolvency law providing for a simplified insolvency regime should specify information that the debtor must include in its application for commencement of a simplified insolvency proceeding, keeping the disclosure obligation at the stage of application to the minimum. It should require that information to be accurate, reliable and complete.<sup>33</sup>

*Effective date of commencement*

19. The insolvency law providing for a simplified insolvency regime should specify that where the application for commencement is made by the debtor:

- (a) The application for commencement will automatically commence a simplified insolvency proceeding; or
- (b) The competent authority will promptly determine its jurisdiction and whether the debtor is eligible and, if so, commence a simplified insolvency proceeding.

(*See recommendation 18 of the Guide.*)

**Commencement on creditor application**

20. The insolvency law providing for a simplified insolvency regime should specify that a simplified insolvency proceeding may be commenced on the application of a creditor of a debtor which is eligible for simplified insolvency proceedings, provided that:

- (a) Notice of application is promptly given to the debtor;
- (b) The debtor is given the opportunity to respond to the application, by contesting the application, consenting to the application or requesting the conversion of the proceeding applied for by the creditor to a different type of proceeding; and
- (c) A simplified insolvency proceeding of the type to be determined by the competent authority commences without agreement of the debtor only after it is established that the debtor is insolvent.<sup>34</sup>

<sup>33</sup> During the May 2020 informal consultations, no support was expressed for amending this draft recommendation by adding references to templates and standard forms for application and to consequences of presenting an incomplete application.

<sup>34</sup> During the May 2020 informal consultations, a suggestion was made to insert in the draft recommendation and the accompanying commentary a cross reference to recommendation 17 of the Guide, *Presumption that the debtor is unable to pay*, reading: “The insolvency law may establish a presumption that, if the debtor fails to pay one or more of its mature debts, and the whole of the debt is not subject to a legitimate dispute or offset in an amount equal to or greater

(See recommendation 19 of the Guide.)

### **Denial of application**

21. The insolvency law providing for a simplified insolvency regime should specify that, where the decision to commence a simplified insolvency proceeding is to be made by the competent authority, the competent authority should deny the application if it finds that it does not have jurisdiction or the applicant is ineligible or the application is an improper use of a simplified insolvency regime. (See recommendation 20 of the Guide.)

### **Notice of commencement of proceedings<sup>35</sup>**

21 bis. The insolvency law providing for a simplified insolvency regime should require that:

(a) The competent authority should serve the notice of the commencement of the simplified insolvency proceeding using the means appropriate to ensure that the information is likely to come to the attention of parties in interest; and

(b) The debtor, all known creditors<sup>36</sup> and other known parties in interest, [including employees,]<sup>37</sup> should be individually notified by the competent authority of the commencement of the simplified insolvency proceeding unless the competent authority considers that, under the circumstances, some other form of notice would be more appropriate. (See recommendations 23 and 24 of the Guide.)

### **Content of the notice of commencement of a simplified insolvency proceeding<sup>38</sup>**

21 ter. The insolvency law providing for a simplified insolvency regime should specify that the notice of commencement of a simplified insolvency proceeding is to include:

(a) The effective date of the commencement of the simplified insolvency proceeding;

(b) Information concerning the application of the stay and its effects;

(c) Information concerning submission of claims or that the list of claims prepared by the debtor will be used for verification;

(d) Where submission of claims by creditors is required, the procedures and time period for submission and proof of claims and the consequences of failure to do so (see recommendation [36] below);

than the amount of the debt claimed, the debtor is generally unable to pay its debts.” That recommendation 17 is accompanied by a footnote reading: “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. 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 offset; 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.” That suggestion was not discussed. The Working Group may wish to formulate its position on that suggestion.

<sup>35</sup> During the May 2020 informal consultations, concerns were expressed about changing the location of the provision on notice of the commencement of simplified insolvency proceedings. The current location matches the location of a similar provision in the Guide.

<sup>36</sup> In its communication to the secretariat dated 3 July 2020, Côte d’Ivoire suggested that notification of the commencement of the proceeding should be sent to all potential creditors.

<sup>37</sup> The words in square brackets were added by the secretariat further to the concern expressed during the May 2020 informal consultations that the text was silent about rights of employees.

<sup>38</sup> During the May 2020 informal consultations, concerns were expressed about changing the location of the provision on the content of the notice of the commencement of a simplified insolvency proceeding. The current location matches the location of a similar provision in the Guide.

(e) Time period for expressing objection to the commencement of a simplified insolvency proceeding.

(See recommendation 25 of the Guide.)

### **Creditor objection to the commencement of a simplified insolvency proceeding**

22. The insolvency law providing for a simplified insolvency regime should specify that creditors may object to the commencement of a simplified insolvency proceeding or a particular type thereof or to the commencement of any insolvency proceeding with respect to the debtor, provided they do so within the time period established in the insolvency law as notified to them by the competent authority in the notice of the commencement of the simplified insolvency proceeding (see recommendations [21 bis and 21 ter above]).<sup>39</sup>

### **No effect of the commenced proceeding on unnotified creditors**

[23. The insolvency law providing for a simplified insolvency regime [should] [could] specify that claims of creditors not notified of the commencement of the simplified insolvency proceeding and having not joined the proceeding are unaffected by the simplified insolvency proceeding and excluded from any discharge that may result from that proceeding.]<sup>40</sup>

### **Dismissal of a simplified insolvency proceeding after its commencement**

24. The insolvency law providing for a simplified insolvency regime should permit the competent authority to dismiss the proceeding if, after its commencement, the competent authority determines, for example, that:

- (a) The proceeding constituted an improper use of the simplified insolvency regime; or
- (b) The applicant was ineligible.

The insolvency law providing for a simplified insolvency regime should require the competent authority to promptly serve notice of its decision to dismiss the proceeding using the procedure that was used for giving notice of the commencement of the simplified insolvency proceeding. It should allow the competent authority to impose costs or sanctions, where appropriate, against the applicant for commencement of the proceeding. (See recommendations 27–29 of the Guide.)

## **G. Notices and notifications<sup>41</sup>**

### **Procedures for serving notices**

25. The insolvency law providing for a simplified insolvency regime should require the competent authority to serve notices related to simplified insolvency proceedings and use simplified [and cost-effective]<sup>42</sup> procedures for such purpose. (See recommendations 22 and 23 of the Guide.)

<sup>39</sup> During the May 2020 informal consultations, it was agreed to redraft the provision to convey the point that the time period will be established in the law but the requirement to notify the creditors about the time period should nevertheless be retained and the provision should retain flexibility for the competent authority to fix a specific time period within the range established in the law.

<sup>40</sup> During the May 2020 informal consultations, views differed on whether this provision should be retained and, if it were to be retained, whether the word “should” in the opening part of the sentence should be replaced with the word “could”.

<sup>41</sup> During the May 2020 informal consultations, support was expressed for including in the text provisions on notices and notifications other than those that are served in the context of the commencement of the proceedings, which are addressed in draft recommendations 21 bis and 21 ter (removed from this section). The title of the section has been changed to convey the amended scope of this section.

<sup>42</sup> The words in square brackets were added by the secretariat further to the suggestions made during the May 2020 informal consultations to emphasize the importance of cost-effective measures in the text. See also amendments proposed to draft recommendation 10.

**Individual notification**

26. The insolvency law providing for a simplified insolvency regime should require that the debtor, any known creditor and any other known party in interest should be individually notified by the competent authority of all matters on which their approval is required, unless the competent authority considers that, under the circumstances, some other form of notification would be more appropriate.<sup>43</sup> (*See recommendation 24 of the Guide.*)

**Appropriate means of giving notice**

27. The insolvency law providing for a simplified insolvency regime should specify that the means of giving notice must be appropriate to ensure that the information is likely to come to the attention of parties in interest. (*See recommendation 23 of the Guide.*)<sup>44</sup>

28. [See draft recommendation 21 ter (“Content of the notice of commencement of a simplified insolvency proceeding”) removed from this section.]

**H. Constitution, protection and preservation of the insolvency estate****Constitution of the insolvency estate**

29. The insolvency law providing for a simplified insolvency regime should identify:

(a) Assets that will constitute the insolvency estate, including assets of the debtor, assets acquired after commencement of the simplified insolvency proceeding and assets recovered through avoidance<sup>45</sup> or other actions; (*See recommendation 35 of the Guide.*)

(b) Where the MSE debtor is an individual entrepreneur, assets excluded from the estate that the MSE debtor is entitled to retain (see recommendation [13 (c)] above). (*See recommendations 38 and 109 of the Guide.*)

**Date from which the insolvency estate is to be constituted**

30. The insolvency law providing for a simplified insolvency regime should specify the effective date of commencement of a simplified insolvency proceeding as the date from which the estate is to be constituted. (*See recommendation 37 of the Guide.*)

**Avoidance in simplified insolvency proceedings**

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

<sup>43</sup> Reference to the notification of the commencement of the insolvency proceeding was removed from this provision in the light of draft recommendation 21 bis.

<sup>44</sup> *Idem.* In addition, the provision and its heading were revised in response to concerns expressed during the May 2020 informal consultations that the wording of the draft recommendation did not allow for sufficient flexibility with respect to issuance of public notices.

<sup>45</sup> “Avoidance provisions” are defined in (c) of the glossary in the introduction to the Guide as “provisions of the insolvency law that permit transactions for the transfer of assets or the undertaking of obligations prior to insolvency proceedings to be cancelled or otherwise rendered ineffective and any assets transferred, or their value, to be recovered in the collective interest of creditors”.

**Stay of proceedings<sup>46</sup>***Scope and duration of the stay*

32. The insolvency law providing for a simplified insolvency regime should specify that the stay of proceedings applies on commencement and throughout simplified insolvency proceedings unless it is lifted or suspended by the competent authority on its own motion or upon request of any party in interest or unless the relief from the stay is granted by the competent authority upon request of any party in interest. Any exceptions to the application of the stay should be clearly stated in the law. (See recommendations 46, 47, 49 and 51 of the Guide.)

*Rights not affected by the stay*

33. The insolvency law providing for a simplified insolvency regime should specify that the stay does not affect:

- (a) The right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor;
- (b) The right of a secured creditor, upon application to the competent authority,<sup>47</sup> to protection of the value of the asset(s) in which it has a security interest;
- (c) The right of a third party, upon application to the competent authority, to protection of the value of its asset(s) in the possession of the debtor; and
- (d) The right of any party in interest to request the competent authority to grant relief from the stay. (See recommendations 47, 51 and 54 of the Guide).

**I. Treatment of creditor claims<sup>48</sup>****Claims affected by simplified insolvency proceedings**

34. The insolvency law providing for a simplified insolvency regime should specify claims that will be affected by simplified insolvency proceedings, which should include claims of secured creditors, and claims that will not be affected by simplified insolvency proceedings. (See recommendations 171 and 172 of the Guide.)

**Procedures with respect to the list of creditors and claims prepared by the debtor***Option 1 [as in A/CN.9/WG.V/WP.170]*

35. The insolvency law providing for a simplified insolvency regime should require the debtor to prepare the list of creditors and claims, with the assistance of the competent authority where necessary, unless the competent authority decides to

<sup>46</sup> Defined in (rr) of the glossary in the introduction to the Guide as “a measure that prevents the commencement, or suspends the continuation, of judicial, administrative or other individual actions concerning the debtor’s assets, rights, obligations or liabilities, including actions to make security interests effective against third parties or to enforce a 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”.

<sup>47</sup> The phrase “upon application to the competent authority” was added in both subparagraphs (b) and (c) to align the provisions with recommendation 50 of the Guide, further to the comments made during the May 2020 informal consultations.

<sup>48</sup> During the May 2020 informal consultations, support was expressed for reconsidering the placement of this section in the text. A point was made that the section could be placed after the sections on simplified liquidation and simplified reorganization, which would correspond to the placement of a similar section in the Guide. At the same time, the circularity problem was noted. For example, under draft recommendation 39 on the effect of admission of claims, creditors are ineligible to participate in simplified insolvency proceedings until and unless their claims have been admitted. Eligibility of MSEs to enter a simplified insolvency regime may also depend on the amount of admitted claims. Hence, if any doubts or challenges regarding the eligibility of an MSE to enter the simplified insolvency regime are raised, or eligibility of other creditors to participate in the proceeding or terms of their participation are challenged, claims would need to be processed first before other steps in liquidation or reorganization can be taken. The Working Group may wish to formulate its position on those matters.

prepare the list of creditors and claims itself or circumstances of the case justify entrusting the preparation of the list to the independent professional or another person. (*See recommendation 170 of the Guide.*) The insolvency law providing for a simplified insolvency regime should specify that:

(a) The list so prepared should be circulated by the competent authority to all listed creditors for verification, indicating the time period for communicating any objection or concern as regards the list to the competent authority;

(b) In the absence of any objection or concern communicated to the competent authority within the established time period, the claims are deemed to be undisputed and admitted as listed;

(c) In case of objection or concern, the competent authority takes action with respect to disputed claim(s) (see recommendation [38] below).

*Option 2*<sup>49</sup>

35. The insolvency law providing for a simplified insolvency regime should require the debtor to prepare the list of creditors and claims. The insolvency law providing for a simplified insolvency regime should also specify that:

(a) The list so prepared should be circulated by the competent authority to all listed creditors for verification, indicating the time period for communicating any objection or concern as regards the list to the competent authority;

(b) In the absence of any objection or concern communicated to the competent authority or the independent professional as applicable within the established time period, the claims are deemed to be undisputed and admitted as listed;

(c) In case of objection or concern, the competent authority takes action with respect to disputed claim(s) (see recommendation [38] below).

*Option 3*

35. The insolvency law providing for a simplified insolvency regime may require the debtor to prepare the list of creditors and claims, with the assistance of the competent authority or the independent professional where necessary, unless the circumstances justify that the competent authority prepares the list itself with the assistance of the debtor or entrusts the independent professional with that task. (*See recommendation 170 of the Guide.*) The insolvency law providing for a simplified insolvency regime should specify that:

(a) The list so prepared should be circulated by the competent authority to all listed creditors for verification, indicating the time period for communicating any objection or concern as regards the list to the competent authority;

(b) In the absence of any objection or concern communicated to the competent authority or the independent professional as applicable within the established time period, the claims are deemed to be undisputed and admitted as listed;

(c) In case of objection or concern, the competent authority takes action with respect to disputed claim(s) (see recommendation [38] below).

**Submission of claims by creditors**

36. The insolvency law providing for a simplified insolvency regime should allow the competent authority, when circumstances of the case so justify, to require creditors, including secured creditors, [who wish to participate in the simplified insolvency proceeding,]<sup>50</sup> to submit their claims to the competent authority,

<sup>49</sup> Options 2 and 3 were considered during the May 2020 informal consultations in writing and communicated to the UNCITRAL secretariat by email.

<sup>50</sup> During the May 2020 informal consultations, support was expressed for deleting the phrase in square brackets.

specifying the basis and amount of the claim.<sup>51</sup> The insolvency law providing for a simplified insolvency regime should require in such case that:

(a) The procedures and the time period for submission of the claims and consequences of failure to submit a claim in accordance with those procedures and time period should be specified by the competent authority in the notice of commencement of the simplified insolvency proceeding (see recommendation [21 ter] above) or in a separate notice;

(b) [Short] [sufficient] [reasonable]<sup>52</sup> time should be given to creditors to submit their claims;

(c) Formalities associated with submission of claims should be minimized and the use of electronic means for such purpose should be enabled where information and communication technology of the State so permits and in accordance with other applicable law of that State.<sup>53</sup> (*See recommendations 169, 170, 174 and 175 of the Guide.*)

#### **Admission or denial of claims**

37. The insolvency law providing for a simplified insolvency regime should allow the competent authority to: (a) admit or deny any claim, in full or in part; (b) subject claims by related persons<sup>54</sup> to a special scrutiny and treatment, in full or in part; and (c) determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset. Where the claim is to be denied or subjected to a special scrutiny or treatment, the insolvency law providing for a simplified insolvency regime should require the competent authority to serve prompt notice of the reasons for the decision to the creditor, indicating the time period within which the creditor can request review of that decision. (*See recommendations 177, 179 and 181 of the Guide.*)

#### **Treatment of disputed claims**

38. The insolvency law providing for a simplified insolvency regime should<sup>55</sup> permit a party in interest to dispute any claim, either before or after admission, and request review of that claim. The insolvency law providing for a simplified insolvency regime should authorize the competent authority to review a disputed claim and decide on its treatment[, including by ordering disputing parties in interest to exercise their rights at law and allowing the proceeding to continue with respect to undisputed claims].<sup>56</sup> (*See recommendation 180 of the Guide.*)

<sup>51</sup> During the May 2020 informal consultations, concerns were expressed that this provision removed flexibility for those jurisdictions that do not require secured creditors to participate in insolvency proceedings as well as for those jurisdictions that may require secured creditors to only notify the competent authority of their security interests but not to submit claims. No support was expressed for amending this provision to accommodate those options as well as for inserting the phrase “and documentation in support of the claim (or relevant documentation)” in this sentence.

<sup>52</sup> During the May 2020 informal consultations, different views were expressed on a qualifier to be used in this provision. It was noted to the secretariat that interests of foreign creditors should not be overlooked in this context. The Working Group may wish to formulate its position on the matter.

<sup>53</sup> For concerns raised with respect to the phrase “where information and communication technology of the State so permits and in accordance with other applicable law of that State”, see the second footnote to draft recommendation 6.

<sup>54</sup> Defined in (jj) of the glossary in the introduction to the Guide as “as to a debtor that is a legal entity, a related person would include: (i) a person who is or has been in a position of control of the debtor; and (ii) a parent, subsidiary, partner or affiliate of the debtor. As to a debtor that is a natural person, a related person would include persons who are related to the debtor by consanguinity or affinity.”

<sup>55</sup> No support was expressed for the suggestion made during the May 2020 informal consultations to replace the word “should” with the word “may” in this instance.

<sup>56</sup> The text in square brackets was added further to the suggestion made during the May 2020 informal consultations.

**Effects of admission**

39. The insolvency law providing for a simplified insolvency regime should specify the effects of admission of a claim, including entitling the creditor whose claim has been admitted to participate in the simplified insolvency proceeding, to be heard, to participate in a distribution and to be counted according to the amount and class of the claim for determining sufficient opposition and establishing the priority to which the creditor's claim is entitled. (*See recommendation 183 of the Guide.*)

**J. Features of simplified liquidation proceedings****Decision on a procedure to be used**

40. The insolvency law providing for a simplified insolvency regime should require that the competent authority, after commencement of a simplified liquidation proceeding, should promptly determine whether the sale and disposal of the assets of the insolvency estate and distribution of proceeds to creditors will take place in the proceeding:

(a) Where it is determined that the sale and disposal of the assets of the insolvency estate and distribution of proceeds to creditors will take place, the insolvency law providing for a simplified insolvency regime should [require] [envisage where necessary]<sup>57</sup> the preparation and approval of a schedule for realization of assets and distribution of proceeds (referred to in this text as the "liquidation [schedule] [report]"<sup>58</sup>);

(b) Where it is determined that the sale and disposal of the assets of the insolvency estate and distribution of proceeds to creditors will not take place, the insolvency law providing for a simplified insolvency regime should require the competent authority to [take a prompt decision on discharge and]<sup>59</sup> close the simplified liquidation proceeding.

**Procedure involving the sale and disposal of assets and distribution of proceeds**

*Preparation of the liquidation [schedule] [report]*

*Option 1 [as in A/CN.9/WG.V/WP.170]*

41. The insolvency law providing for a simplified insolvency regime should require the debtor to prepare the liquidation schedule,<sup>60</sup> with the assistance of the competent authority where necessary, unless the competent authority decides to prepare it itself or circumstances of the case justify entrusting the preparation of the liquidation schedule to an independent professional or another person.

<sup>57</sup> During the May 2020 informal consultations, views differed on whether any reference to the liquidation schedule, report, plan or another document of this kind should be made in the text and, if so, whether the insolvency law should require the preparation of such document in all cases.

<sup>58</sup> During the May 2020 informal consultations, different terms were suggested for a document that should be prepared in the simplified liquidation proceedings to ensure at least some transparency and the possibility of timely review and challenges by parties in interest.

<sup>59</sup> During the May 2020 informal consultations, it was suggested to replace references to "discharge" in draft recommendations 48 to 50 with references to "the closure of the proceedings" since discharge would be relevant only to natural persons and might precede or follow the closure of proceedings, depending on jurisdictions. In addition, it was noted that section L dealt with discharge and a cross reference to that section would be sufficient.

<sup>60</sup> During the May 2020 informal consultations, concerns were expressed about the suggestion that, as a general rule, the competent authority should request the debtor to prepare the liquidation schedule. It was considered that the competent authority should be allowed to do so only in very exceptional circumstances. The other view was that the text should not suggest that such task can be entrusted to the debtor only in exceptional cases. The secretariat notes a close link with draft recommendation 11 bis.

*Option 2*<sup>61</sup>

41. The insolvency law providing for a simplified insolvency regime should require the competent authority or independent professional as applicable to prepare the liquidation [schedule] [report].

*Option 3*<sup>62</sup>

41. The insolvency law providing for a simplified insolvency regime [should] [may] require the competent authority to prepare the liquidation [schedule] [report] unless circumstances of the case justify entrusting the preparation of the liquidation [schedule] [report] to the debtor, an independent professional or another person.

*Time period for preparing a liquidation [schedule] [report]*

42. The insolvency law providing for a simplified insolvency regime should specify the maximum time period for preparing a liquidation [schedule] [report] after commencement of a simplified liquidation proceeding, keeping it short, and authorize the competent authority to establish a shorter time period where the circumstances of the case so justify. The insolvency law providing for a simplified insolvency regime should specify that any time period established by the competent authority must be notified to the person responsible for preparing the liquidation [schedule] [report] and to (other) parties in interest.<sup>63</sup>

*Minimum contents of the liquidation [schedule] [report]*

43. The insolvency law providing for a simplified insolvency regime should specify the contents of a liquidation [schedule] [report], keeping it to the minimum, including that the liquidation [schedule] [report] should:

- (a) Identify the party responsible for the realization of the assets of the insolvency estate;
- (b) Specify the means of realization of the assets (public auction or private sale or other means);
- [(c) List amounts and priorities of the admitted claims;]<sup>64</sup>
- (d) Indicate the timing and method of distribution of proceeds from the realization of the assets;
- (e) Contain the terms and conditions of any debt repayment plan for the individual entrepreneur.

<sup>61</sup> Option 2 was considered during the May 2020 informal consultations in writing and was communicated to the UNCITRAL secretariat by email.

<sup>62</sup> Option 3 was included by the secretariat in response to the comments made during the May 2020 informal consultations, in particular that preparation of the liquidation schedule should not be required in all cases; and that it is the competent authority, not the debtor, that will be required to prepare the liquidation schedule unless circumstances of the case justify entrusting the preparation of such document to another person, including the debtor.

<sup>63</sup> During the May 2020 informal consultations, concern was expressed that consequences of failure to prepare the liquidation schedule were not identified in this recommendation or related commentary. In comparison, the consequences of failure to prepare the reorganization plan were identified in draft recommendation 52.

<sup>64</sup> During the May 2020 informal consultations, a question arose about the minimum contents of a liquidation schedule, report, programme, plan or another document of this kind. In the light of the provisions on the treatment of creditor claims (see section I above), doubts were expressed that such document should list the amounts and priorities of the admitted claims. The utility of a liquidation schedule, report, programme, plan or another document of this kind without such information was however questioned. While the importance of transparency and accountability was recognized, it was proposed, instead of referring to this type of document, to redraft provisions in this section to state that the competent authority should notify the parties about the method of sale and provide to them other pertinent information related to the liquidation proceeding.

**Notification of the liquidation [schedule] [report] to creditors**

44. The insolvency law providing for a simplified insolvency regime should require the competent authority to review the liquidation [schedule] [report] and ascertain its compliance with the law, and upon making any required modifications to ensure that it is so compliant, give notice of the liquidation [schedule] [report] to all known parties in interest. The insolvency law providing for a simplified insolvency regime should require the notice of the liquidation [schedule] [report] to specify a short period for expressing any objection [or opposition] to the liquidation [schedule] [report].

**Approval of the liquidation [schedule] [report]**

*Option 1 for draft recommendations 45 and 46 [as in A/CN.9/WG.V/WP.170]*

*Undisputed liquidation schedule*

45. The insolvency law providing for a simplified insolvency regime should specify that the liquidation schedule is deemed to be approved if it receives no objection and no [sufficient]<sup>65</sup> opposition within the established time period and there are no other grounds for the competent authority to reject the liquidation schedule.

*Disputed liquidation schedule*

46. The insolvency law providing for a simplified insolvency regime should allow modification of the liquidation schedule to resolve objection or sufficient opposition to the liquidation schedule and require any modified liquidation schedule to be communicated by the competent authority to all known parties in interest with a short time period indicated for expressing any objection or opposition to the modified liquidation schedule. The insolvency law providing for a simplified insolvency regime should allow the competent authority to approve the modified liquidation schedule over any objection or opposition to the modified liquidation schedule or convert the proceeding to a different type of insolvency proceeding.

*Option 2 for draft recommendations 45 and 46<sup>66</sup>*

45. The insolvency law providing for a simplified insolvency regime should specify that the liquidation [schedule] [report] is deemed to be approved if it receives no objection within the established time period and there are no other grounds for the competent authority to reject the liquidation [schedule] [report].

46. Where there is objection, the insolvency law providing for a simplified insolvency regime should allow the competent authority either to modify the liquidation [schedule] [report], approve it unmodified or convert the proceeding to a different type of insolvency proceeding.

**Prompt distribution**

*Option 1 [as in A/CN.9/WG.V/WP.170]*

47. The insolvency law providing for a simplified insolvency regime should specify that, in simplified liquidation proceedings, distributions are to be made promptly. (See recommendation 193 of the Guide.) It should also specify rules for distribution,

<sup>65</sup> In its communication to the secretariat dated 3 July 2020, Côte d'Ivoire suggested deleting the word "sufficient" to avoid subjectivity by giving the competent authority much discretion.

<sup>66</sup> Option 2 was included by the secretariat further to the suggestions made during the May 2020 informal consultations that the provisions of draft recommendations 45 and 46 should be redrafted to provide that no creditors' approval of the liquidation schedule would be needed since the liquidation schedule would be nothing more than a programme under which the disposal of assets would take place. It would be transmitted to creditors for information and approved as is by the competent authority if no objections of creditors are received. The competent authority should be allowed to modify the schedule to eliminate the ground for objection by any creditor.

providing, as a general principle, that similarly ranked claims are paid *pari passu*.<sup>67</sup> (See recommendation 191 of the Guide.)

*Option 2*<sup>68</sup>

47. The insolvency law providing for a simplified insolvency regime should specify that, in simplified liquidation proceedings, distributions are to be made promptly. (See recommendation 193 of the Guide.) The distribution should take place in accordance with the insolvency law. (See recommendation 191 of the Guide.)

**Simplified liquidation proceeding where there are no assets to realize, no proceeds to distribute, or no income for debt repayment**<sup>69</sup>

*Notification of a decision to proceed with [a discharge] [the closure of the proceeding]*<sup>70</sup>

48. The insolvency law providing for a simplified insolvency regime should require the competent authority to promptly notify the debtor, all known creditors and other known parties in interest about its determination that no sale and disposal of the assets of the insolvency estate and no distribution of proceeds to creditors will take place in the proceeding. The insolvency law providing for a simplified insolvency regime should require the notice to include reasons for that determination and the list of creditors, assets and liabilities of the debtor and to establish a short time period for expressing any objection to that decision.

*Decision on [discharge and] the closure of the proceeding in the absence of objection*

49. The insolvency law providing for a simplified insolvency regime should require the competent authority, [in the absence of any objection to its decision to proceed with a discharge or other grounds to revoke that decision, to promptly take a decision on discharge of the debtor and close the proceeding] [in the absence of any objection to its decision, to close the proceeding].

*Treatment of objections*

50. Where the competent authority receives an objection to its decision to proceed with [a discharge] [the closure of the proceeding], the insolvency law providing for a simplified insolvency regime should permit the competent authority to commence verification of reasons for the objection, following which the competent authority may decide:

- (a) To revoke its decision and commence a simplified liquidation proceeding involving the sale and disposal of assets and distribution of proceeds;
- (b) To convert a simplified liquidation proceeding to a different type of insolvency proceeding; or
- (c) Proceed with [a discharge] [the closure of the proceeding].

<sup>67</sup> Defined in (cc) of the glossary in the introduction to the Guide as “the principle according to which similarly situated creditors are treated and satisfied proportionately to their claim out of the assets of the estate available for distribution to creditors of their rank”.

<sup>68</sup> **Option 2 was included by the secretariat further to the suggestions made during the May 2020 informal consultations that draft recommendation 47 should be redrafted not to imply that new rules for distribution of proceeds will be established for a simplified insolvency regime since the distribution will follow the usual insolvency law rules for distribution of proceeds. The other view was that the possibility of establishing different distribution rules specifically for a simplified insolvency regime should not be excluded.**

<sup>69</sup> **Further to the suggestion made during the May 2020 informal consultations, the heading was changed from “Simplified liquidation proceeding not involving the sale and disposal of assets and distribution of proceeds” in document A/CN.9/WG.V/WP.170.**

<sup>70</sup> **During the May 2020 informal consultations, it was suggested to replace references to “discharge” in draft recommendations 48 to 50 with references to “the closure of the proceedings” since discharge would be relevant only to natural persons and might precede or follow the closure of proceedings depending on jurisdictions. In addition, it was noted that section L dealt with discharge and a cross reference to that section would be sufficient.**

## K. Features of simplified reorganization proceedings

### Decision to proceed with reorganization or convert to liquidation

#### *Option 1 [as in A/CN.9/WG.V/WP.170]*

51. The insolvency law providing for a simplified insolvency regime should require that the competent authority, after commencement of a simplified reorganization proceeding, should determine as soon as possible whether the financial well-being and viability of the debtor's business can be restored and the business can continue to operate and:

(a) Where the competent authority finds that the debtor is insolvent and the financial well-being and viability of its business cannot be restored and the business cannot continue, the competent authority should promptly convert the simplified reorganization proceeding to the simplified liquidation proceeding; or

(b) Where the competent authority finds that the financial well-being and viability of the debtor's business can be restored and the business can continue, the competent authority should allow the debtor sufficient time to prepare and submit a reorganization plan, if such plan has not been already submitted with the application to commence a simplified reorganization proceeding. The insolvency law providing for a simplified insolvency regime should allow the competent authority to appoint an independent professional to assist the debtor with that task, where necessary, or to decide that circumstances of the case justify entrusting the preparation of the plan to an independent professional or another person.

#### *Option 2<sup>71</sup>*

Delete draft recommendation 51 and replace it with the following wording that should appear later in the section on reorganization:

xx. The insolvency law providing for a simplified insolvency regime should provide that at any point during a simplified reorganization proceeding, the competent authority may, on its own initiative or at the request of a party in interest or an independent professional, decide that the proceeding be discontinued and converted to a liquidation, if the competent authority determines that the debtor is insolvent and there is no prospect for viable reorganization. If such conversion is considered before submission of a reorganization plan, in considering such conversion, the competent authority should be mindful of the time needed to prepare and submit a reorganization plan.

yy. [The competent authority may [request] [require] the independent professional to opine on such conversion [and/or the independent professional shall have [the right to be heard] [the obligation to opine] on any such conversion]].<sup>72</sup> [The competent authority should request the independent professional, if one has been appointed, to

<sup>71</sup> Option 2 was considered during the May 2020 informal consultations in writing and was communicated to the secretariat by email and subsequently amended by the proponent of that text during the September 2020 informal consultations. It was suggested that the commentary should explain that this provision applies to any time period before or after the submission of the plan, the creditors' voting on the plan or the confirmation of the plan. The commentary should also note that in some jurisdictions, if reorganization proceedings are revoked or terminated before confirmation of the plan and if the debtor is insolvent, the court may, on its own initiative or at the request of a creditor or the debtor, decide that liquidation proceedings be commenced against the debtor. If the reorganization proceedings are however terminated after the confirmation of the plan and if the debtor is insolvent, the court should decide, on its own initiative, that liquidation proceedings be commenced against the debtor. During the September 2020 informal consultations, support was expressed for the provisions contained in option 2 with some modifications.

<sup>72</sup> As proposed during the May 2020 informal consultations.

make a recommendation as to whether the case should be converted or not and to set forth the basis for the recommendation.]<sup>73</sup>

zz. The insolvency law providing for a simplified insolvency regime should allow the competent authority to appoint an independent professional to assist the debtor with the preparation of the reorganization plan, where necessary, or to decide that circumstances of the case justify entrusting the preparation of the plan to an independent professional or another person, but subject to verification of the assets, liabilities and plan required by the debtor. Any undisclosed or concealed assets remain part of the insolvency estate[, regardless of whether the reorganization plan has been confirmed or simplified reorganization has been converted to liquidation].<sup>74</sup>

#### **Time period for the proposal of the reorganization plan**

52. The insolvency law providing for a simplified insolvency regime should fix the maximum time period for the proposal of a reorganization plan after commencement of a simplified reorganization proceeding and authorize the competent authority, where the circumstances of the case so justify, to establish a shorter time period subject to its possible extension up to the maximum period specified in the law. (*See recommendation 139 of the Guide.*) The insolvency law providing for a simplified insolvency regime should require any time period established by the competent authority to be notified to the person responsible for preparing the reorganization plan and to (other) parties in interest. The insolvency law providing for a simplified insolvency regime should specify that the insolvent debtor is deemed to enter liquidation, while the proceeding with respect to the solvent debtor is terminated if the reorganization plan is not submitted within the established time period. (*See recommendation 158 (a) of the Guide.*)

#### **Alternative plan**

53. The insolvency law providing for a simplified insolvency regime may envisage the possibility for creditors to file an alternative plan. Where it does so, it should specify the conditions and the time period for exercising such an option.

#### **Content of the reorganization plan**

54. The insolvency law providing for a simplified insolvency regime should specify the minimum contents of a plan, including:

- (a) The terms and conditions of the plan;
- (b) The list of creditors and the treatment provided for each creditor by the plan (e.g., how much they will receive and the timing of payment, if any);
- (c) Proposed ways of implementing the plan.

(*See recommendation 144 of the Guide.*)

#### **Notification of the reorganization plan to all known parties in interest**

##### *Option 1 [as in A/CN.9/WG.V/WP.170]*

55. The insolvency law providing for a simplified insolvency regime should require the competent authority to [review the reorganization plan and ascertain its compliance with the law, and upon making any required modifications to ensure that it is so compliant, to] notify the plan to all known parties in interest to enable them to object or express opposition to the proposed plan. The notice of the plan should specify a [short] [sufficient] time period for expressing any objection or opposition to the plan [and explain that abstention would be counted as approval].<sup>75</sup>

<sup>73</sup> As proposed during the September 2020 informal consultations.

<sup>74</sup> The words in square brackets were added further to the suggestion made during the September 2020 informal consultations.

<sup>75</sup> During the May 2020 informal consultations, concern was expressed that, as drafted, recommendation 55 envisaged cumbersome procedures and did not encourage consensual

*Option 2*<sup>76</sup>

55. The insolvency law providing for a simplified insolvency regime should require the competent authority or independent professional as applicable to send notification of the plan to all known parties in interest to enable them to object or express opposition to the proposed plan and explain the consequences of any abstention.

**Consequences of the failure to notify the plan**

56. The insolvency law providing for a simplified insolvency regime should specify that a creditor whose rights are modified or affected by the plan should not be bound by the terms of the plan unless that creditor has been [notified of the plan and]<sup>77</sup> given the opportunity to express objection or opposition. (*See recommendation 146 of the Guide.*)

**Approval of the reorganization plan by creditors***Undisputed reorganization plan**Option 1 [as in A/CN.9/WG.V/WP.170]*

57. The insolvency law providing for a simplified insolvency regime should specify that the plan is deemed to be approved by creditors if the competent authority receives no objection and no sufficient opposition<sup>78</sup> to the proposed plan within the established time period.

*Option 2*<sup>79</sup>

57. The insolvency law providing for a simplified insolvency regime should specify that, upon a finding by the competent authority that the plan otherwise satisfies the

solutions. It was also suggested that all provisions on time limits or deadlines should be consolidated in one provision (e.g., draft recommendation 9).

<sup>76</sup> Option 2 was considered during the May 2020 informal consultations in writing and was communicated to the secretariat by email and subsequently amended by the proponent of that text.

<sup>77</sup> During the September 2020 informal consultations, the suggestion was made to delete the words in square brackets taking into account that recommendation 146 of the Guide does not require individual notification of the plan to creditors. The secretariat notes a close link of that suggestion with draft recommendations 12 and 26 and the immediately preceding recommendation 55 and the impact of that suggestion on the current title of draft recommendation 56 (Consequences of the failure to notify the plan).

<sup>78</sup> During the September 2020 informal consultations, concerns were raised about the introduction of the concept of “sufficient opposition” because it may give rise to disputes over characterization of actions by creditors as objections or opposition and over a threshold for establishing a sufficient opposition. In response, reference was made to the discussion of the Working Group of the same matters at its fifty-sixth session in December 2019 (A/CN.9/1006, para. 55).

<sup>79</sup> Proposed during the September 2020 informal consultations.

requirements for approval, [the plan is deemed to be approved]<sup>80</sup> [the competent authority may pronounce the plan approved].<sup>81</sup>

*Disputed plan*

58. The insolvency law providing for a simplified insolvency regime should:

(a) Allow the modification of the plan [by the competent authority]<sup>82</sup> to address objection or sufficient opposition to the plan;

(b) Establish a short time period for introducing modifications and transmitting a modified plan to all known parties in interest;

(c) Require the competent authority to transmit any modified plan to all known parties in interest indicating a short time period for expressing any objection or opposition to the modified plan;

(d) Require the competent authority to terminate the simplified reorganization proceedings for a solvent debtor or convert the simplified reorganization proceeding to a simplified liquidation proceeding for an insolvent debtor (i) if modification of the original plan [by the competent authority] to address objection or sufficient opposition is not possible or (ii) if objection or sufficient opposition to the modified plan is communicated to the competent authority within the established time period (*See recommendation 158 (b) of the Guide.*);

(e) Specify that the modified plan is [deemed to be] approved by creditors if the competent authority receives no objection and no sufficient opposition to the modified plan within the established time period.

**Conditions for the confirmation of the plan by the competent authority**

59. The insolvency law providing for a simplified insolvency regime should require the competent authority to confirm the plan [deemed to be] approved by creditors. It should require the competent authority, before confirming the plan, to ascertain that the creditor approval process was properly conducted, creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment, and the plan does not contain provisions contrary to law. (*See recommendations 152 and 153 of the Guide.*)

<sup>80</sup> During the September 2020 informal consultations, different views were expressed about the desirability of excluding voting as an option or requirement for approval of the reorganization plan by creditors. Some delegates considered that the draft recommendations should be revised to provide for voting and for a specific threshold for the approval of the plan. In response, it was observed that some systems allowed approval of the plan without creditors' vote, including over creditors' objection, and that draft recommendations 55 and 57 (read together) did not deprive creditors of the right to raise objection or opposition but provided a more efficient and effective mechanism for exercising such right. The concern that the new approach would negatively affect the availability of credit for MSEs was not shared, on the basis that creditors not interested in participating in MSE insolvency might be expected to be equally disinterested to adjust costs of providing credit to MSEs. Instead of amending the recommendations, it was suggested that the commentary might suggest that those States that might consider a deemed approval insufficient for protection of creditors' rights might provide for the possibility or requirement of voting (see a footnote to para. 132 of the commentary). The Working Group may wish to formulate its position on these issues, taking into account draft recommendation 12 and other relevant recommendations.

<sup>81</sup> During the September 2020 informal consultations, it was proposed that the provisions should make it clear that pronouncement by the competent authority of the approval of the plan would be required in all cases.

<sup>82</sup> During the September 2020 informal consultations, a query was raised on whether the competent authority should indeed have authority to modify the plan. The Working Group may wish to formulate its position on this issue.

**Challenges to the confirmed plan**

60. The insolvency law providing for a simplified insolvency regime should permit the confirmed plan to be challenged on the basis of fraud. It should specify:

- (a) A time period for bringing such a challenge calculated by references to the time the fraud is discovered;
- (b) The party that may bring such a challenge;
- (c) That the challenge should be heard by the relevant review body; and
- (d) That a simplified reorganization proceeding may be converted to a simplified liquidation proceeding or a different type of insolvency proceeding where the confirmed plan is successfully challenged.

*(See recommendations 154 and 158 (d) of the Guide.)*

**Amendment of a plan**

61. The insolvency law providing for a simplified insolvency regime should permit the amendment of a plan and specify:

- (a) The parties that may propose amendments;
- (b) The time at which the plan may be amended, including between submission and approval and during implementation, and a mechanism for communicating amendments to the competent authority;
- (c) The mechanism for approval of amendments of the confirmed plan, which should include a notice by the competent authority of proposed amendments to all parties in interest affected by the amendments, the approval of the amendments by those parties, the confirmation of the amended plan by the competent authority, and consequences of failure to secure approval of proposed amendments. *(See recommendations 155 and 156 of the Guide.)*

**Duration of the simplified reorganization proceedings**

62. The insolvency law providing for a simplified insolvency regime should specify that a simplified reorganization proceeding remains open until its closure by the competent authority after confirmation of the full implementation of the plan.

**Supervision of the implementation of the plan**

*Option 1 [as in A/CN.9/WG.V/WP.170]*

63. The insolvency law providing for a simplified insolvency regime should entrust supervision of the implementation of the plan to the competent authority [and authorize the competent authority to appoint, where necessary, an independent professional to assist the competent authority with that task]. *(See recommendation 157 of the Guide.)*

*Option 2<sup>83</sup>*

63. The insolvency law providing for a simplified insolvency regime should entrust supervision of the implementation of the plan to the competent authority or an independent professional as applicable.

*Option 3*

63. The insolvency law providing for a simplified insolvency regime should entrust supervision of the implementation of the plan to the competent authority.

<sup>83</sup> Options 2 and 3 were considered during the May 2020 informal consultations in writing and were communicated to the secretariat by email and subsequently amended by the proponent of that text.

**Consequences of the failure to implement the plan**

64. The insolvency law providing for a simplified insolvency regime should specify that, where there is substantial breach by the debtor of the terms of the plan or inability to implement the plan, the competent authority may:

(a) Convert the simplified reorganization proceeding to a simplified liquidation proceeding or a different type of insolvency proceeding; or

(b) Close the simplified reorganization proceeding and parties in interest may exercise their rights at law. (*See recommendations 158 (e) and 159 of the Guide.*)

**L. Discharge**<sup>84</sup>**General provisions***Conditions for discharge*

65. Where the insolvency law providing for a simplified insolvency regime specifies that conditions may be attached to the MSE debtor's discharge, those conditions should be kept to a minimum and clearly set forth in the insolvency law. (*See recommendation 196 of the Guide.*)

*Exclusions from discharge*

66. Where the insolvency law providing for a simplified insolvency regime specifies that certain debts are excluded from a discharge, those debts should be kept to a minimum and clearly set forth in the insolvency law. (*See recommendation 195 of the Guide.*)

*Criteria for denying discharge or revoking discharge granted*

67. The insolvency law providing for a simplified insolvency regime should specify criteria for denying a discharge and criteria for revoking a discharge granted, keeping them to a minimum. In particular, the insolvency law should specify that the discharge is to be revoked where it was obtained fraudulently. (*See recommendation 194 of the Guide.*)

*Option 1 [as in A/CN.9/WG.V/WP.170]**Partial discharge*

68. The insolvency law may envisage a possibility of partial discharge in simplified insolvency proceedings by allowing a discharge of only undisputed claims and referring disputed claims to separate proceedings.<sup>85</sup>

*Option 2*<sup>86</sup>*[Phased] [Limited] [Delayed] discharge*

68. The insolvency law providing for a simplified insolvency regime may envisage a possibility of partial discharge by postponing a discharge of claims excluded from discharge under recommendation [66] until timely disputes challenging the discharge of such claims are resolved in separate proceedings.

*Option 3*

Delete recommendation 68.

<sup>84</sup> Defined in (m) of the glossary in the introduction to the Guide as "the release of a debtor from claims that were, or could have been, addressed in the insolvency proceedings".

<sup>85</sup> During the September 2020 informal consultations, concerns were expressed about the concept of "partial discharge" and including reference to disputed claims in that context. It was noted that, although a need for a phased discharge might arise in some cases, such possibility might be addressed in the commentary (e.g., with cross references to draft recommendation 66 (debts excluded from discharge) and different categories of debt (business as opposed to private debts)).

<sup>86</sup> Options 2 and 3 are included further to the views expressed and suggestions made during the September 2020 informal consultations.

**Discharge in simplified liquidation proceedings***Decision on discharge*

69. The insolvency law providing for a simplified insolvency regime should specify that, in a simplified liquidation proceeding, discharge should take effect upon decision of the competent authority following the distribution of proceeds or the determination that no distribution can be made.

*Discharge conditional upon expiration of a monitoring period*

70. Where the insolvency law provides that discharge may not apply until after the expiration of a specified period of time following commencement of insolvency proceedings during which period the debtor is expected to cooperate with the competent authority, the insolvency law providing for a simplified insolvency regime should fix the maximum period, which should be short, and allow the competent authority to establish a shorter period. The insolvency law providing for a simplified insolvency regime should specify that, after expiration of the period established by the competent authority, the debtor should be discharged upon decision of the competent authority where the debtor has not acted fraudulently and has cooperated with the competent authority in performing its obligations under the insolvency law. (See recommendation 194 of the Guide.)

*Discharge conditional upon the implementation of a debt repayment plan*

71. The insolvency law providing for a simplified insolvency regime may specify that full discharge may be conditional upon the implementation of a debt repayment plan during a certain time period (the discharge period). In such case, it should require the discharge procedures to include verification by the competent authority:

(a) Before the debt repayment plan becomes effective, that the debt repayment obligations reflect the situation of the individual entrepreneur and are proportionate to his or her disposable income and assets during the discharge period, taking into account the equitable interest of creditors; and

(b) On expiry of the discharge period, that the individual entrepreneur has fulfilled his or her repayment obligations under the debt repayment plan, in which case the individual entrepreneur is discharged upon confirmation by the competent authority of the fulfilment of the debt repayment plan by the debtor.

**Discharge in simplified reorganization proceedings**

72. The insolvency law providing for a simplified insolvency regime [should] [may] specify that full discharge in simplified reorganization is conditional upon successful implementation of the reorganization plan and it shall take immediate effect upon confirmation by the competent authority of such implementation.<sup>87</sup>

**M. Closure of proceedings**

73. The insolvency law providing for a simplified insolvency regime should specify minimal and simple procedures by which simplified insolvency proceedings should be closed. (See recommendations 197 and 198 of the Guide.)

<sup>87</sup> During the September 2020 informal consultations, it was suggested that the commentary should explain that, to the extent the plan has been approved but there is a default by the debtor under the plan, the default is to be determined with reference to the amount of debt approved for repayment under the plan rather than the original debt owed upon commencement of the simplified insolvency proceeding. The same point may be relevant in other contexts, such as those addressing effects of conversion.

## **N. Treatment of personal guarantees. Procedural consolidation and coordination**

### **Treatment of personal guarantees**

74. A simplified insolvency regime should address, including through procedural consolidation or coordination of linked proceedings, the treatment of personal guarantees provided for business needs of the MSE debtor by individual entrepreneurs, owners of limited liability MSEs or their family members.

### **Procedural consolidation or coordination of linked business, consumer and personal insolvency proceedings**

#### *Orders of procedural consolidation and coordination*

75. The insolvency law may require procedural consolidation or coordination of linked business, consumer and personal insolvency proceedings in order to address comprehensively intertwined business, consumer and personal debts of individual entrepreneurs, owners of limited liability MSEs and their family members. The law may specify that, in such cases, the competent authority or another relevant State body, as the case may be, may order procedural consolidation or coordination of linked proceedings on its own motion or upon request of any party in interest, which may be made at the time of application for commencement of insolvency proceedings or at any subsequent time.

#### *Modification or termination of an order for procedural consolidation or coordination*

76. The insolvency law should specify that an order for procedural consolidation or coordination may be modified or terminated, provided that any actions or decisions already taken pursuant to the order are not affected by the modification or termination. Where more than one State body is involved in ordering procedural consolidation or coordination, those State bodies may take appropriate steps to coordinate modification or termination of procedural consolidation or coordination.

#### *Notice of procedural consolidation and coordination*

77. The insolvency law should establish requirements for giving notice with respect to applications and orders for procedural consolidation or coordination and modification or termination of procedural consolidation or coordination, including the scope and extent of the order, the parties to whom notice should be given, the party responsible for giving notice and the content of the notice.

## **O. Conversion**

### **Conditions for conversion**

78. The insolvency law should provide for conversion between different types of proceedings in appropriate circumstances and subject to applicable eligibility and other requirements.

### **Procedures for conversion**

79. The insolvency law should address procedures for conversion, including notification to all known parties in interest about the conversion, and mechanisms for addressing objections to that course of action.

### **Effect of conversion on post-commencement finance**

80. The insolvency law should specify that where a simplified reorganization proceeding is converted to a liquidation proceeding, any priority accorded to post-commencement finance in the simplified reorganization proceeding should continue to be recognized in the liquidation proceeding. (*See recommendation 68 of the Guide.*)

**Other effects of conversion**

81. The insolvency law should address other effects of conversion, including on deadlines for actions, the stay of proceedings and other steps taken in the proceeding being converted. (*See recommendation 140 of the Guide.*)

**P. Appropriate safeguards and sanctions**

82. The insolvency law providing for a simplified insolvency regime should build in appropriate safeguards to prevent abuses and improper use of a simplified insolvency regime and permit the imposition of sanctions for abuse or improper use of the simplified insolvency regime, for failure to comply with the obligations under the insolvency law and for non-compliance with other provisions of the insolvency law. (*See recommendations 20, 28 and 114 of the Guide.*)

**Q. [Pre-insolvency] [Insolvency prevention]<sup>88</sup> aspects****Obligations of [MSEs] [persons exercising control over management and oversight of the MSE operations]<sup>89</sup> in the period approaching insolvency of that MSE**

83. The law relating to insolvency<sup>90</sup> should specify that, at the point in time when [individual entrepreneurs and owners and managers of other types of MSEs (as well as any other person exercising factual control over the business)] [persons exercising control over management and oversight of the MSE operations]<sup>91</sup> knew or ought reasonably to have known that insolvency was imminent or unavoidable, they should have due regard to the interests of creditors and other stakeholders [such as shareholders]<sup>92</sup> and to take reasonable steps [at an early stage of financial distress]<sup>93</sup> to avoid insolvency and, where it is unavoidable, to minimize the extent of insolvency. Reasonable steps might include:<sup>94</sup>

- (a) Evaluating the current financial situation of the business;
- (b) Seeking professional advice where appropriate;<sup>95</sup>
- (c) Not committing the business to the types of transaction that might be subject to avoidance unless there is an appropriate business justification;
- (d) Protecting the assets so as to maximize value and avoid loss of key assets;

<sup>88</sup> The Working Group may wish to consider which of the two alternatives for the title of the section conveys better the intended scope of the provisions in this section.

<sup>89</sup> The text in the second set of square brackets is included by the secretariat in response to the concerns expressed during the May and September 2020 informal consultations and in writing about the persons intended to be covered by the provisions.

<sup>90</sup> Reference to the “insolvency law” in this provision in [A/CN.9/WG.V/WP.170](#) was changed to “the law relating to insolvency” to make it consistent with the Guide.

<sup>91</sup> Different views were expressed during the May 2020 informal consultations on who should be covered by these provisions. Subsequently, the secretariat received written communication from the International Bar Association expressing concern about including a reference to “owners” in this provision because the owners will not always be in control of the MSE business. The same view was reiterated during the September 2020 informal consultations with reference to part four of the Guide where such term is not used, rather reference is made to persons exercising control over the business (including shadow directors). The Working Group may wish to consider the alternative text in the second set of square brackets included by the secretariat in response to those concerns.

<sup>92</sup> The words in square brackets were added here and in subparagraph (e) by the secretariat further to the suggestion during the September 2020 informal consultations.

<sup>93</sup> The words in square brackets were added by the secretariat further to the suggestion during the May 2020 informal consultations to highlight in the provision that the listed steps were expected to be taken at an early stage of financial distress.

<sup>94</sup> Further to the suggestion made during the May 2020 and the September 2020 informal consultations, the order of the listing of reasonable steps in subparagraphs (a) to (g) has changed.

<sup>95</sup> During the September 2020 informal consultations, it was suggested to add in the commentary reference to services of an “independent professional” that may be made available to MSEs at an

(e) Ensuring that management practices take into account the interests of creditors and other stakeholders [such as shareholders];

(f) Considering holding informal debt restructuring negotiations with creditors; and

(g) Applying for commencement of insolvency proceedings if it is required or appropriate to do so.<sup>96</sup>

*(See recommendation 256 of the Guide.)*<sup>97</sup>

#### **Early warning signals**

84. As a means of encouraging the early rescue of MSEs, a State should consider establishing mechanisms of providing early signals of financial distress to MSEs, increasing financial and business management literacy among MSE managers and owners [and promoting access to professional advice. These mechanisms should be easily ascertainable by MSEs].<sup>98</sup>

#### **Informal debt restructuring negotiations**

85. For the purpose of avoiding MSE insolvency, the State may consider identifying and removing legislative and other disincentives for the use of informal debt restructuring negotiations.

86. The State may consider providing appropriate legislative incentives for the participation of creditors, including public bodies,<sup>99</sup> [and other relevant stakeholders, in particular employees,]<sup>100</sup> in informal debt restructuring negotiations.

87. The State may consider providing for:

(a) Involvement of a [competent State body] [competent public or private body],<sup>101</sup> where necessary, to facilitate informal debt restructuring negotiations between creditors and debtors and between creditors;

earlier stage of financial distress. The Working Group may wish to express its position on that suggestion in conjunction with a question raised in a footnote to para. 39 bis of the commentary.

<sup>96</sup> Different views were expressed during the May 2020 informal consultations on the desirability of retaining draft recommendation 83. One view was that it was repetitive with recommendation 256 of the Guide. The other view was that it should be retained because it considerably simplified that recommendation by adapting it to the MSE context. During the September 2020 informal consultations, those different views were reiterated. In addition, it was noted that obligations of directors of limited liability MSEs in the period approaching insolvency were already addressed in part four of the Guide. As regards obligations of individual entrepreneurs in the period approaching insolvency, it was noted that they would be addressed in domestic law in the context of debtors' obligations to creditors. In addition, it was noted that the discharge provisions of the text envisaged consequences for individual entrepreneurs acting in bad faith.

<sup>97</sup> During the May and September 2020 informal consultations, concerns were expressed that draft recommendation 83 was not accompanied by any provision addressing liability of relevant persons for the failure to take the steps listed in that recommendation. The Working Group's past consideration of that matter was recalled (A/CN.9/1006, para. 88). It was suggested that the commentary might explain that recommendation 83 set out the standard for behaviour expected of persons exercising control over management and oversight of the MSE operations in order to prevent insolvency of that MSE; the consequence of the failure to adhere to that standard would be the imposition of personal liability on those persons.

<sup>98</sup> The words in square brackets were added by the secretariat further to the suggestion made during the May 2020 informal consultations.

<sup>99</sup> During the May 2020 informal consultations, the term "public bodies" was preferred to the term "public authorities" used in A/CN.9/WG.V/WP.170.

<sup>100</sup> The words in square brackets were added by the secretariat further to the suggestion made during the May 2020 informal consultations and concerns expressed that the text did not address rights of employees.

<sup>101</sup> The alternative wording in the second set of square brackets is proposed by the secretariat in response to the comments made during the May 2020 informal consultations that the mentioned functions could be delegated to private entities in accordance with the law of the relevant State, and flexibility should therefore be retained by not mentioning only State bodies in this context.

(b) A neutral forum to facilitate negotiation and resolution of debtor-creditor and inter-creditor issues[; and

(c) Mechanisms for covering the costs of the services mentioned in subparagraphs (a) and (b) above [where the MSE concerned has no means to cover them]].<sup>102</sup>

**[Pre-commencement]<sup>103</sup> business rescue finance**

88. The law should:

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

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

(c) Ensure appropriate protection for those parties whose rights may be affected by the provision of such finance.<sup>104</sup>

## IV. Draft commentary

5. The Working Group may wish to consider the following draft commentary:

### “I. Introduction

#### A. Purpose of this [text]

1. Micro, small and medium-sized enterprises (MSMEs) constitute the majority of businesses in economies around the world. Those in the micro and small-sized part of the spectrum (MSEs), in most economies, take the form of sole proprietorships or small partnerships whose founders, owners or members do not enjoy limited liability protection and thus are exposed to unlimited liability for business debts of MSEs. MSEs tend to be relatively undiversified as regards creditor, supply and client base and heavily depend on payments from their clients. As a result, they often face cash flow problems and higher default risks that follow from the loss of a significant business partner or from late payments by their clients. MSEs also face scarcity of working capital, higher interest rates and larger collateral requirements, which make raising finance, especially in situations of financial distress, difficult, if not impossible. As a consequence, they may be prone to business failure more often than larger enterprises. MSEs in financial distress may themselves be the clients of other MSEs that would share the same characteristics, with the consequence that

<sup>102</sup> Subparagraph (c) was added by the secretariat further to the suggestion made during the May 2020 informal consultations that draft recommendation 87 should also address mechanisms for covering costs of services provided by a debt advisor. The Working Group may wish to consider whether the text “[where the MSE concerned has no means to cover them.]” is needed.

<sup>103</sup> Added by the secretariat to clarify that draft recommendation 88 addresses pre-commencement finance. Post-commencement finance is addressed in recommendations 63–68 of the Guide, which are cross-referred in draft recommendations 11 and 11 ter.

<sup>104</sup> Different views were expressed during the May 2020 informal consultation on the desirability of retaining draft recommendation 88. In support of deleting it, noting that the provision dealt not with post-commencement finance but with pre-commencement finance, it was explained that it may potentially overlap with the future work of Working Group I on MSMEs’ access to credit but in any event it did not raise anything unique in the MSE context. During the September 2020 informal consultations, it was noted that, although the incentives for providing finance to MSEs in financial distress should be created, they should be accompanied by safeguards to avoid favouring some creditors.

business failure of one MSE may cause business failures in the MSE supply chain.

2. Standard business insolvency processes, where they are costly, complex, lengthy and procedurally rigid, may be unavailable, prohibitive or unsuitable for MSEs. Burdened by unresolved financial difficulties and old debt, MSEs may be discouraged from taking new risks, may become trapped in a cycle of debt or may be driven to the informal sector of the economy.

3. Efforts are being made at the international, regional and national levels to find solutions tailored to the specific needs of MSEs in financial distress in the light of the broad impact of MSE insolvency on job preservation, the supply chain, entrepreneurship and the economic and social welfare of society. Solutions sought aim at allowing deserving MSEs to restart entrepreneurial activities, drawing on their know-how, skills and lessons from the past.

4. This [text] was prepared to assist policymakers with those efforts. [*The Working Group may wish to decide how the text should be referred to. In considering this issue, the Working Group may wish to take into account that the text is expected to contribute to the UNCITRAL texts addressing the entire life cycle of MSMEs. In the light of a broader scope of the work by UNCITRAL Working Group I (MSMEs), the title of the text may need to convey, for avoidance of doubt, that its scope encompasses only MSEs.*]<sup>105</sup>. It discusses features of a simplified insolvency regime that could encourage MSEs to address financial distress at an early stage. The focus is on faster, simpler, accessible and affordable insolvency proceedings, with appropriate safeguards. [This [text] also touches upon some MSE insolvency prevention measures, acknowledging however that they would usually fall outside the insolvency law.] [*The Working Group may wish to decide whether the [text] should contain recommendations and commentary on insolvency prevention measures taking into account the expected work of Working Group I on legal measures to facilitate access by MSMEs to credit.*]<sup>106</sup>

## **B. Interaction of this [text] with the UNCITRAL Legislative Guide on Insolvency Law**

[5. The introduction to the UNCITRAL Legislative Guide on Insolvency Law (“the Guide”) explains that its purpose is to assist in the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference point when preparing new insolvency law or when reforming, modernizing or reviewing the adequacy of existing insolvency law.

5 bis. This [text] is intended to supplement the advice given in the Guide and is specifically designed to address the unique circumstances of MSEs. It is not intended to replace the Guide, but to supplement it with a specific focus on how insolvency and its avoidance should be dealt with where MSEs are involved, and it should therefore be read in this context. References are made in this [text] to specific recommendations in the Guide which are of particular relevance to,

<sup>105</sup> The following title was proposed during informal consultations: “Legislative Guidance on Insolvency Law for Micro and Small Enterprises”. During the September 2020 informal consultations, it was suggested to emphasize in the title that the text addresses a simplified insolvency regime.

<sup>106</sup> In its communication to the secretariat dated 3 July 2020, Côte d’Ivoire expressed its support for including provisions on insolvency prevention measures. During the May 2020 informal consultations, support was expressed for retaining, with amendments, draft recommendations 83–87 that address those measures. Different views were expressed as regards the need to retain draft recommendation 88. (See annotations to those draft recommendations above.)

or are supplemented by, this [text]. Where this [text] diverges from the Guide's recommendations, this is also expressly made clear.]<sup>107</sup>

## **C. Issues taken into account in preparing this [text]**

### **1. Specific characteristics of MSEs and issues they face in financial distress**

6. MSEs may often operate without a separate legal personality and have closely intermingled business and personal debts and a centralized governance model in which ownership, control and management overlap (often within a family). Few or no business records may exist, including of transactions between owners, family members, friends and other individuals involved in the operation and financing of the business. There may be no clearly established ownership of key commercial assets (such as tools or other essential equipment). It is not unusual for owners to use personal assets for business purposes and to use business assets for personal or family needs. Work and services performed for MSEs may be undocumented or remunerated not in accordance with typical commercial practices.

7. Access to credit by MSEs is often made subject to the granting of personal guarantees by the owners or their relatives and friends whose personal assets could be equal to or of greater value than that of the MSE. A personal guarantee will typically extend liability for the debts of the MSE to those individuals, affecting both personal effects (such as the family home) and business assets.

8. When facing financial problems, the management may be unwilling to request the commencement of insolvency proceedings at the risk of losing control over the business. An owner may hide a financial crisis out of fear of damaging a good commercial name and relationships with employees, suppliers and the market and disrupting existing lines of credit. MSEs may be prone to adopt more high-risk strategies, attempting to save their business, which may be their only source of income, at all costs. [Lack of the sophistication of many MSEs in financial and business matters may aggravate the situation. In addition, because of the high prevalence of personal guarantees provided by owners or managers of MSEs for business debts of MSEs, owners or managers of MSEs may be reluctant to commence insolvency proceedings for the fear that such commencement would trigger creditors' demands to perform under personal guarantees.]<sup>108</sup> These factors may contribute to the financial crisis and lead MSEs to address financial difficulties at a time when liquidation of the business might be the only solution left.

9. Any physical assets of MSEs, which may be the main or the only assets of value to creditors, may already be encumbered to one or a very limited number of secured creditors who are usually able and willing to use enforcement methods available to them under law. Unencumbered assets of MSEs are usually of little or no value for distribution to unsecured creditors. As a result, those creditors may not be willing to invest the time and resources for resolution of MSE financial difficulties because the costs of their participation in those efforts may outweigh the return. The hold-outs by secured creditors and disengagement of unsecured creditors jeopardize chances of successful debt restructuring negotiations and reorganization of viable MSEs, leaving liquidation as the only option.

10. Because MSEs lack the financial sophistication of larger enterprises, they may not have the financial information required for an application to commence insolvency proceedings as readily available as larger enterprises and they may

<sup>107</sup> The inclusion of these two paragraphs in the text was supported during the May 2020 informal consultations.

<sup>108</sup> The text in square brackets was added further to the suggestions made during the September 2020 informal consultations.

not understand their rights and obligations in insolvency proceedings and in the period approaching insolvency. Because of all those characteristics, MSEs encounter specific difficulties in financial distress, which larger enterprises would not usually face.

## 2. Situation under existing insolvency regimes with respect to MSEs

11. Existing standard business insolvency regimes may be designed with complexities and sophistication of larger enterprises in mind. They may presuppose the presence of an extensive insolvency estate of significant value and the active engagement of creditors and an insolvency representative, whereas in many cases an MSE will be unable and the creditors will be unwilling to finance the MSE insolvency proceedings and there will be very few creditors and no or very few assets left for distribution to creditors. Because of the lack of (sufficient) funds in the insolvency estate, MSEs may be ineligible to apply for insolvency in some jurisdictions, or insolvency proceedings may be terminated after their commencement in other jurisdictions.<sup>109</sup>

12. A possible separation of owners and managers of an insolvent entity from the operation of the business may operate as a disincentive for MSEs to apply for insolvency. In addition, existing standard business insolvency regimes may restrict insolvency proceedings to the business debts of a distinct business entity, which would not comprehensively address intermingled business and personal debts usually involved in MSE insolvency. Individual entrepreneurs may be treated as individual defaulters and be subject to personal insolvency frameworks, where such frameworks exist. The latter may not provide temporary protection from creditors, nor allow for debt restructuring procedures and discharge. Where discharge is available for individual entrepreneurs, a long waiting period before discharge may apply, leaving full personal liability for many years after liquidation of the business. Heavy penalties, including limitations on freedom of movement and other personal restrictions, may also apply.

## 3. Different approaches to treating MSE insolvency<sup>110</sup>

13. This [text] recommends that States include a simplified insolvency regime in their legal framework, either by adjusting their standard business insolvency law<sup>111</sup> or by establishing a separate simplified insolvency regime, where their existing insolvency regime does not serve the needs of MSEs. At the same time, it recognizes that conditions for access to such regime and its features may vary greatly.

14. As regards access to a simplified insolvency regime, there is no uniform definition of an MSE. The latter may cover a range of persons, from individual entrepreneurs to unincorporated and incorporated entities with limited and unlimited liability, that meet certain criteria (e.g., low liabilities, no real estate, no or very few employees). In the light of such diversity, this [text] leaves it to policymakers to identify in their jurisdictions persons that may benefit from access to a simplified insolvency regime envisaged in this [text].

<sup>109</sup> Some jurisdictions may allow the proceedings to progress only if debtors can cover administrative costs and ensure a minimum percentage of proceeds to creditors. Other laws may allow the proceedings to progress for debtors that cannot meet those requirements only if they were stricken by specific, compelling, exceptional circumstances (hardship relief).

<sup>110</sup> **Further to the comments made during the September 2020 informal consultations, the title of this section was changed in order to more accurately describe the content of the section, which describes not only approaches of States to treating MSE insolvency but also approaches taken in this text.**

<sup>111</sup> **Further to the comments made during the September 2020 informal consultations, this part was redrafted in the light of the content of the preceding section, to avoid conveying the idea that adjustment of only some features of the existing insolvency law would be sufficient.**

15. As regards features of a simplified insolvency regime, in some jurisdictions it may focus on reorganization while in others it may focus on liquidation. [This text addresses both simplified reorganization and simplified liquidation proceedings in a neutral manner, recognizing that the need for either may arise depending on the circumstances of an MSE insolvency case.]<sup>112</sup> Some jurisdictions may favour a liberal approach to discharge while others may be concerned about the impact of such an approach on incentives (e.g., enabling moral hazard).<sup>113</sup> Constitutional, cultural, social and economic norms of the State as well as regional integration dynamics and concerns over “forum shopping”, i.e., situations when MSEs would consider relocating their business to other jurisdictions to access more friendly regimes, will dictate policy choices on these matters. [This text advocates a cost-effective approach to discharge, accompanied by appropriate safeguards against abuse or improper use by either the debtor or creditors.]<sup>114</sup>

#### **4. The need for holistic legislative measures to address the needs of MSEs in financial distress**

16. Amendments of existing legislation other than insolvency law may be required so as to ensure the smooth functioning of a simplified insolvency regime under a cohesive body of law. Business registry regulations as well as banking laws and regulations may, for example, be relevant to generating and maintaining information about MSEs throughout their life cycle and channelling that information to the MSE insolvency system. Banking and data protection laws and regulations may also be relevant in that context.

17. Smooth interaction of a simplified insolvency regime with secured transactions law and law applicable to third-party guarantees would also be necessary in the light of the important role that secured creditors and personal guarantors usually play in the MSE insolvency context. In addition, in the light of its close interlinkage with consumer and personal insolvency, a simplified insolvency regime will have to properly interact with consumer protection law and regulations, family and matrimonial law, as well as human rights instruments.

18. Furthermore, specific issues faced by MSEs in financial distress suggest a need for legislative measures that would incentivize MSEs to be as forthcoming as possible with identifying and addressing financial distress at an early stage. Some of those measures can be addressed in the insolvency law, such as protection from avoidance of business rescue finance provided to an MSE before the commencement of insolvency proceedings and recognition at subsequent insolvency proceedings of agreements reached during informal debt restructuring negotiations. Some other measures may fall outside the insolvency law. In particular, tax and accounting regulations may build in a system of early warning signals of financial distress to MSEs and create incentives for early debt restructuring negotiations (e.g., tax relief from debt write-offs).

#### **5. Institutional support**

19. Not all measures aimed at mitigating the challenges facing MSEs in financial distress are capable of legal resolution. A combination of institutional measures may be required to ensure that a simplified insolvency regime is effective in practice.

<sup>112</sup> This sentence was added further to the suggestion made during the September 2020 informal consultations.

<sup>113</sup> During the September 2020 informal consultations, it was suggested to replace reference to “their economies” with “incentives” and to refer in that context to moral hazard.

<sup>114</sup> During the September 2020 informal consultations, it was suggested to revise the paragraph to explain clearly the stance of the text on the issues addressed in that paragraph. The paragraph was redrafted accordingly (see the text in square brackets).

20. In particular, the proper institutional and administrative structures and human resources should be in place to operate and administer a simplified insolvency regime. Effective implementation and the operational efficacy of a simplified insolvency regime will also be enhanced by standardized online procedures and forms and sample documents and by appropriate interaction of relevant State bodies and systems at the administrative level. In addition, training may need to be provided, on the one hand, to State authorities and insolvency practitioners with the aim of building the capacity in the public and private sectors necessary to handle specificities of MSE insolvencies, and on the other hand, to MSEs to increase their financial and business management literacy and awareness of their obligations in the vicinity of and during insolvency.

21. Many insolvency reforms aimed at lowering barriers for access to insolvency by MSEs are complemented by other institutional support to MSEs, in particular debt counselling, mediation and conciliation services and assistance with application for commencement of insolvency proceedings and compliance with disclosure obligations under insolvency law.

## II. Glossary

22. The following paragraphs explain the meaning and use of certain expressions that appear frequently in this [text]. They as well as other terms used in this text should be read in conjunction with the terms and explanations used in the Guide: [*to be completed, see chapter II of the present document*].

[22 bis. The following rules of interpretation apply: (a) “or” is not intended to be exclusive; (b) use of the singular also includes the plural; (c) “include” and “including” are not intended to indicate an exhaustive list; (d) “such as” and “for example” are to be interpreted in the same manner as “include” or “including”; (e) “may” indicates permission and “should” indicates instruction; and (f) references to “person” should be interpreted as including both natural and legal persons.]<sup>115</sup>

## III. Core provisions for an effective and efficient simplified insolvency regime

### A. Key objectives of a simplified insolvency regime [see draft recommendation 1]<sup>116</sup>

23. Recommendations 1 to 7 of the Guide list the key objectives of an effective insolvency law, including: providing certainty in the market to promote economic stability and growth; maximizing value of assets; striking a balance between liquidation and reorganization; ensuring equitable treatment of similarly situated creditors; providing for timely, efficient and impartial resolution of insolvency; preserving the insolvency estate to allow equitable distribution to creditors; ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and recognizing existing creditors’ rights and establishing clear rules for ranking of priority claims. This [text] adds to that list the establishment of an effective simplified insolvency regime that should focus on specific issues arising in MSE

<sup>115</sup> This text has been inserted further to the suggestion during the September 2020 informal consultations to include rules of interpretation in the text.

<sup>116</sup> During the May 2020 informal consultations, the suggestion was made to follow the structure of the Guide where the commentary precedes the respective recommendations. During the September 2020 informal consultation, support was expressed for that suggestion. Depending on the Working Group’s decision on this issue, the text may be restructured accordingly when it is presented to the fifty-eighth session of the Working Group, expected to take place in May 2021.

insolvencies, such as MSEs' lack of financial and business sophistication, creditor disengagement, concerns over stigmatization and the lack of (sufficient) assets in the insolvency estate.

24. In devising mechanisms to address those issues, the balance between competing goals and interests would need to be achieved. For example, eligibility and commencement standards, provisions on notices and other procedural steps and criteria for discharge of MSEs from debts should be formulated for a simplified insolvency regime with the aim of minimizing the complexity and length of insolvency proceedings and their associated costs. At the same time, expedited and simple procedures should not jeopardize the right of persons affected by a simplified insolvency proceeding to obtain information, to express objection or opposition and to seek review.

25. Facilitation of participation of all parties in interest in simplified insolvency proceedings and the protection of their interests will need to be maintained as the key objectives in the simplified insolvency regime. The debtor-in-possession regime may in particular encourage and incentivize early access of MSEs to simplified insolvency proceedings and reduce concerns over stigmatization. At the same time, appropriate assistance and oversight and, where appropriate, displacement of the debtor from the operation of the business would be required to address MSE's lack of sophistication in financial, business and insolvency matters and ensure protection of creditors. Measures should also be in place to overcome bottlenecks that may arise if any party in interest chooses not to participate in the proceedings or to cause obstruction or delay. The effective system of safeguards and sanctions would generally be required to prevent abuse, fraud and irresponsible behaviour and provide appropriate penalties for misconduct.<sup>117</sup>

## B. Scope

### 1. Application to all MSEs [see draft recommendation 2]

26. Although it is left to States to identify persons that will be qualified as MSEs and thus be eligible for access to a simplified insolvency regime, this [text] was drafted primarily for persons that share the characteristics described in paragraphs [6–10] above, i.e., micro and small-sized enterprises, which larger enterprises, including medium-sized ones, would not possess. To the extent that any MSE is excluded from the insolvency law, it will neither enjoy the protections, nor be subject to the discipline, of the insolvency law. An all-inclusive approach to the design of a simplified insolvency regime, encompassing individual entrepreneurs, unlimited liability MSEs and limited liability MSEs, is therefore justified, recognizing however that insolvency of individual entrepreneurs and unlimited liability MSEs may raise policy considerations different from insolvency of limited liability MSEs.

27. A simplified insolvency regime should focus on early resolution of financial difficulties of MSEs, irrespective of the legal structure through which their economic activities are conducted (limited liability company, partnership, sole trader, etc.) and whether or not they are conducted for profit. The term "economic activities" should be given a broad interpretation so as to cover matters arising from all relationships involving economic activity, whether contractual or not. These relationships would include, but are not limited to: any trade transaction for the supply or exchange of goods or services; distribution

<sup>117</sup> During the September 2020 informal consultations, in the context of the discussion of deemed approval, suggestions were made to emphasize in the commentary that a simplified insolvency regime would benefit not only States and MSE debtors but also creditors, and that in some cases speed and simplicity should prevail over other considerations, such as procedural and other safeguards that increase complexity of proceedings. The Working Group may wish to formulate its position on that matter.

agreement; commercial representation or agency; consulting; and joint venture and other forms of business cooperation.

**2. Comprehensive treatment of all debts of individual entrepreneurs [see draft recommendation 3]**

28. A number of States have insolvency laws that apply different rules to business debts as opposed to personal or consumer debts. In the context of MSEs, it may not always be possible to separate the debts into clear categories. Individual entrepreneurs, owners of limited liability MSEs and their family members may all be involved in the business and use consumer credit to finance the business either as start-up capital or for operations. Business insolvency may lead to personal or consumer insolvency once a business fails, even if the business is a separate legal entity. For that reason, separate procedures with different access conditions and procedural steps applicable to various debts involved in MSE insolvency may not be an optimal solution. It is advisable to cover all debts of an MSE debtor in a single simplified insolvency proceeding; where that is not possible, at least procedural consolidation or coordination of linked insolvency proceedings should be ensured.

**3. Types of simplified insolvency proceedings [see draft recommendation 4]**

29. A simplified insolvency regime should recognize that a majority of MSE insolvency cases may result in liquidation. It should therefore provide for a simple mechanism to sell the MSE debtor's assets, if any, distribute the proceeds to creditors and liquidate the business. At the same time, a simplified insolvency regime should build in safeguards against the risk of prematurely liquidating viable MSEs. To ensure that insolvency proceedings are not abused by either creditors or the MSE debtor and that the procedure most appropriate to resolution of the MSE debtor's financial difficulty is available, an insolvency law should provide for conversion between the different types of proceedings in appropriate circumstances. Achieving the balance between liquidation (often preferred by secured creditors) and reorganization (often preferred by unsecured creditors and the debtor) will have implications for broader policy considerations, such as promotion of entrepreneurship and employment.

30. Other options for the timely rescue of viable MSEs, such as informal debt restructuring negotiations, may not fall under the insolvency law framework. [They are discussed in section Q of this [text]].

**C. Institutional framework**

**1. The competent authority entrusted with functions related to a simplified insolvency regime [see draft recommendation 5], 5 bis and 5 ter]**

31. The competent authority to be designated by a State will play an important role in ensuring that a simplified insolvency regime fulfils its objectives, in particular that it provides for easily accessible and available, expeditious, simple, flexible and low-cost insolvency proceedings, and at the same time ensures that the regime is not abused or improperly used.

32. The term "competent authority" was preferred to the term "court" used in the Guide and defined in its glossary,<sup>118</sup> to convey the point that the competent authority would not necessarily be a judicial or other authority competent to exercise overall supervision and control over insolvency proceedings in the State. In some States, the competent authority will indeed be such a body, while in other States, conduct and oversight of simplified insolvency proceedings may be entrusted to another body. The choice will depend, among other things, on

<sup>118</sup> See (i) "Court": a judicial or other authority competent to control or supervise insolvency proceedings."

the administrative and legal systems of the State as well as the capacities of existing institutions [and the need to ensure cost-efficiency and speed of proceedings].<sup>119</sup>

33. In most jurisdictions, insolvency proceedings are 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 of overall supervision and control over insolvency proceedings.

34. In those States in which simplified insolvency proceedings are already handled or can be handled through the existing body, whether in the judiciary or otherwise, exercising overall supervision and control over insolvency proceedings in the State, there may be little advantage in introducing another body in the system. Institutional reforms, including amendments in procedural rules, may nevertheless be needed to enable that body to deal efficiently with simplified insolvency proceedings, minimizing costs and delays while at the same time ensuring proper checks and balances. Procedural rules may need in particular to envisage the possibility of *ex parte* commencement of simplified insolvency proceedings and holding summary proceedings in lieu of ordinary proceedings.

35. In other jurisdictions, where simplified insolvency proceedings before the existing body exercising overall supervision and control over insolvency proceedings in the State are expected to be costly, or where the capacity of such body is limited, a different body may be entrusted with public functions related to simplified insolvency proceedings.

36. Recognizing the widely differing systems of State administration as well as varying approaches and capacities throughout the world, this [text] does not suggest to States that a specific State authority should become the competent authority. The focus of this [text] is instead on functions that the competent authority should be able to perform in order to fulfil the objectives of a simplified insolvency regime.

37. Some of the functions of the competent authority would stem from its general responsibility to provide public oversight over simplified insolvency proceedings necessary to ensure their integrity and promote confidence and trust in the use of a simplified insolvency regime. Those functions would typically include: (a) verification of eligibility requirements for commencement of a simplified insolvency proceeding; (b) verification of accuracy of information provided to the competent authority by the debtor, creditors and other parties in interest, including as regards the debtor's assets, liabilities and recent transactions; (c) determination of the type of the proceeding to commence; (d) conversion of one proceeding to another; (e) control over the insolvency estate; (f) verification of the liquidation [schedule] [report] and the reorganization plan for compliance with law; (g) supervision of the implementation of a debt repayment or reorganization plan and verification of the implementation of the plan; and (h) decisions related to the stay of proceedings, relief from the stay, creditors' objections or opposition, disputes and approval or confirmation of a liquidation [schedule] [report] or reorganization plan (see recommendation [5 bis]). [Some of the listed functions could be delegated by the competent authority to an independent professional to

<sup>119</sup> The text in square brackets was added further to the suggestions made during the September 2020 informal consultations.

save costs or to benefit from expertise and for other reasons (see paras. [42-48] below).]<sup>120</sup>

38. Other functions of the competent authority would stem from its responsibility to conduct simplified insolvency proceedings. In particular, the competent authority will be expected to issue decisions on commencement, dismissal and closure of proceedings, to admit or deny creditor claims, to serve notices, to ascertain the existence or absence of sufficient opposition and deemed approval, etc.

39. Some other functions of the competent authority would stem from its general responsibility to provide institutional support to intended users of a simplified insolvency regime. Such support may take different forms, including raising public awareness about the existence of the simplified insolvency regime and its features and making available templates, standard forms, online procedures and services of independent professionals (see section C.2 below).

[39 bis. More than one competent authority may need to be involved in a simplified insolvency regime. A judicial body, for example, will not be able to perform certain functions envisaged in the text (see, for example, recommendation [37]) that are more appropriate for an administrative body. An administrative body may not necessarily have review and adjudication powers (e.g., those envisaged in recommendation [38]): in some jurisdictions, such functions may be performed only by judicial bodies; in other jurisdictions such functions can be performed by administrative bodies but decisions will be subject to judicial review. When dividing different functions among several competent authorities involved in a simplified insolvency regime, the State should consider the need to avoid conflicts of interest among various functions and duties (e.g., public duties, review functions and duties to the insolvency estate and creditors and other parties in interest).]<sup>121</sup>

40. The system of review of decisions taken by the competent authority will reflect the legal tradition in a particular State as well as the place of the competent authority in the State administration and the structure of the State administration. For example, in some jurisdictions, decisions of the competent authority that is a judicial body would not be appealable at all or would be appealable only on limited grounds, such as fraud (see recommendation 154 of the Guide in that respect) or prejudice to the parties. In other jurisdictions, no such limitations may be imposed. Decisions of a competent authority that is an administrative body should be reviewable by a judicial body. In some jurisdictions, they may also be made subject to review by an administrative body that would exercise hierarchical authority or control over the competent authority. In some legal systems where both administrative and judicial review is provided, judicial review may be sought only after opportunities for other challenges have been exhausted. In other systems, the two means of challenge or review are available as options.

41. Keeping in mind the need to ensure expedited simplified insolvency proceedings, a simplified insolvency regime should build in measures to avoid protracted reviews of the competent authority's decisions. Time periods for review should be short. In order to ensure that the MSE insolvency can be addressed and resolved in an orderly, quick and efficient manner without undue disruption, the insolvency law should also provide that appeals in simplified insolvency proceedings should not, as a general rule, have suspensive effect (see

<sup>120</sup> The text in square brackets was added further to the suggestion made during the September 2020 informal consultations.

<sup>121</sup> This text was added further to the suggestions made during the May 2020 informal consultations. It was also suggested at that time that the commentary should explain how the competent authority – especially, if the authority is a court – can appoint an independent professional before commencing an insolvency proceeding. The Working Group may wish to formulate its position on that point.

recommendation 138 of the Guide in that respect). To avoid abuse of the review mechanism, the request for review of the competent authority's decision should not by itself convert a simplified insolvency proceeding into a standard one.<sup>122</sup>

2. **Support with the use of a simplified insolvency regime [see draft recommendation[s 5 ter and] 6]**
  - (a) **Services of an independent professional**

42. The insolvency law should allow the competent authority to engage the services of an independent professional where necessary and as appropriate, on the understanding however that the competent authority would remain responsible for the oversight over, and for ensuring the integrity of, simplified insolvency proceedings. In that context, it would be necessary to identify the functions of the competent authority that can be assigned to an independent professional and the functions that are truly public and cannot be assigned to an independent professional, as otherwise trust and confidence in a simplified insolvency regime will be jeopardized (see recommendations [5 bis and 5 ter] and paras. [37-39] above).

43. The term “independent professional” is generic and intends to encompass any professional (either an individual or a body) from the public, private or public-private sector whose services the competent authority may decide to engage for one or more tasks related to a simplified insolvency proceeding. That term was preferred to the term “insolvency representative” used in the Guide and defined in its glossary,<sup>123</sup> in order to convey the idea that functions that may be entrusted by the competent authority to the independent professional would not necessarily relate to the administration of the reorganization or the liquidation of the insolvency estate.

44. The services of an independent professional may in particular be required for MSEs in the light of the expected low degree of sophistication of MSEs in financial, business and insolvency matters. Making them available to MSEs prior to commencement of a simplified insolvency proceeding may expedite subsequent steps in the proceeding. An independent professional may explain to the MSE its rights, duties and obligations and assist with the preparation of an application for commencement of insolvency proceedings or a response to the creditor's application for commencement of insolvency proceedings. In some cases, the competent authority may request an independent professional to prepare a detailed list of the debtor's assets, liabilities, payments, transactions and transfers or ascertain that the list prepared by the debtor is accurate and complete. In some other cases, the services of an independent professional may need to be engaged to assess the viability of the reorganization plan or for the valuation of the business or particular assets.

44 bis. In the debtor-in-possession regime, an independent professional may be appointed to assist the parties with the preparation and negotiation of a reorganization plan, to supervise the activities of the debtor or to take partial control over the assets or affairs of the debtor during those negotiations, to oversee the implementation of the plan by the debtor and to ensure compliance

<sup>122</sup> During the May 2020 informal consultations, it was suggested that more prominence should be given in the commentary to the discussion of review of the competent authority's decisions. Paragraphs 40 and 41 may be expanded and put in a separate section linking the discussion closer to the recommendation(s) that address this topic. See also para. 138 below for the related discussion. During the September 2020 informal consultations, support was expressed for that suggestion. Depending on the Working Group's decision on this matter, the text may be restructured accordingly when it is presented to the fifty-eighth session of the Working Group, expected to take place in May 2021.

<sup>123</sup> See (v) “‘Insolvency representative’: a person or body, including one appointed on an interim basis, authorized in insolvency proceedings to administer the reorganization or the liquidation of the insolvency estate.”

with reporting obligations of the debtor to the competent authority. Where the debtor-in-possession regime is not an option from the outset or later in the proceedings, the competent authority may entrust an independent professional with the usual functions of the insolvency representative.<sup>124</sup>

45. An independent professional will be expected to receive appropriate training and meet qualification and other criteria for appointment corresponding to the task for which that independent professional is appointed. The considerations raised in the Guide (part two, chapter III, section B.2, and recommendations 115–117) as regards the qualifications, personal qualities and the absence of conflicts of interest usually required of a person who can be appointed as an insolvency representative are relevant in that context.

45 bis. Where an independent professional belongs to a regulated profession, such as administrator, liquidator, auditor, trustee, receiver, mediator or lawyer, the person will be expected to adhere to standards of that profession at the risk of losing the right to work in that profession. Those standards usually address ethical and other requirements, including as regards independence, impartiality, the code of conduct and standards of professional performance. In addition, independent professionals may be made subject to oversight and regulatory mechanisms aimed at supervising the work of independent professionals with a view to ensuring that their services are provided in an effective and competent way and, in relation to the parties involved, that they are provided impartially and independently. The same or additional mechanisms may exist for holding independent professionals accountable for failure to perform their duties to the expected standards. Information about the authorities exercising those functions over independent professionals should be made publicly available.

46. In addition to having the requisite knowledge, experience and skills, independent professionals will be expected to demonstrate integrity, impartiality and independence. Integrity should require that an independent professional has a sound reputation and no criminal record or record of financial wrongdoing, no previous insolvency or removal from a position of public administration. Impartiality and independence relate to the absence of conflicts of interest, whether existing or potential, between the independent professional and the debtor, the creditor and other parties in interest. An obligation to disclose existing or potential conflicts of interest would apply to a person proposed for appointment as the independent professional before the appointment and to the appointed person throughout the performance of the assigned task. Depending on the needs, one or more independent professionals may be appointed in any single simplified insolvency proceeding to avoid conflicts of interest and to ensure independence and impartiality vis-à-vis the debtor, creditors and other parties in interest as required. In order to avoid any conflict of interest, debtors and creditors should have the opportunity to either object to the selection or appointment of the independent professional or request the replacement of the particular independent professional.<sup>125</sup>

47. The services of an independent professional may be paid from public funds or the insolvency estate, depending on the circumstances, or may be provided pro bono. A schedule of fees may be established by the competent authority (fixed or sliding, depending on the size of the insolvency estate and the complexity of the case), coupled with a system of incentives for professionals to perform services pro bono in simplified insolvency proceedings.

48. The independent professional is to be differentiated from other third parties whose services would not be engaged by the competent authority but who may nevertheless be relevant to a simplified insolvency regime. For

<sup>124</sup> Paragraph 44 was split into two because of its length resulting from the addition of new elements in what is now the first sentence of paragraph 44 bis.

<sup>125</sup> Paragraphs 45, 45 bis and 46 were restructured and expanded with additional points related to conflicts of interest, further to the comments made during the May 2020 informal consultations.

example, various State and non-State entities may be involved, on a voluntary basis or otherwise, in informing MSEs about early signals of financial distress and their pre-insolvency obligations or in facilitating negotiations, or mediating disputes, between MSEs and their creditor(s). Those measures usually fall outside or go beyond the insolvency law. [They are addressed in section Q of this [text].]

**(b) Templates, online procedures and integration of State administrative processes**

49. Other measures should be put in place to make a simplified insolvency regime easily accessible and usable, including by making available standard forms and templates. [Although the value of such forms and templates for unification, standardization and compiling and processing of the relevant information should not be underestimated, it might be counterproductive to require their use in all situations and at all costs. There could be situations when MSEs would be unable to fill standard forms in or follow suggested templates (e.g., due to the lack of sophistication or presence of unique characteristics or circumstances that available forms and templates cannot accommodate). The possibility of submitting relevant information in a non-uniform and non-standardized form should therefore not be completely excluded.

49 bis. Enabling the online filing of applications and claims, submission of restructuring plans, serving of notices and notifications and lodging of challenges and appeals could be essential means of achieving the objectives of the simplified insolvency regime. Recognizing that adoption of modern technology has not progressed equally among or within States, the use of online procedures and forms would by necessity be tailored to the State's technological and socioeconomic capacity. Phased-in implementation of online procedures may start with the submission of online applications. This would allow, at a minimum, to store the information provided by the applicant in electronic form in a computer database. More advanced electronic systems may provide for standard forms that are easier to understand and complete (e.g., with automated error checks, suggested entries). Most advanced systems would allow automatization of other stages of proceedings, verification of compliance with applicable law requirements through searches of the linked databases, such as business registries, registries of rights to immovable and movable property and registries of secured transactions. They also facilitate collection, aggregation and disaggregation of data.]<sup>126</sup>

49 ter. States should envisage interaction of the competent authority with other State bodies such as tax authorities and State-run registries (e.g., business registries and security interest registries). Electronic government platforms may considerably expedite that task. Those measures could facilitate the collection of information about the assets, liabilities and transfers of the MSE debtor and assist with channelling that information to the competent authority. They may also facilitate verification of that information by the competent authority, with the result that a decision on the application and the right course of action will be taken within a shorter time period.

**3. Mechanisms for covering costs of administering simplified insolvency proceedings [see draft recommendation 7]**

50. One of the purposes of putting in place a simplified insolvency regime is to address insolvency cases of MSEs with no or insufficient assets to cover the costs of insolvency proceedings and to prevent situations when financial distress of such MSEs would remain unresolved because the MSE application for

<sup>126</sup> The text in square brackets was added further to the comments made during the May and September 2020 informal consultations. Because of the resulting length of paragraph 49, it was split into three separate paragraphs.

commencement of simplified insolvency proceedings will be denied for lack of sufficient funds in the insolvency estate. Access to simplified insolvency proceedings should thus not depend on the MSE's ability to cover the administrative costs of the proceedings. Eligible debtors that do not have enough assets to fund a proceeding should be able to commence a proceeding to address their financial difficulties and obtain a discharge. Broader public interest considerations, such as the need to ensure the observance of fair commercial conduct or to further standards of good governance, may also require the simplified insolvency proceedings to progress in such cases. [Among other benefits, this could complement any existing mechanisms and efforts aimed at identifying and locating misappropriated assets or their proceeds and returning them to their legitimate claimants and holding responsible persons accountable.]<sup>127</sup>

51. There should be alternative mechanisms to meet the costs of administering the simplified insolvency proceedings when the MSE debtor cannot meet them, including using public funds or establishing a fund out of which the costs of simplified insolvency proceedings may be met. [Surcharging proceeds from the realization of insolvency estate assets could defray at least some of the costs of administration of a simplified insolvency proceeding.]<sup>128</sup> Creditors may be required to guarantee the payment of costs of any additional step that they may request in simplified insolvency proceedings (e.g., services of an independent professional), subject to reimbursement from the estate if assets of the debtor turn out to be sufficient to cover the cost of the proceedings or part thereof. Allowing payment of administrative expenses in instalments, including from future income through the implementation of a debt repayment plan or reorganization plan, would allow the MSE debtor to share the costs of the proceedings at least in part.

## **D. Main features of a simplified insolvency regime**

### **1. Default procedures and treatment [see draft recommendation 8]**

52. To avoid delays and at the same time to ensure transparency and predictability, a simplified insolvency regime should provide for default procedures and treatment that can be overridden by the decision of the competent authority on its own motion or upon request of any party in interest. The competent authority may modify the proceedings by introducing, for example, a mandatory mediation stage or replacing the debtor in possession with an independent professional. To allow any party in interest to request alternative procedures and treatments in a timely fashion, the insolvency law should require that all default procedures and treatment should be notified to all parties in interest sufficiently in advance.

### **2. Short time periods [see draft recommendation 9]**

53. The rules applicable to simplified insolvency proceedings should allow for expedited procedures. Shorter statutory time periods than those applicable in standard business insolvency proceedings should apply and only narrow grounds for possible extensions of the default time periods within any maximum permissible number of requests for extensions (usually once or twice) should be specified in the law. Non-compliance with the established statutory deadlines

<sup>127</sup> This sentence was revised further to concerns expressed during the September 2020 informal consultations that the previous wording conveyed the impression that, in the absence of any commenced insolvency proceedings, there would be no mechanisms for tracing and recovering assets concealed from creditors.

<sup>128</sup> This sentence was added further to the suggestion made during the September 2020 informal consultations.

should trigger certain consequences, including conversion of one type of proceedings to another type.<sup>129</sup>

### 3. Reduced formalities [see draft recommendation 10]

54. Recognizing that MSEs tend to have less complicated operations and financial arrangements, simplified insolvency proceedings should have fewer and simpler procedural formalities than those existing in standard business insolvency proceedings. In particular, elaborate rules on public notices, creditor committees, creditor meetings and verification of claims should be lifted or adjusted, especially where little or no value is available for distribution, and creditors may therefore be expected not to be involved in the proceedings. *[Discussion on cost-effectiveness may need to be added depending on the agreed text of draft recommendation 10.]*

### 4. Debtor-in-possession<sup>130</sup> [see draft recommendations 11, 11 bis and 11 ter]

55. Use of the debtor-in-possession approach as the norm in simplified insolvency proceedings is usually justified by reference to the characteristics of MSEs. These include the fact that the MSE debtor often has unique knowledge about its business, as well as ongoing relationships with creditors, suppliers and customers. The risk of being displaced from the helm can create a disincentive for the MSE debtor to seek timely commencement of insolvency proceedings. In addition, the insolvency estate of the MSE debtor may be insufficient to fund the appointment of the insolvency representative.

56. The debtor-in-possession approach may not be appropriate in some cases, for example where the MSE debtor was responsible for misappropriation or concealment of property or poor management that caused its financial distress. It may also be inappropriate in involuntary commencement where the MSE debtor could be expected to be hostile to creditors or where the reorganization plan was imposed on the MSE debtor by creditors. In such cases, the competent authority may appoint a third party, such as the independent professional, to take on a supervisory role or even displace the MSE debtor or make an interim stay order preventing the debtor from taking certain actions (such as disposing of assets or incurring liabilities above specified caps).

57. In some jurisdictions, an independent professional (e.g., the insolvency representative) may be a mandatory participant in insolvency proceedings and, although a debtor-in-possession approach may still be possible, it may need to be coupled with the involvement of such professional who will closely supervise the process and keep the competent authority continuously informed.

### 5. Deemed approval [see draft recommendation 12]<sup>131</sup>

58. To avoid delays<sup>132</sup> that may arise if creditors decide not to participate in the proceedings, the insolvency law may replace the requirement of a formal vote with deemed approval procedures under which all parties in interest, after

<sup>129</sup> During the September 2020 informal consultations, it was suggested that this paragraph should convey the point that, in imposing short time periods throughout simplified insolvency proceedings, the insolvency law should nevertheless recognize the need for flexibility in some cases, e.g., during the COVID-19 pandemic, the need arose to extend deadlines. Reference was made in that context to other situations of force majeure that may justify extension of deadlines. The Working Group may wish to formulate its position on this issue.

<sup>130</sup> During the May 2020 informal consultations, a suggestion was made to explain in the commentary where debtor-in-possession in liquidation may be justified and emphasize that the debtor should fulfil requirements that are usually imposed on debtors-in-possession in order to protect creditors. The Working Group may wish to formulate its position on these matters.

<sup>131</sup> This section may need to be redrafted depending on the Working Group's decisions on the issues raised as regards deemed approval during the informal consultations.

<sup>132</sup> During the September 2020 informal consultations, it was suggested to replace the word "bottlenecks" with the word "delays". That suggestion was implemented in the present draft.

due notification, will be bound by the outcome of the proceedings [where the plan complies with other requirements for approval]<sup>133</sup> if they failed to object or express opposition on time.

59. Any party in interest should be expected to have legal standing to raise an objection or express opposition when its rights, interests in assets or duties under the insolvency law are affected. Nevertheless, the right to raise objections or express opposition should be balanced with the need for efficient administration of simplified insolvency proceedings. The time period for such actions should be generally very short. The insolvency law [may] [should]<sup>134</sup> provide for the minimum and maximum time periods and give the competent authority discretion to fix a specific time within that range, depending on the situation.

60. The insolvency law should generally provide that creditors whose rights are not modified or affected by a particular step in a simplified insolvency proceeding (e.g., a reorganization plan) should not have a legal standing before the competent authority [in regard to that step]<sup>135</sup> (see recommendation 147 of the Guide in that respect). Objecting or opposing creditor(s) may be required to represent a certain number of creditors or percentage of the debt to have legal standing to proceed with actions before the competent authority.<sup>136</sup> The insolvency law may alternatively require objection or opposition to be brought by the creditors generally. Such requirements may depend upon the grounds of the objection or opposition raised.

61. The term “objection” is used in this [text] to refer to rejection of the proposed course of action on any legal ground (e.g., a mistaken allocation of priority to a particular claim or violation of the pari passu principle established in the insolvency law for distribution of proceeds in simplified liquidation). The term “opposition” is used in this [text] to refer to rejection of any aspects of the proposed course of action for [extra-legal] [business]<sup>137</sup> reasons (e.g., [on the viability of a reorganization plan,]<sup>138</sup> on private sale as opposed to a public auction where both options are permitted by the insolvency law). An objecting party might be expected to provide legal arguments for objection, while a simple dissatisfaction with the proposed course of action might be sufficient to convey opposition. An objection by one creditor might be sufficient to prevent the approval of a proposed course of action, while one creditor’s opposition may not produce such effect if a threshold for approval is otherwise met.

## **E. Participants**

### **1. Rights and obligations of parties in interest [see draft recommendation 13]**

62. For certainty and the protection of different parties in interest involved in simplified insolvency proceedings, it will be important for the insolvency law

<sup>133</sup> During the September 2020 informal consultations, with reference to the proposed option 2 for draft recommendation 57, it was suggested to add the words in square brackets.

<sup>134</sup> In its communication to the secretariat dated 3 July 2020, Côte d’Ivoire suggested replacing “may” with “should”, to be in line with the wording found in the Guide.

<sup>135</sup> During the September 2020 informal consultations, it was suggested to add the words in square brackets to narrow down the reference to legal standing. The understanding was that there could be a legal standing to express objection on other grounds, e.g., classification of a claim.

<sup>136</sup> In its communication to the secretariat dated 3 July 2020, Côte d’Ivoire suggested that the insolvency law should specify the exact threshold.

<sup>137</sup> During the September 2020 informal consultations, it was suggested to replace the word “business” with the word “extra-legal” to avoid unintended litigation. It was noted that, at least in one jurisdiction, the obligation to act in good faith was the only constraint on a creditor to express opposition.

<sup>138</sup> During the September 2020 informal consultations, it was proposed to delete the words in square brackets since, at least in one jurisdiction, rejection of the plan because of its unfeasibility/non-viability would fall under the examples of rejection of the proposed course of action on a legal ground, i.e., it would be characterized as an objection, not opposition.

to set out clearly their rights and obligations. Common rights of all parties in interest usually include the right to participate in proceedings, to be heard, to request review and to obtain information, subject to protection of information that enjoys protection under applicable law (e.g., commercially sensitive, confidential and private information). Common obligations include the obligation not to act fraudulently or commit [wilful misconduct].<sup>139</sup> In addition to those common rights and obligations, the debtor and creditors will have some distinct rights and obligations.

63. The rights and obligations of parties in interest, including the debtor and creditors, are addressed in the Guide (see recommendations 108–114 and 126–138 and the accompanying commentary). They will be generally applicable in a simplified insolvency regime.

## 2. Obligations of the debtor [see draft recommendation 14]

64. On the commencement of a proceeding and throughout the proceeding, to ensure that simplified insolvency proceedings can be conducted effectively and efficiently, the MSE debtor should assume a general obligation to cooperate with and assist the competent authority in performing its functions and to refrain from actions that might be injurious to the conduct of the proceedings. An essential part of the obligation to cooperate will be enabling the competent authority to take effective control of the insolvency estate where required, by surrendering control of assets and any business records and books.

65. The insolvency law may impose obligations that are ancillary to the MSE debtor's obligation to cooperate, assist and provide necessary information during simplified insolvency proceedings, including the duty to inform the competent authority about any expected change of the place of business or residence. Such ancillary obligations may be automatically applicable, or may be ordered at the discretion of the competent authority where necessary for the administration of the estate or other purpose of the proceedings. These obligations should be proportionate to their underlying purpose and to the overall purpose of the general duty to cooperate, assist and provide necessary information. Human rights norms will be applicable to some of them (e.g., the requirement to disclose correspondence or other requirements that may infringe on privacy or personal freedom). The competent authority may need to be specifically authorized to issue orders that apply limitations on individual entrepreneurs.

66. In the debtor-in-possession approach, which is envisaged as the default in this [text] for simplified reorganization, imposing additional obligations on the MSE debtor may be justified. The MSE debtor and creditors will need to know which rights the MSE debtor will have with respect to the day-to-day operation of the business and which safeguards will be in place to ensure that those rights are not abused and the obligations of the MSE debtor are fulfilled. It will be important to clearly identify the content and terms of the MSE debtor's obligations and to whom each obligation is owed. They should include the obligations to protect and preserve the assets of the estate, to regularly report about the business to the competent authority and to seek approval of the competent authority before any [or some specified] actions with respect to the business and assets of the estate are taken (e.g., on post-commencement finance, the use and disposal of assets and treatment of contracts). [Clarity as regards disposals of assets made in or outside the ordinary course of business may

<sup>139</sup> During the September 2020 informal consultations, concerns were expressed about the term in square brackets. Noting the use of that term in recommendation 135 of the Guide, it was proposed that examples of wilful misconduct should be provided in the commentary, drawing on the respective commentary found in the Guide. Depending on the Working Group's decision on this matter, this proposal may be implemented in the text that will be presented to the fifty-eighth session of the Working Group, expected to take place in May 2021.

facilitate the continuing day-to-day operation of the business, without imposing the complexity of obtaining approvals to conduct routine activities.] When the assets are subject to a security or other interest (e.g., a lease), the MSE debtor-in-possession will be required to take special measures to protect the economic rights of the holder of that interest.

67. Where the MSE debtor fails to comply with its obligations, the insolvency law should address how that failure should be treated and the legal consequences of actions taken in violation of the obligations, taking into account the nature of different obligations and appropriate sanctions. Where the MSE debtor fails to observe the restrictions and enters into contracts requiring consent of the competent authority without first obtaining that consent, the insolvency law should address the validity of such transactions and provide appropriate sanctions for the MSE debtor's behaviour, including displacement from operation of the business, harsher terms for discharge and conversion to liquidation, provided it is in the best interests of creditors. Such sanctions may also be imposed where the MSE debtor withholds information. In more serious cases of withholding information, criminal sanctions may be imposed on a person in control of the MSE debtor.

## **F. Eligibility, application and commencement**

### **1. Eligibility [see draft recommendation 15]**

68. Eligibility will be closely linked to the definition of MSEs adopted in a particular jurisdiction. As noted above, practices with defining MSEs vary greatly across jurisdictions. Thresholds and other criteria may be used for such purpose (e.g., the amount of total debt or liabilities being equal to or less than a specified maximum, the maximum number of employees or assets and income not exceeding a certain level prescribed by law). In addition, certain types of business activity (e.g., involving real estate) may not be eligible for simplified insolvency proceedings. This [text] recommends minimizing the number of eligibility criteria for MSE debtors.<sup>140</sup>

69. Creditors of the eligible debtors may also apply for commencement of simplified insolvency proceedings with respect to those debtors under conditions to be specified in the insolvency law. A main reason for allowing creditor applications is that there will be cases where the MSE debtor will not or cannot apply for commencement, and this may cause further impairment of creditors' rights and dissipation of insolvency estate assets unless creditors can seek appropriate measures, including the imposition of a stay on the MSE debtor's actions as regards its assets. In the light of a limited creditor base and the high probability of creditor disengagement in the MSE insolvency context, it may often be the case that only one creditor may be interested in pursuing an MSE insolvency case. This text therefore does not recommend requiring that a minimum number of creditors apply for commencement of a simplified insolvency proceeding for the proceeding to commence. (Such requirement is applicable in some jurisdictions, where the number of creditors is more than an established threshold, to minimize risks that a single creditor will use simplified insolvency proceedings as a substitute for a debt enforcement mechanism).

<sup>140</sup> During the September 2020 informal consultations, it was suggested that the commentary should encourage States to specify in their legislation at which point in time the determination that the applicant meets the eligibility criteria would be made. It was noted that making such determination at the time of application would lead to more stability, acknowledging however that this would depend on the domestic law of each country. The Working Group may wish to formulate its position on this suggestion.

## 2. Commencement on debtor application [see draft recommendations 17–19]

### (a) No requirement to prove insolvency

70. The cessation of payments test and the balance sheet test are two usual standards for commencement of insolvency proceedings. Where the insolvency law adopts a single test, the Guide recommends that the cessation of payments test and not the balance sheet test should be used. Where the insolvency law contains both tests, the Guide states that the proceedings can be commenced if one of the tests can be satisfied (see recommendation 16 of the Guide).

71. The balance sheet test may be impractical for MSE debtors because they often do not maintain proper records. Moreover, personal assets and liabilities are likely to be mingled with business assets and liabilities, particularly where the MSE debtor is an individual entrepreneur. The cessation of payments test may be more workable in comparison. The law may accept a declaration from the MSE debtor that it is unable to pay its debts and specify the indicators of the MSE debtor's inability to pay its debts or establish a presumption to that effect when the debtor suspends payment of its debts.

72. This text recommends not requiring a MSE debtor to prove insolvency. That approach removes the need to collect and file extensive financial documents to prove insolvency or financial distress, may incentivize and facilitate early access by MSEs to the simplified insolvency regime and alleviate concerns over the stigma of insolvency. This text similarly does not recommend imposing a requirement for the debtor to demonstrate "good faith" at the entry point. The administrative efficiency of simplified insolvency proceedings would not be achieved if demonstrating good faith is made a condition of access by MSEs to a simplified insolvency proceeding since proving and verifying good faith may be time- and record-consuming.<sup>141</sup> [Although good faith is not a precondition for entry to simplified insolvency proceedings, negative consequences may follow at later stages of the proceeding if the debtor fails to act in good faith before or at any stage of the proceeding.]<sup>142</sup>

73. Where the competent authority is required to make the commencement decision, it will have the opportunity to review the application and allow time for creditors to object to the commencement of simplified insolvency proceedings or a particular type thereof. Where the application functions to automatically commence proceedings, the competent authority will have such opportunity after the commencement of proceedings. In both cases, attempts to misuse the application procedure can be reviewed. If, after the commencement of simplified insolvency proceedings, the competent authority finds that the eligibility criteria were not met or the information submitted with the application was false or constituted a misrepresentation or the debtor, by filing the application, otherwise abused a simplified insolvency regime, the competent authority will terminate the proceedings and impose sanctions. If it is shown at a later stage that the proceeding to which the debtor applied cannot or should not proceed, the competent authority may decide to convert it to another type (e.g., simplified reorganization to liquidation or vice versa or simplified insolvency proceedings to standard ones) or terminate the proceedings (e.g., where reorganization of the solvent debtor failed).

<sup>141</sup> In the light of the comments made during the May 2020 informal consultations, the commentary may need to explain the meaning of the phrase included in draft recommendation 17 "at an early stage of financial distress", at least that the concept should be understood as defined by national law but will go beyond the insolvency and likelihood of insolvency tests which are already covered by recommendation 15 of the Guide. During the September 2020 informal consultations, a view was expressed that there was no need for adding such explanation in the commentary. The Working Group may wish to formulate its position on this suggestion.

<sup>142</sup> This sentence was added further to the suggestion made during the September 2020 informal consultations.

**(b) Information to be included in the application**

74. In line with the objectives of a simplified insolvency regime to provide for expeditious, simple, flexible and low-cost insolvency proceedings and to make such proceedings easily available and accessible, the disclosure obligation upon application should be kept to an essential minimum. Recognizing that the debtor will be under the general obligation under the insolvency law to cooperate and provide information to the competent authority throughout the proceedings (see recommendation [14]), the information provided upon application may be supplemented with additional information at later stages of the proceedings, if necessary. Otherwise, conditions for entry to a simplified insolvency regime will become burdensome for MSEs.

75. The information to be provided upon application should be sufficient to allow the competent authority to assess the eligibility of the debtor for commencement of a simplified insolvency proceeding. That information would vary depending on eligibility requirements of States. In addition, the debtor may be expected to submit a list of its assets, liabilities and creditors. For an application for a simplified reorganization proceeding, some minimal additional information may be required.

76. After commencement, the competent authority on its own motion or upon a creditor's request may request the debtor to present additional information, in particular to assess any need for commencement of avoidance proceedings or for conversion of the commenced proceeding to another type. In some cases, information about the MSE's financial position may need to be supplemented by information about the MSE's business affairs, such as specifics of profession, contracts and customer lists. Such information will be particularly relevant in the context of simplified reorganization proceedings, to identify the business's prospects and chances of successful reorganization, but it may also be useful in the context of simplified liquidation proceedings, for example for the organization of an asset sale. The extent of additional disclosure may depend on the situation. It may be more extensive where objections are raised by creditors to the commencement of simplified insolvency proceedings or a particular type thereof or where the application gives rise to suspicion of fraud, misrepresentation or doubts regarding the real financial situation of the applicant.

77. Sufficient time should be allowed to the debtor to collect all the requested information. The duration would vary depending on the requested information and the state of the debtor's records. Standard forms that set out the specific information required from the debtor may assist MSEs in complying with disclosure obligations. In addition, assistance of an independent professional may be required to gather the requested information and ensure that such information is up to date, complete, accurate and reliable, including by evaluating the debtor's assets, financial situation and business affairs. The ability of the debtor to meet disclosure obligations would favourably impact terms of discharge and, in a simplified reorganization context, may serve to enhance the confidence of creditors and the competent authority in the ability of the debtor to continue managing the business.

**(c) Effective date of commencement**

78. Simplified insolvency proceedings of the type to which the debtor applied will commence automatically upon application of the debtor or promptly upon decision of the competent authority, depending on domestic law requirements. Not requiring the MSE debtor to prove insolvency and allowing the competent authority to take a decision *ex parte*, on the basis of a preliminary examination of the application, would help to avoid delays between the application and

commencement where a decision of the competent authority is required for commencement of the proceeding.

### 3. Commencement on creditor application [see draft recommendation 20]

79. As addressed in recommendation [15] of this [text], creditors of eligible debtors should have the right to apply for the commencement of simplified insolvency proceedings, including both simplified liquidation and simplified reorganization proceedings, under conditions to be specified in the law. Certain safeguards should be in place. First, in the event of a creditor application for commencement of insolvency proceedings, the MSE debtor should have a fundamental right to immediate notice of the application. Where the MSE debtor has disappeared or is avoiding receipt of personal notice, public notice might suffice or notice could be served at the last known address of the MSE debtor.

80. Second, the MSE debtor should be given an opportunity to respond to the application, contest the application, consent to the application or request the conversion of the proceedings requested in the creditor application to another type of insolvency proceedings. The deadline for a response from the MSE debtor, as established by the competent authority, must be short and strictly enforced to protect the rights of creditors. MSEs should be able to avail themselves of an independent professional's assistance when responding to a creditor application for commencement of insolvency proceedings.

81. If the MSE debtor agrees to the creditor application, simplified insolvency proceedings of the type specified by the creditor(s) will commence unless the competent authority decides otherwise. The competent authority should also decide which type of proceedings to commence if the MSE debtor agrees to enter the insolvency process but prefers a different type of proceeding than that specified in the creditor application. For example, the MSE debtor may request the commencement of simplified reorganization instead of liquidation. In such cases, the law may set forth the maximum period and other conditions under which simplified reorganization requested by the MSE debtor could be continued against the will of the creditors. Where reorganization of an insolvent MSE is not likely to, or cannot, succeed, the competent authority should commence simplified liquidation proceedings.

82. The third safeguard applies where the MSE debtor does not agree with the commencement of insolvency proceedings on the basis that it is solvent or where the MSE debtor fails to respond to the creditor application. In such cases, the simplified insolvency proceedings should not proceed without establishing the debtor's insolvency. While this [text] allows an MSE debtor to enter simplified insolvency proceedings before a state of insolvency, safeguards should be in place to prevent an MSE debtor from involuntarily doing so. The requirement to prove insolvency unless the debtor is actively agreeing to enter the insolvency process provides an essential check against abuse by the creditor(s).

83. The State may specify the test that would need to be met to prove the MSE debtor's insolvency. In MSE insolvency, it would most likely be the cessation of payments test, e.g., creditor(s) may be required to prove to the competent authority that their rights have already been impaired because a demand for debt repayment has been made but it has not been satisfied by the debtor after a certain time period fixed in the law has expired (see also para. [71] above).<sup>143</sup>

<sup>143</sup> During the May 2020 informal consultations a suggestion was made to insert in the draft recommendation and the commentary a cross reference to recommendation 17 of the Guide, *Presumption that the debtor is unable to pay*, reading: "The insolvency law may establish a presumption that, if the debtor fails to pay one or more of its mature debts, and the whole of the debt is not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt claimed, the debtor is generally unable to pay its debts." That recommendation 17 is accompanied by a footnote reading: "Where the debtor has not paid a mature debt and the creditor has obtained a judgement against the debtor in respect of that

84. The competent authority will need to determine whether to commence simplified insolvency proceedings and, if so, which one, taking into consideration all the information supplied by the MSE debtor and creditor(s) and the rights of both creditor(s) and the MSE debtor. Where insolvency is not proved, the proceedings should be terminated. The competent authority's decision should be promptly notified to the MSE debtor and the applicant to allow them to challenge that decision in a timely fashion if they so choose.<sup>144</sup>

## **G. [Notice of commencement of a simplified insolvency proceeding and other notices]<sup>145</sup>**

### **1. Simplified and cost-efficient notification [see draft recommendations 25–27]**

85. The insolvency law should specify that the competent authority will be responsible for giving notices to the MSE debtor, creditors and the public [at large] [where necessary].<sup>146</sup> It may give discretion to the competent authority to determine the most cost-effective procedures for serving such notices depending on the circumstances of the case and the state of the MSE debtor's application and other records. For example, it may not be necessary to require publication at considerable expense in a national newspaper when the MSE business is based and conducted locally or a particular MSE has a very limited supply and creditor base. The insolvency law should require at a minimum that the MSE debtor and all known creditors should be notified individually while the means of giving notice to other potential parties in interest must be appropriate to ensure that the information is likely to come to their attention. Options for achieving effective notification may include the use of standard forms, relevant public registries and electronic means of communication.

### **2. Notice of commencement<sup>147</sup> [see draft recommendations 21 bis, 21 ter, 22 and 23]**

86. Giving notice of the commencement of insolvency proceedings is central to several key objectives of an insolvency regime. It ensures the transparency of the proceedings and that all parties in interest are equally well informed and can challenge the commencement of the proceeding in a timely fashion. For those

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debt, there would be no need for a presumption to establish that the debtor was unable to pay its debts. 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 offset; 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." That suggestion was not discussed. The Working Group may wish to formulate its position on this suggestion.

<sup>144</sup> During the September 2020 informal consultations, it was noted that draft recommendation 21 (on denial of application) was not accompanied by any commentary. It was suggested adding such commentary, drawing on the relevant commentary in the Guide as appropriate and, in addition, pointing out in such commentary that, if the application were to be denied because of the applicant's failure to meet the eligibility criteria for entry to a simplified insolvency regime, it would be desirable to refer the case to ordinary insolvency proceedings upon the applicant's consent if the requirements for commencement of such ordinary insolvency proceedings were met. The Working Group may wish to formulate its position on this suggestion.

<sup>145</sup> The title and content of this section would need to be revised in the light of the changes proposed to the respective draft recommendations, in particular if the current location of draft recommendations 21 bis and 21 ter is confirmed by the Working Group.

<sup>146</sup> In its communication to the secretariat dated 3 July 2020, Côte d'Ivoire suggested replacing "at large" by "where necessary". During the September 2020 informal consultations, it was suggested to delete both phrases.

<sup>147</sup> During the May 2020 informal consultations, it was suggested that the commentary could explain reasons which may justify exceptions to the public notice (e.g., confidentiality). The Working Group may wish to formulate its position on the matter.

reasons, this [text] requires the notice of commencement of insolvency proceedings to be individually notified to all known parties in interest.

87. The information required in the notice of the commencement of insolvency proceedings should include the effective date of the commencement of the simplified insolvency proceeding; information about the stay; whether the list of claims prepared by the debtor will be used in the proceeding or creditors are required to submit their claims; if the latter, the procedures and time period for submission and proof of claims and consequences of failure to do so in the prescribed manner; and the time period for expressing objection to the commencement of the proceeding.

88. Creditors will have an interest in being notified of the commencement in order to be able to protect their interests in insolvency proceedings and make an informed decision concerning continuing provision of goods and services to the MSE debtor to avoid the accumulation of further debt. In addition, they may have grounds to object to the commencement of the proceeding or a particular type thereof or to the commencement of any insolvency proceeding with respect to the debtor. Provided they object within the time period fixed for that purpose in the notice of commencement of the proceeding, their objections would have to be duly considered by the competent authority and may lead to the dismissal of the proceeding after its commencement. Claims of creditors not notified of the commencement of the proceeding will not be affected by the proceeding unless they subsequently join the proceeding.

## **H. Constitution, protection and preservation of the insolvency estate**

### **1. Constitution of the insolvency estate [see draft recommendations 29 and 30]**

89. The insolvency law should specify that the insolvency estate is to be constituted from the effective date of commencement of the proceeding. It should also specify the manner of constituting the insolvency estate. Different approaches may be taken. In particular, in case of an individual entrepreneur, all assets may be included in the insolvency estate, and the MSE debtor may be allowed to request exclusion of some assets up to a specified value limit. Alternatively, assets could be excluded subject to specific ceilings or categories, or across-the-board exclusion of all assets of the MSE debtor could be permitted subject to challenge by creditors. The adoption of one approach over another has significant ramifications for efficiency and the costs of administration of insolvency proceedings. The approach based on the exemption of particular assets by the MSE debtor can be more costly than where a creditor seeks to reclaim items of very high value.

90. The scope of assets excluded from the insolvency estate of MSE debtors would impact the achievement of the objectives of a simplified insolvency regime. The exclusion of two particular categories of assets, the family home and tools of the trade, is especially relevant for reducing stigmatization, the impact of insolvency on the entire household of an individual entrepreneur and the prospects of his or her fresh start.

### **2. Stay of proceedings [see draft recommendations 32 and 33]**

91. On the understanding that no time or very little time will elapse between application and the commencement of simplified insolvency proceedings, this [text], unlike the Guide, does not envisage the need for provisional measures addressed in recommendations 39–45 of the Guide.<sup>148</sup>

<sup>148</sup> In a written submission circulated during the May 2020 informal consultations, this statement was challenged on the basis that the need for provisional measures, in particular

92. Like the Guide (see recommendation 46), this [text] provides for the stay of any proceedings against the debtor and its assets upon commencement of a simplified insolvency proceeding. The stay has many objectives, including: (a) protection of all creditors against an individual action by one of them; (b) preservation and maximization of the value of the insolvency estate by protecting the insolvency estate from individual actions by creditors as well as actions by the debtor; and (c) fair and orderly administration of the proceedings. The stay will in particular allow the competent authority to take stock of the MSE debtor's situation and decide on the right course of action, including on conversion of one type of proceedings to another where necessary and on appropriateness of the continued application of the stay and its scope. In a simplified liquidation proceeding, the stay will allow arranging a sale that will give the highest return for the benefit of all creditors and avoid making forced sales that would fail to maximize the value of the assets being liquidated. In a simplified reorganization proceeding, the stay will allow all parties concerned to carefully assess chances of business survival and ways of successful reorganization of viable business.

93. To achieve those objectives and to promote transparency and predictability, this [text] suggests the broadest scope of the stay of proceedings against the debtor or in relation to its assets, subject to very narrowly defined exceptions. Examples of the types of action and acts that may be stayed could include: the commencement or continuation of self-help and administrative, judicial or enforcement proceedings in relation to assets of the debtor, including the execution of a judgment and actions to make security interests effective; 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 a security interest in respect of a debt incurred by the debtor prior to the commencement date; the termination of a contract with the debtor by the counterparty (except where the contract provides a termination date that happens to fall after commencement); and termination, suspension or interruption of supplies of essential services (e.g., water, gas, electricity and telephone) to the debtor. Exceptions usually include actions against the debtor for personal injury or family law claims and those taken to protect public policy interests, to prevent abuse (such as the use of insolvency proceedings as a shield for illegal activities) or to preserve a claim against the debtor as well as actions that do not affect the insolvency estate.

94. The overall design of a simplified insolvency regime is aimed at ensuring speedy and efficient proceedings. It is therefore expected that short time periods envisaged for all steps, including the approval of the liquidation [schedule] [report] and reorganization plan, would shorten the duration of the stay in simplified insolvency proceedings, including upon conversion of one type of a simplified insolvency proceeding to another.

95. Nevertheless, this [text] recognizes that the immediate benefits that accrue by having a broad stay quickly imposed upon commencement of simplified insolvency proceedings will need to be balanced against the longer-term benefits. The broad stay, for example, may interfere with the continued operation of business and contractual relations between the debtor and creditors. There may also be a desire by the MSE debtor to ensure limited publicity of

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**in involuntary cases upon application of creditors, would indeed arise. During the September 2020 informal consultations, this view was shared. It was explained that, just because in practice there might be a very short time between application and commencement, the text should not suggest that the need for provisional measures would never arise. It was suggested that, if not draft recommendations themselves, at least the commentary should discuss provisional measures that might be helpful, in particular to prevent dissipation of assets. The other view was that the text should not refer to provisional measures unless experience from jurisdictions suggested that those measures might be useful in the simplified insolvency context. The point was made that the focus of the text should remain on incentives for commencing the proceedings promptly. The Working Group may wish to formulate its position on this point.**

financial distress, which the imposition of a broad stay will not ensure. This [text] therefore envisages the possibility of lifting or suspending the stay or tailoring it to the needs of the specific case upon request of any party in interest or by the competent authority on its own motion. It also allows any party in interest to request relief from the application of the stay.

96. The Guide discusses competing interests that need to be balanced in considering [whether] [the extent to which]<sup>149</sup> to include actions by secured creditors within the scope of the stay (see part two, chapter II, section B.8). At the same time, it points out that a growing number of States accept that in many cases permitting secured creditors to freely enforce their rights against the encumbered asset can frustrate the basic objectives of the insolvency proceedings. Including encumbered assets in the estate and thus limiting the exercise of rights by secured creditors on commencement of proceedings may assist not only in ensuring equal treatment of creditors, but may be crucial to the proceedings where the encumbered asset is essential to the business, which is often the case in the MSE insolvency context. There may be a need not to separate assets before it can be determined how they should be treated in insolvency. This [text] has therefore been drafted on the understanding that actions by secured creditors should be included within the scope of the stay in simplified insolvency proceedings. Unlike the Guide (see recommendation 49 (c) of the Guide), this [text] does not envisage a limited duration of the stay for secured creditors in liquidation on the understanding that the entire duration of a simplified liquidation proceeding is intended to be very short.

97. Secured creditors negatively affected by the stay are entitled to certain protections, in particular protection of the value of their encumbered asset and the right to seek relief from a stay where such protection is not ensured. Measures to protect the value of the encumbered asset itself or the value of the secured portion of the claim typically include providing additional or substitute assets, making periodic cash payments corresponding to the amount of the diminution in value or paying interest. The interests of secured creditors can be protected by other means, e.g., in a simplified liquidation proceeding, by consulting them on the sale of the encumbered asset and allowing them to take over the asset where the asset is worth less than the secured claim.

98. The competent authority will have to assess the desirability of such measures on a case-by-case basis. In the simplified insolvency context, the provision of adequate protection to a secured creditor may rarely be feasible or would be overly burdensome to the estate, especially in simplified liquidation proceedings. The provision of protection may also necessitate making time-consuming and complex decisions on the questions of protection (e.g., which type of protection to accord in which case) and valuation (e.g., the basis and date for determining value, the cost of valuation and the party to undertake the valuation, and the party to bear the cost of valuation).

99. Relief from the stay may be a more viable alternative in the simplified insolvency context, especially in simplified liquidation proceedings, if it can be demonstrated that the creditor is not receiving protection for the diminution in the value of the encumbered asset and the provision of such protection may not be feasible or would be overly burdensome to the estate; where the encumbered asset is not needed for the liquidation or reorganization of the business; or where relief is required to protect or preserve the value of assets, such as perishable goods. Where such relief is granted, the asset ceases to be part of the estate. To minimize cost implications for the estate, the competent authority may relinquish the asset and place the costs of its removal on the creditor.

<sup>149</sup> During the September 2020 informal consultations, it was proposed to include the phrase in the second set of square brackets to keep all options open as regards inclusion of actions by secured creditors within the scope of the stay. In considering this suggestion, the Working Group may wish to note that the reference in this sentence is to the Guide rather than the present text.

## **I. Treatment of creditor claims [see draft recommendations 34–39]**

100. Ensuring that the list of creditor claims, indicating clearly amounts and the class of the claim, is accurate is essential for subsequent steps in simplified insolvency proceedings, including for: (a) admitting creditors to the proceeding and notifying them of all matters requiring their approval; (b) establishing priority of creditor claims; and (c) determining the existence of sufficient support or opposition to the approval of matters requiring creditor approval.

101. As noted in paragraph [75] above, an MSE debtor would be expected to include a list of its assets, liabilities and creditors in its application for commencement of a simplified insolvency proceeding. Such list may be prepared with the assistance of an independent professional whom the competent authority may decide to involve at a pre-commencement stage to ensure the accuracy and reliability of the list. The list of creditor claims included in the MSE application should therefore be used as the starting point for verifying creditor claims in a simplified insolvency regime.

102. There could be cases when the competent authority may decide to prepare the list itself or assign that task to an independent professional. That course of action would in particular be justified where a simplified insolvency proceeding commences against the will of a MSE debtor, i.e., upon a creditor application. It will also be justified in situations where the MSE debtor's records do not exist or they are in such a poor state that submission of claims by creditors to the competent authority would be a more efficient way to compile and ensure the accuracy of the list of creditor claims. In those cases, the competent authority may require, for example through a public notice, creditors, including secured creditors, to file claims with the competent authority or the independent professional within a specified short time period. The consequences of failure to do so by the established deadline, e.g., that the debt may be extinguished or security rights may be waived or forfeited or the creditor may lose its priority in the distribution of proceeds, should be notified to creditors at the time they are notified of the deadline for the submission of claims. The procedures for submission of claims and the supporting evidence should be simplified, for example by reducing evidentiary requirements for proof of claims, by dispensing with the requirement that the claims must be certified and by allowing presentation of evidence online.

103. Means for appropriate verification of the list of claims prepared by the debtor, the competent authority or the independent professional by creditors themselves should be in place. All identified and identifiable creditors and other parties in interest should be notified of the list and be allowed a short time to object.

104. The competent authority should be entrusted with the adjudication of disputes between the debtor and creditors and among creditors and be allowed to refer any disputed claim that is not capable of being resolved in the proceeding to a separate proceeding. It should also be able to subject claims by related persons to special treatment as may be permitted by the insolvency law, such as subordination of the claim or reduction of the amount of the claim. The insolvency law should permit the creditor whose claims have been denied or subjected to special treatment as well as any party in interest that disputes any claim to request review of the competent authority's decision.

## **J. Features of simplified liquidation proceedings [see draft recommendations 40–50]**

### **1. General**

105. The Guide refers to “liquidation” as proceedings to sell and dispose of assets for distribution to creditors in accordance with the insolvency law (see the glossary, subpara. (w)). Liquidation in the context of limited liability MSEs usually leads to dissolution and the disappearance of the legal entity. The owner(s) of such entity will not be liable for residual claims. Liquidation in the context of individual entrepreneurs and unlimited liability MSEs would mean the liquidation of the insolvency estate and discharge of individual entrepreneurs personally liable for unsatisfied claims.

106. Where there are assets in the insolvency estate, they should be realized expeditiously and effectively so as to give the highest return for the benefit of all creditors.<sup>150</sup> Where no distribution to creditors is possible due to the lack of (sufficient) assets in the insolvency estate, the law should allow a discharge procedure subject to appropriate safeguards such as verification that the debtor meets eligibility requirements for this type of procedure and the possibility of reopening the case and revoking any discharge granted, for example if it was obtained by fraud (see recommendation [67]).

### **2. Procedures for realization of assets and distribution of proceeds**

#### **(a) Party responsible for realization of assets and distribution of proceeds**

107. In most MSE liquidation cases, the competent authority will be in a position to liquidate the MSE debtor’s estate and distribute the proceeds among the creditors itself. In other cases, it might be more efficient to entrust liquidation to an independent professional or a creditor or creditor(s). The insolvency law may require that decisions on certain issues, such as the time period, form and conditions of sale, be taken exclusively by the competent authority.

#### **(b) Preparation of the liquidation [schedule] [report]<sup>151</sup>**

108. The party responsible for liquidation should be required to prepare within a short time period after the commencement of the simplified liquidation proceeding a schedule for the realization of assets and distribution of proceeds (referred to in this [text] as the “liquidation [schedule] [report]”). The insolvency law may specify the minimum content of the liquidation [schedule] [report], such as the party responsible for the realization of the insolvency estate, the means to be used (public or private auction or other means), [amounts and priorities of claims] and the timing and method of distribution of proceeds from the realization of the insolvency estate. Presenting those requirements in an online form, template or schedule would considerably simplify preparation of a complete, accurate and law-compliant liquidation [schedule] [report]. [Preparing a good-quality liquidation [schedule] [report] may considerably expedite simplified insolvency proceedings, including when liquidation is

<sup>150</sup> During the May 2020 informal consultations, a suggestion was made to emphasize in the commentary that the objective of “prompt distribution” should not preclude taking all necessary steps to ensure thorough verification of the value of the encumbered asset, the amount owed by the debtor to the secured creditor and the commercial reasonableness of the intended method of the realization of the asset.

<sup>151</sup> During the May 2020 informal consultations, it was suggested that the commentary should discuss circumstances that would justify entrusting the preparation of the liquidation schedule to the debtor (e.g., special skills, specifics of business, market, etc.). During the September 2020 informal consultations, it was recalled that there were still open issues as regards the liquidation schedule. The title and the section might need to be modified depending on the Working Group’s decisions as regards the relevant draft recommendations.

converted to reorganization (for example, if after commencement of a simplified liquidation proceeding the debtor is able to raise post-commencement finance for reorganization of business).]

109. Where the party responsible for preparing the liquidation [schedule] [report] is different from the competent authority, it should submit the liquidation [schedule] [report] within the established time period to the competent authority for verification of the compliance of the liquidation [schedule] [report] with the law. The competent authority should be authorized to modify the proposed liquidation [schedule] [report] in order to rectify irregularities or fill in any missing information required to ensure its compliance with the law.

**(c) [Approval of the liquidation [schedule] [report]]<sup>152</sup>**

110. The liquidation [schedule] [report] as verified by the competent authority should be [transmitted] [made known to all parties in interest]<sup>153</sup> by the competent authority to all known parties in interest. This ensures that the procedure for disposal of assets is transparent and well-publicized and the sale is efficiently organized and the maximum price is achieved.

111. The absence of any objection to the liquidation [schedule] [report] within a specified time period after its notification should lead to its approval by the competent authority, and the liquidation will proceed as stated in the liquidation [schedule] [report]. In case of any objection, the competent authority may itself modify the liquidation [schedule] [report] or allow a short time period for the contesting party to submit to the competent authority an alternative liquidation [schedule] [report] or a plan for converting a simplified liquidation to a simplified reorganization or to a standard insolvency proceeding (either liquidation or reorganization).

112. The failure of the contesting party to submit an alternative liquidation [schedule] [report] or a plan for an alternative course of action within the established time period when requested to do so by the competent authority may lead to the approval by the competent authority of the originally notified liquidation [schedule] [report] or modification of that [schedule] [report] by the competent authority in response to the objection. Any modified schedule or alternative plan should be notified to all known parties in interest before its approval by the competent authority. Where an objection is raised to the modified liquidation [schedule] [report] or to the alternative plan, the competent authority may decide itself on the course of action, leaving any unsatisfied party to exercise its right of review of the competent authority's decision according to the domestic law.

**(d) Sale and disposal of assets**

113. The sale and disposal of assets may become a cumbersome process in simplified insolvency proceedings. Efficiency may be achieved through online sales, such as electronic public auctions or private sales using electronic platforms. The law should allow flexibility, provided that transparency in the sale and disposal of assets is ensured.

114. In public auctions, all prospective purchasers should be notified in a manner that will ensure that the information is likely to come to the attention of

<sup>152</sup> During the September 2020 informal consultations, it was recalled that there were still open issues as regards the approval of the liquidation schedule. The title and the section might need to be modified depending on the conclusions of the Working Group on that matter.

<sup>153</sup> During the September 2020 informal consultations, the phrase in the second set of square brackets was proposed to replace the word “transmitted”, recognizing that more flexibility and cost-efficiency should be envisaged, including the possibility of making the liquidation schedule generally available on the website instead of transmitting it individually to each party in interest involved in the proceeding.

interested parties. Pre-bidding qualification may need to take place and precautions may need to be taken to avoid collusion among bidders. The evaluation of assets by an independent professional (especially in the case of real estate and specialized property) may assist with the determination of the starting price in the auction. Private sales, in addition to public auctions, may be permitted when they would best realize the value of assets. In particular, sales to a creditor to offset that creditor's claim and the sale of any of the debtor's assets in the possession of a third party to that third party for a reasonable market price should be allowed. A sale to related persons should be carefully scrutinized and should be made subject to a valuation of the assets before being allowed to proceed, to avoid fraud and collusion.

115. Special measures may be in place for perishable and other assets whose value might rapidly deteriorate and for any burdensome assets that should be allowed to be relinquished if creditors do not object to that course of action. Where the MSE debtor and another person co-own assets and those assets can be divided, it should be possible to sell the estate's interest without affecting the co-owners.<sup>154</sup> Where the division of the assets between the estate and the co-owners is impractical, the estate's interest and that of the co-owners in those assets may need to be sold together if, for example, 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, hence, the benefit of such a sale to the estate outweighs any detriment to the co-owners.

116. The competent authority may exclude encumbered assets from the insolvency estate; in such case, the secured creditor will generally be free to enforce its security interest. Otherwise, unless relief from the stay is granted to a secured creditor, only the competent authority can dispose of the assets. The competent authority may have a time-limited exclusive right to sell the encumbered asset; once that exclusive period has expired, the secured creditor may exercise its rights. The insolvency law should require that secured creditors be notified of any proposed disposal and that they have an opportunity to object.

**(e) Simplified distribution of proceeds**

117. Distribution will take place according to the agreed liquidation [schedule] [report], which would set out the amounts and priorities of claims and the timing and method of distribution (see recommendation [43]). Recommendations 185–193 and the accompanying commentary in the Guide address priorities and the distribution of proceeds and are generally applicable in a simplified insolvency regime.

118. Many insolvency laws recognize the rights of secured creditors to have first priority for satisfaction of their claims. The method of distribution to secured creditors depends on the method used to protect secured interests during the proceedings. If the security interest was protected by preserving the value of the encumbered asset, the secured creditor will generally have a priority claim on the proceeds of the sale of that asset to the extent of the value of its secured claim. Alternatively, if the security interest was 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 encumbered 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.

<sup>154</sup> During the September 2020 informal consultations, it was suggested to redraft this sentence. That suggestion was implemented in the present draft.

### 3. Discharge procedures where realization of assets and distribution of proceeds are not possible

#### (a) Conditions for use

119. Generally, discharge procedures should be made available where certain conditions are met: (a) the insolvency estate of the MSE debtor has no assets or has assets but of such low value that the sale and distribution of proceeds would not justify the costs, time and other resources to organize the sale and distribution; (b) the debtor has no income and prospects of future income do not exist, making debt repayment unlikely;<sup>155</sup> (c) there are no grounds to suspect fraud or other improprieties; and (d) other conditions imposed by the State for access to this type of procedure, which should be clearly set out in the law, are met (e.g., the total amount of debt and the value of the insolvency estate assets may need to be below a certain threshold specified in the law). The competent authority may determine that the debtor meets the conditions for commencement of this type of procedure from the outset of a proceeding on the basis of the debtor's application or at subsequent stages of the proceeding if, for example, the competent authority discovers that certain assets should have been excluded from the insolvency estate and, as a result of their exclusion, the conditions for commencing the discharge procedure are met.

120. In some jurisdictions, a debtor with encumbered assets may not be eligible for this type of procedure on the understanding that the competent authority would be expected, as a minimum, to verify the value of the encumbered assets. Where that value exceeds the amount owed by the debtor to the secured creditor, the competent authority may be expected to organize the sale of the encumbered asset and distribution of the proceeds. In some cases, a debtor with encumbered assets may nevertheless become eligible for that procedure. For example, where it was determined that the encumbered asset is worth less than the amount owed by the debtor to the secured creditor, the competent authority may allow the secured creditor to take over the asset with the result that the insolvency estate might have no asset for realization. It may also be determined that, upon the distribution of proceeds from the sale of the encumbered asset to the secured creditor(s), the remaining value of the insolvency estate would be below an established threshold to justify distribution to other creditors.

#### (b) Notification of the procedure and treatment of objections

121. Where the determination is made that no distribution to creditors is possible due to the lack of (sufficient) assets in the insolvency estate, the competent authority notifies all known parties in interest about its decision to proceed with [discharge procedures] [the closure of the proceedings] [the closure of the proceedings and the discharge of the debtor], along with a summary of the debtor's assets and liabilities. When an objection to that decision is raised, the competent authority should evaluate the grounds for the objection and decide whether the decision to proceed with [discharge] [the closure of the proceeding] [the closure of the proceedings and the discharge of the debtor] should be revoked.<sup>156</sup>

122. The debtor should cease to be eligible for the procedure when there appear to be grounds to commence avoidance proceedings or to involve the services of an independent professional for additional verification or investigation. Those grounds may be brought to the attention of the competent authority by creditors

<sup>155</sup> During the September 2020 informal consultations, the suggestion was made to qualify "debt repayment" with such words as "substantial" or "meaningful", recognizing that in some cases debt repayment might likely take place but the amounts involved would be so insignificant that they would not justify the effort to put in place a mechanism for debt repayment.

<sup>156</sup> During the September 2020 informal consultations, it was noted that the provisions in this section would need to be redrafted in the light of the Working Group's decision on open issues in the respective recommendations.

or discovered by the competent authority itself upon examination of additional information obtained from the debtor or other sources. Where it is proven that sufficient assets do exist or where the sale of an encumbered asset and the distribution of proceeds from that sale have to be organized by the competent authority, the competent authority should proceed with a simplified liquidation or convert to a standard insolvency proceeding. In other cases, the competent authority should proceed with [a discharge and] closure of the proceeding after notification of its final decision to the objecting creditor.

**(c) Essential safeguards**

123. Although this procedure may further reduce the cost of simplified insolvency proceedings, it should build in additional safeguards and an effective sanctions system to mitigate risks of perverse incentives and systematic abuse, including fraud and collusion between debtors and creditors. The procedure may in particular encourage debtors to bring the value of their estate to below the required threshold before application for an insolvency proceeding or to strategically time the filing of the application to allow them to escape from debt obligations while benefiting later from post-discharge income.

124. In addition to the ex ante safeguards in the form of verifications and notification of all known parties in interest about the decision to use this procedure, there should be ex post safeguards. Creditors and other parties in interest should be allowed to request reopening of bad faith cases, and the competent authority should be able to revoke any discharge granted and retroactively collect assets and distribute the proceeds to creditors. Sanctions, including criminal ones, may be imposed in certain cases of abuse of this procedure.

**K. Features of simplified reorganization proceedings [see draft recommendations 51–64]**

**1. General**

125. The Guide refers to “reorganization” as the process by which the financial well-being and viability of a debtor’s business can be restored using various means (e.g., debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or parts of it) as a going concern) and the business can continue to operate (see the glossary, subpara. (kk)). Reorganization in MSE cases will likely translate into debt forgiveness or debt rescheduling for which complex reorganization steps usually envisaged for larger enterprises will not be necessary. For those reasons, putting in place simplified reorganization proceedings for MSEs will be justified.

126. Many systems that provide for a simplified insolvency regime recognize that expedient liquidation of non-viable MSEs may be personally, societally and economically more desirable than rehabilitation of non-viable MSEs with no prospects for recovery. For those reasons, conversion of simplified reorganization to simplified liquidation should be envisaged where it is clear to the competent authority after commencement of a simplified reorganization proceeding that the financial well-being and viability of the MSE debtor’s business cannot be restored and the business cannot continue. Such conversion should also be envisaged where an insolvent MSE debtor cannot reach agreement with its creditors on a reorganization plan or fails to implement the agreed plan.

**2. Preparation of a reorganization plan**

127. The MSE debtor should be allowed to submit a reorganization plan upon commencement of a simplified reorganization proceeding or within a specified period after commencement. Where it is clear that the MSE debtor will not be

able to propose a plan, the competent authority should be allowed to entrust the preparation of a plan to other parties in interest or an independent professional. Provided that the plan contains sufficient information to enable assessment of its viability by creditors and where necessary by the competent authority, submission of a disclosure statement as envisaged in recommendations 141–143 of the Guide should not be required. The law may impose a duty on all parties in interest to cooperate in negotiating the plan.<sup>157</sup>

### 3. Alternative plan

128. Although it may be desirable to permit the parties to propose an alternative plan, this may complicate the proceedings and lead to confusion, inefficiency and delay. For those reasons, the insolvency law may permit submitting an alternative plan only in cases where, in the assessment of the competent authority, this course of action is likely to be beneficial in a particular case.

### 4. Contents of the reorganization plan

129. Recommendation 144 of the Guide sets out the minimum requirements for the content of the plan. Not all of them would always be applicable in a simplified insolvency regime, but at a minimum the plan should be expected to set out terms and conditions of business reorganization, ways of implementing the plan and the treatment to be accorded to each creditor, in particular how much each of them is expected to receive and the timing of payment, if any. The reorganization plan may modify priorities and the subordination of claims as may be permitted by the insolvency law, e.g., key suppliers that themselves could be MSEs heavily dependent on payments by the debtor may receive priority in payment during the implementation of the plan. The plan should also address the protection of interests of secured creditors and third parties whose assets may need to remain in the possession of the debtor during the implementation of the plan (e.g., third-party-owned equipment or a leased office space may be central to the debtor's business operations). In some cases, it may be in the best interests of the estate to sell encumbered assets to provide needed working capital or to further encumber the already encumbered asset to raise finance. Recommendations 52 to 68 of the Guide provide essential protections for creditors in those instances. Those provisions are generally applicable in a simplified insolvency regime.

### 5. Notification and approval of a plan by creditors

130. Upon receipt of the plan, the competent authority should be expected to ascertain that the plan complies with the law before communicating the plan to all known parties in interest. Any non-compliance with law should be rectified by the party responsible for preparing the plan or by the competent authority itself.<sup>158</sup>

131. The competent authority should be expected to notify all known parties in interest of the plan by cost-efficient means, such as electronic means. In a simplified insolvency regime, minimal formalities for the approval of the plan by creditors should be established, including exceptions to the requirements to

<sup>157</sup> During the May 2020 informal consultations, it was suggested that, in order to help MSE debtors prepare such plan, comprehensive checklists for reorganization plans, adapted to the needs and specificities of MSEs, should be developed at the domestic level and made available online. During the September 2020 informal consultations, it was however noted that procedural rigidity, including by requiring the use of standard forms and templates, should be avoided.

<sup>158</sup> During the September 2020 informal consultations, it was suggested to clarify how the competent authority would be able to rectify any non-compliance with law (would it, for example, be able to amend the plan?). The Working Group may wish to formulate its position on this matter.

establish a creditor committee, to hold disclosure statement hearings and to convene a creditor meeting.<sup>159</sup>

132. The plan will be deemed approved by creditors if: (a) the creditors that are entitled to vote on the approval of the plan are notified of the plan, of the deadline and procedures for expressing any objection or opposition to the plan and of the consequences of abstention, i.e., expressing no objection or opposition would be counted as approval; and (b) they raise no objection or opposition to the plan within that deadline or the opposition raised is not sufficient to block the approval of the plan according to the threshold for the approval of the plan established in the insolvency law.<sup>160</sup>

133. In case of any objection, the competent authority would be expected to review grounds for objection and remove them where necessary by modifying the plan or instructing the party responsible for preparing the plan to do so. To minimize delays in simplified reorganization proceedings, the competent authority may be authorized to dismiss an objection on purely procedural grounds, by taking into account the extent of the irregularity, the state of the debtor and other circumstances.

134. In case of opposition, the competent authority would need to ascertain whether the plan has received the requisite support, or the opposition expressed is sufficient to block the approval of the plan. Sufficient opposition to the plan

<sup>159</sup> During the May 2020 informal consultations, the point was made that the draft text is silent about employees' rights and interests. The text was drafted on the understanding that MSEs would most likely have no or very few employees since surveyed legislation of several States indeed make only MSEs with no or very few employees eligible for simplified insolvency proceedings. The text thus does not refer to measures that are commonly in place to protect workers in the case of large or medium-scale layoffs (e.g., negotiation with trade unions or, if those are absent, with representatives of workers). The commentary may emphasize that the obligations under national law concerning informing and consulting employees about insolvency proceedings and seeking their approval, where required, of a reorganization plan that includes measures leading to changes in the work organization and in contractual relations with employees should remain applicable in the simplified insolvency context. Furthermore, some States may decide to exclude employment and pension entitlements from reorganization plans or other debt restructuring frameworks in order to protect employees.

<sup>160</sup> During the May 2020 informal consultations, concerns were expressed about the concept of "deemed approval" and the newly introduced concept of "sufficient opposition". The commentary may explain that, although formation of classes of creditors and a formal vote on a reorganization plan, including in each class and with a defined participation threshold for the vote, may be required in some jurisdictions, recommendations are drafted on the understanding that MSEs, on account of their relatively simple capital structure, should be exempted from the obligation to treat affected parties in separate classes and that a formal vote will not always be required and can be replaced by an agreement of the requisite majority. The requisite majority should be established by national law to ensure that a minority of affected parties cannot obstruct the adoption of a restructuring plan which does not unfairly affect their rights and interests. According to the deemed approval principle in draft recommendation 12, silence by the creditor will be considered as approval and, by implication, silent creditors will thus be taken into account for a participation threshold and for the calculation of a majority. To ensure that parties have a say in the adoption of the plan proportionate to the stake they have in the business, the requisite majority should be based on the amount of the creditors' claims or equity holders' interests. In response to some concerns about "deemed approval" expressed during the September 2020 informal consultations (see the relevant footnote to draft recommendation 57), it was suggested to stress in the commentary that the right of creditors to vote was not eliminated by the new mechanism of decision-making (deemed approval) since the creditors' right to raise an objection or express opposition was not removed and essential safeguards to protect creditors' interests were still in place (such as notification of creditors about upcoming actions and the content of the reorganization plan, steps required from their side and the deadline for taking them). In the light of apathy of creditors, it was said that the new mechanism would expedite decision-making, unlikely producing any negative effect on the availability of credit. Nevertheless, it was suggested that the commentary should acknowledge that some States may consider that deemed approval was not sufficient and may require voting in all cases or may require voting in some specified cases and preserving it as an option in other cases. Such States should consider allowing the counting of the absent votes or abstentions as positive votes.

may lead to conversion to liquidation. Alternatively, in an effort to achieve a consensual plan, the competent authority may seek views of creditors on how to modify the plan so as to make it acceptable to them. Failure to achieve a consensual plan should lead to the conversion of the proceeding to liquidation (or termination of the proceeding in case of a solvent debtor). If parties in interest do not express any objection or sufficient opposition to any modified plan communicated to them by the competent authority, they are deemed to accept the compromise reached in the modified plan.<sup>161</sup>

## **6. Confirmation by the competent authority of the plan approved by the creditors**

135. In standard business insolvency proceedings, the competent authority is usually not expected to evaluate economic and financial merits of the plan and may not be required to confirm the plan approved by creditors. It may be expected to simply acknowledge the existence of sufficient support among creditors for the plan. The plan approved by creditors will take effect automatically and be binding on any dissenting party in interest unless it is successfully challenged in a review body.

136. In a simplified insolvency regime, confirmation by the competent authority of the plan deemed approved by creditors may be desirable in all cases in order to mitigate risks that no proper assessment of fairness and viability of the plan has taken place because the deemed approval of the plan is the result of creditors' disinterest and disengagement. Confirmation by the competent authority of the plan deemed approved by creditors will seek: (a) to provide additional assurance to the MSE debtor that the plan does not impose undue burden on the debtor; (b) to give comfort to those creditors of the debtor that have no means of verifying themselves the viability and fairness of the plan (e.g., employees, MSE creditors) and that they will not be disproportionately affected by the plan; and (c) to ascertain, with the assistance of an independent professional where necessary, that the plan is otherwise fair and ensures the survival of the business. The competent authority may reject a plan deemed to be approved by creditors where it would not have a reasonable prospect of preventing liquidation of the debtor or ensuring the viability of the business or where it is not feasible or impossible to implement the plan from a practical, rather than an economic, point of view.

137. Recommendation 152 of the Guide sets out conditions for confirmation of the plan by the court, such as: the approval process was properly conducted; creditors will receive at least as much under the plan as they would have received in liquidation, unless each of them has specifically agreed to receive lesser treatment; and the plan does not contain provisions contrary to law. Those requirements will be applicable in a simplified insolvency regime for confirmation of the plan by the competent authority. The competent authority may decide to engage the services of an independent professional for determination of the outcome of an alternative liquidation scenario.

## **7. Challenges to the confirmed plan**

138. The law should enable an appeal of a decision to confirm or reject a reorganization plan taken by the competent authority that is a judicial authority to be brought before a higher judicial authority and of one taken by an administrative authority to be brought before a judicial authority. In order to ensure that the MSE insolvency can be addressed and resolved in an orderly,

<sup>161</sup> During the May 2020 informal consultations, it was suggested that some template or form for expressing objection or opposition should be provided given that not only unsophisticated debtors but also unsophisticated MSE creditors may be involved in a simplified regime. During the September 2020 informal consultations, concerns were raised that the introduction of standard forms and templates might lead to procedural rigidity.

quick and efficient manner without undue disruption: (a) a right to challenge the confirmed plan may be limited to factors such as the importance of the issue (e.g., fraud) and prejudice to the parties; (b) the time period for challenge should be short; and (c) any challenge brought should not, as a general rule, have suspensive effect on the execution of the plan unless suspension of the plan or part thereof is necessary and appropriate to safeguard the interest of a party. These restrictions will be in line with recommendations 138 and 154 of the Guide. Where appeal is successful, the plan may be set aside or confirmed with or without amendments and with appropriate compensation to the party that incurred monetary losses.

## **8. Amendments of the reorganization plan**

139. Any party in interest should be permitted to propose amendments to the original plan at any time before its approval by creditors and confirmation by the competent authority. Mechanisms for modifying the plan at that stage and consequences of the failure to secure approval or confirmation of modifications are addressed in recommendation [58]. To avoid delays, short time limits should generally be imposed for proposing and accepting any modifications at that stage.

140. In addition, the law should provide for the possibility of amending the plan after its approval by creditors and confirmation by the competent authority. To ensure predictability and smooth implementation of the plan, conditions may be imposed for amending the plan at that stage (e.g., circumstances should warrant the amendment; for example, a certain problem arose that makes the implementation of the plan in whole or in part impossible and unless that problem is remedied, provided that it can be remedied, the implementation of the plan will fail). The parties that may propose amendments at that stage should be identified in the law and may be limited to the MSE debtor and creditors affected by the implementation of the plan. A mechanism for approving an amendment to the plan at the stage of its implementation should ensure transparency and the protection of creditor interests and proper verification of the proposed amendment by the competent authority. It will thus resemble the approval and confirmation of the original or modified plan and involve: (a) notification of proposed amendments by the competent authority to at least all parties in interest affected by the amendments, if not all parties in interest; (b) the approval of the amendments by those parties; and (c) the confirmation of the amended plan by the competent authority. As in other cases in a simplified insolvency regime where approval of creditors is required, the amendments will be deemed approved by creditors where no objection or sufficient opposition is communicated to the competent authority by the deadline established by the competent authority for such purpose. The law should specify the consequences of failure to secure approval of the amendments, e.g., implementation of the originally confirmed plan may continue, or where it is impossible to continue the implementation of that plan, liquidation may commence, or if the debtor is solvent, the simplified reorganization proceeding may terminate.

141. Some plans could be self-modifying, e.g., those that call for fluctuating payments based on the MSE debtor's actual income. The implementation of such plans may require monitoring. Alternatively, debt repayments may be based on projected income and expenses, and the insolvency law should allow parties to modify the plan to reflect the MSE debtor's actual situation as compared to the projections embodied in the plan. There could be systems that permit reductions but not increases in payments.

## **L. Discharge [see draft recommendations 65–72]**

### **1. General**

142. When the MSE debtor is a separate legal entity, the question of its discharge following liquidation does not arise; generally the law provides for the disappearance of the legal entity, or alternatively, it will continue to exist as a shell with no assets. In limited liability MSEs, the equity holders will not be liable for the residual claims unless they also provide personal guarantees for business debts, in which case a special treatment may be accorded to them (see section [N] below). In insolvency of individual entrepreneurs and unlimited liability MSEs, the question arises as to whether individual entrepreneurs will still be personally liable for unsatisfied claims following liquidation of their insolvency estate.

### **2. Discharge in simplified liquidation proceedings**

143. This [text] recommends discharge of an honest, non-fraudulent individual entrepreneur following distribution in liquidation or a determination that no distribution to creditors can take place. Although discharge procedures may be initiated earlier in no-distribution cases, conditions for discharge should remain the same. A discharge period may still be imposed in those cases, which would ensure monitoring the debtor, its assets and income.

144. In some jurisdictions, an individual entrepreneur will remain personally liable for debts until all of them are fully paid. In other jurisdictions, an individual entrepreneur remains liable for debts subject to a limitation period during which the individual entrepreneur is expected to make a good faith effort to repay its debts. Discharge may be possible only after the debt repayment plan is fully implemented unless acceptable grounds existed justifying the failure to implement the plan. The length of the debt repayment period may vary from jurisdiction to jurisdiction, and within the same jurisdiction it may vary depending on circumstances. Under some laws, that period might be long, e.g., 10 years. The emerging trend is to shorten that period with the objective of expediting a fresh start. Another approach is to provide incentives to the individual entrepreneur to comply with the debt repayment plan by making the length of the discharge period dependent on the rate of return to creditors and the individual entrepreneur's compliance with other obligations. At the same time, a predictable and consistent method of assessing disposable income may need to be provided in the debt repayment plan to leave sufficient income for household needs of individual entrepreneurs and their families.

145. Recognizing that there are different approaches to discharge in different jurisdictions and also that unconditional discharge (e.g., without any debt repayment plan or prohibition from obtaining a new credit for a specified period (e.g., six months to a year)) may produce a negative impact on financial discipline and disrespect of contractual obligations, this [text] envisages various discharge options. The competent authority may be authorized to choose the most appropriate one depending on the circumstances of the case and domestic law requirements.

### **3. Discharge in simplified reorganization proceedings**

146. This [text] recommends that simplified reorganization proceedings should remain open until the full implementation of the reorganization plan by the debtor, after which discharge is granted. It has been considered that this approach incentivizes the debtor to fulfil the plan and protects creditors. The competent authority, upon confirmation of the full implementation of the reorganization plan, will give binding effect to the forgiveness, cancellation or alteration of debts in accordance with the approved plan. Where the reorganization plan is not fully implemented or cannot be implemented or there

is a substantial breach of the plan by the MSE debtor, the insolvency law may provide for conversion of a simplified reorganization proceeding to liquidation with the result that terms of discharge will be addressed in that new proceeding.

#### 4. Exceptions to and exclusions from discharge

147. A discharge is usually unavailable for an individual entrepreneur who has acted fraudulently, engaged in criminal activity, actively withheld or concealed information, or concealed or destroyed assets or records after the application for commencement. If granted, discharge is usually revoked retroactively upon discovery of those facts. The insolvency law should specify grounds for refusing or revoking a discharge.

148. Certain types of debt, such as debts based on certain tort claims, family support obligations, fraud, criminal penalties, and taxes, are usually excluded from discharge. They should be identified in the insolvency law and should be kept to a minimum in order to facilitate the individual entrepreneur's fresh start.

149. The discharge generally affects only debts arising before the commencement of a formal insolvency proceeding. Following discharge, claims that have not been satisfied would be rendered unenforceable. Nevertheless, so called "debt reaffirmation", "debt reinstatement" or "ride-through" arrangements may reinstate those claims. Under them, the debtor reaffirms its obligation to repay a discharged debt usually in exchange for retaining an asset (a car or an office space) or to obtain a new credit following insolvency. Such reaffirmation may occur through conduct (e.g., the debtor continues paying discharged debts) or express agreement concluded before, during or after the insolvency proceedings.

150. In some jurisdictions such arrangements are unenforceable as being against the fresh start principle and the objectives of fairness and predictability since the debtor is allowed to selectively pay one or more, but not all, of its creditors. In other jurisdictions, they are enforceable but only under certain conditions (e.g., a debt reaffirmation agreement must be concluded before the discharge, relate to a secured claim, be disclosed during insolvency proceedings and there should be no undue hardship on the debtor and its dependants as a result of the repayment of the debt).

#### 5. Conditions attached to discharge

151. A discharge of debt may be accompanied by conditions and restrictions relating to professional, commercial and personal activities, for example to start a new business or carry on the old business, to obtain new credit, to leave the country, to practise in a profession, to hold public office or to act as a company director or manager. They may take effect automatically or upon an order of the competent authority. The period of effectiveness of those conditions and restrictions may be linked to the discharge period and may be extended. It may be longer or even indefinite where the individual entrepreneur is a member of a profession to which specific ethical rules apply or where disqualifications were ordered by a court in criminal proceedings. For individual entrepreneurs who manage their own businesses or who became insolvent because of giving personal guarantees, some of those restrictions and conditions may have serious consequences, effectively prohibiting them from being involved in future business. Where the insolvency law provides that conditions may be attached to an individual entrepreneur's discharge, those conditions should be kept to a minimum in order to facilitate the individual entrepreneur's fresh start and they should be clearly set forth in the insolvency law.<sup>162</sup>

<sup>162</sup> During the September 2020 informal consultations, it was proposed to explain in the commentary what would be considered the debt under the approved and confirmed reorganization plan, in particular that the original debt will be substituted by the amount

## M. Closure of the proceedings [see draft recommendation 73]

152. Requirements that may apply for the closure of standard business insolvency proceedings may need to be waived in a simplified insolvency regime. In particular, no hearing of a final accounting of the realization of assets and distribution of proceeds or implementation of the reorganization plan should be required.

153. In simplified liquidation proceedings, the party responsible for liquidation (where it is different from the competent authority) may be expected to file to the competent authority the report on the completion of the liquidation (where a final accounting of realization of assets and distribution of proceeds is presented). The competent authority may communicate that report to the other parties in interest using electronic means where possible. Provided that no objection or opposition is raised, the competent authority may file the final accounts and report of the simplified liquidation proceedings with the body responsible for registration of business entities so that the latter could make the necessary entries in the State records. Some laws may however require a formal application to that body for an order of dissolution of a legal entity.

154. Simplified reorganization proceedings should be allowed to automatically close: (a) upon the competent authority's confirmation of successful implementation of the plan and discharge; or (b) upon the termination of a simplified reorganization proceeding with respect to a solvent debtor where reorganization failed. Whether conversion constitutes the formal closing of the proceedings and commencement of new proceedings depends upon the approach of the jurisdiction in question.

155. The decision to close may be notified only to parties that participated in the proceeding. Requiring the issuance of a public notice of closure of a simplified insolvency proceeding may defeat measures taken in the proceeding to reduce the stigma of insolvency.<sup>163</sup>

## N. Treatment of personal guarantees. Procedural consolidation or coordination of linked proceedings [see draft recommendations 74–77]

### 1. Treatment of personal guarantees

156. Lenders to MSEs often require guarantees to secure business loans. Such guarantees are commonly provided by founders, owners or members of unlimited liability MSEs or of limited liability MSEs or by their family members or other related persons. Personal guarantors will face payment claims where the guaranteed obligation cannot be performed by the debtor, which is usually before or after the opening of an insolvency proceeding. Allowing unrestricted enforcement of guarantees could lead to destitution for the entire family of an individual entrepreneur or owners of limited liability MSEs.

157. Generally, the insolvency proceedings and discharge have no alleviating effect on the liability of the guarantor. The purpose of requiring a personal guarantee is to protect against the principal debtor's insolvency by ensuring that the creditor will be paid. Adjusting the guarantor's liability in the insolvency proceeding would reduce the protection for the creditor. This could, in the long

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**owed to creditors under the reorganization plan. If the debtor defaults under the plan and the case is then converted to liquidation, based on the confirmed plan unless there are contractual provisions to the contrary, the debtor owes the creditors after default the non-repaid amount under the plan, not the original debt (i.e., the approval by the creditors of the reorganization plan modifies the debt in conformity with the plan).**

<sup>163</sup> In its communication to the secretariat dated 3 July 2020, Côte d'Ivoire emphasized the need to issue a public notice of closure of the proceeding in order to prevent abuse by the MSE debtor.

run, restrict access to credit, including for MSEs many of which may not be able to obtain financing in other ways.

158. Nevertheless, where invoking a personal guarantee would likely result in, in addition to the business insolvency, the personal insolvency of individual entrepreneurs, owners of limited liability MSEs or their family members, consideration should be given to providing a procedure to address the position of the MSE debtor and its guarantors together. This may be achieved through procedural consolidation or coordination of proceedings against the MSE debtor and its guarantors, as discussed below. Where no separate proceeding has been commenced against personal guarantors of the MSE debtor, potential claims of creditors could be brought and accorded appropriate treatment in the insolvency proceeding commenced for the MSE debtor.

159. These measures may facilitate the successful reorganization of the MSE debtor or would alleviate a disproportionate hardship on the guarantor. A stay may be imposed on the enforcement against personal guarantors of the MSE debtor for a limited duration on a case-by-case basis. When approving or confirming a reorganization plan, the competent authority may accord special treatment to a guarantor's claim against the MSE debtor vis-à-vis other claims in the plan. The insolvency law may permit MSE debtors' guarantors to petition for a reduction or discharge of their obligations under the guarantee if those obligations are disproportionate to the guarantor's revenue and may also permit the guarantor to pay in instalments for an extended period. The competent authority or another relevant State body may be allowed to exercise discretion in favour of the guarantor's discharge or the reduction of the obligation to the part of the debt not covered by the MSE debtor's debt repayment obligations.

160. Special measures of protection may be envisaged in law other than insolvency law for especially vulnerable guarantors, e.g., those who are found to have provided guarantees under duress or those who are dependent on or have strong emotional ties with the debtor. Special treatment has been accorded to such guarantors, for example, when the guarantee was found unreasonable or because, at the time of signing the contract, the financiers did not explain the consequences of giving a personal guarantee or agreeing on certain clauses (e.g., "all money" clauses). Some jurisdictions may impose restrictions on the kinds of guarantee a spouse, child or other dependent person may give.

## **2. Procedural consolidation or coordination of linked business, consumer and personal insolvency proceedings**

161. The need for procedural consolidation or coordination of linked proceedings in a simplified insolvency regime may also arise because of the cross-over of commercial and personal insolvency, the overlap of business and household assets and intertwined debts of related persons. Since more than one State body may be involved in handling linked proceedings, achieving procedural consolidation or coordination of those proceedings would not only be procedurally convenient and cost-efficient but would also facilitate sharing of information to obtain a more comprehensive evaluation of the situation of the various parties involved and finding the best solution for all concerned.

162. The scope of an order for procedural consolidation or coordination would generally be determined by the competent authority or other relevant State body in each case. The conduct and administration of any related proceedings could be consolidated (procedural consolidation) or could run in parallel with measures put in place to ensure close coordination between or among them (procedural coordination). Although administered in a coordinated manner, the assets and liabilities of each person involved in the procedural consolidation or coordination would remain separate and distinct. Accordingly, the effect of procedural consolidation or coordination would be limited to administrative aspects of the proceedings (e.g., coordinating deadlines) and would not involve

a substantive consolidation as discussed in part three of the Guide. While the need for substantive consolidation of assets of various persons involved in MSE insolvency cannot be excluded altogether, the complexities arising from the substantive consolidation will most likely necessitate commencement of a standard insolvency proceeding.

163. States may already adequately provide for the possibility of coordinating or consolidating linked proceedings, considering joint applications and using other means to accord proper treatment to closely linked interests of different persons. Specific requirements and procedures to that effect may nevertheless be introduced in the insolvency law providing for a simplified insolvency regime.

## **O. Conversion [see draft recommendations 78–81]**

164. Reasons for conversion of one type of a simplified insolvency proceeding to the other and of simplified insolvency proceedings to standard insolvency proceedings have been addressed in preceding sections of this [text]. Conversion of a simplified insolvency proceeding to a standard business insolvency proceeding will usually be justified by the complexity of the case (e.g., allegations of fraudulent transfers of the MSE debtor's assets to related persons). The need for conversion will be assessed in each case by the competent authority. The conversion of a standard business insolvency proceeding to a simplified insolvency proceeding may also need to be envisaged.

165. Where the insolvency law permits conversion, a related question is how conversion can be triggered – whether it should be automatic once certain conditions are fulfilled, with the law allowing a dissenting party to challenge such an automatic conversion, or require application to a relevant State body by an interested party. Such body could also be given the power to convert on its own motion where certain conditions are met.

166. Automatic conversion would help to avoid the delay and expense of a separate application by the party interested in conversion. It may not however always be desirable. For example, in some cases, even where the failure to implement the reorganization plan is attributable to a breach of obligation or the lack of a debtor's cooperation, creditors may prefer reorganization to liquidation to extract more value from the business. Instead of conversion to liquidation, they may opt for replacement of the debtor-in-possession with an independent professional (e.g., the insolvency representative). It may also be preferable to leave creditors to pursue their rights at law, without necessarily liquidating the debtor, in particular where the debtor commenced a reorganization proceeding to address financial difficulties at an early stage and was not necessarily eligible for liquidation proceedings. Serving an advance notice of intended conversion to all parties in interest to allow them to object to that course of action may therefore be considered an essential safeguard.

167. Where conversion is treated as a continuation of the originally filed proceeding, adjustments would need to be made to the standard time periods that run from the effective date of commencement of that proceeding, since a significant period of time may have elapsed between commencement of the proceeding and its conversion. In particular, where a simplified liquidation proceeding is converted to a reorganization proceeding, for example where business rescue finance became available to the MSE debtor after the commencement of the simplified liquidation proceeding, the insolvency law should address the impact of conversion on time periods for proposing a reorganization plan. The insolvency law should address other implications of conversion, in particular: (a) the status of any actions taken prior to the conversion (e.g., continued application of the stay); (b) the effect of the conversion on the exercise of avoidance powers in respect of payments made in

the course of the reorganization proceedings; (c) the effect of the conversion on the timing of the suspect period; (d) the treatment of creditor claims that have been adjusted in the reorganization, i.e., whether in any subsequent liquidation they are to be reinstated to the original value or enforced with the adjusted value;<sup>164</sup> (e) treatment in a subsequent liquidation of post-commencement finance extended under the reorganization plan (e.g., priority accorded in the reorganization to such finance may need to be recognized in a subsequent liquidation in order to encourage the provision of such finance to financially distressed debtors undergoing reorganization); and (f) any additional costs arising from conversion (e.g., the party asking for conversion may be required to provide security to cover additional costs).

168. Conversion of proceedings should be differentiated from introduction of modifications within the same proceeding, such as replacing the debtor-in-possession regime or introducing a mediation stage to resolve disputes among creditors or between the debtor and its creditor(s). The insolvency law should allow the competent authority to introduce modifications on its own motion or upon request by any party in interest where the circumstances of the case so justify.<sup>165</sup>

## **P. Appropriate safeguards and sanctions [see draft recommendation 82]**

169. The insolvency law should build in appropriate safeguards and sanctions to deter abuses or improper use of the simplified insolvency regime and provide punishment for them when they have occurred. They should be in place before the commencement of, throughout and after simplified insolvency proceedings and should in particular deter and provide punishment for: (a) inappropriate commencement of simplified insolvency proceedings, either by MSEs or their creditors or by ineligible persons; (b) fraudulent, dishonest or bad faith behaviour, including by unjustifiably delaying the commencement of simplified insolvency proceedings; and (c) failure to fulfil obligations under the insolvency law.

170. Safeguards may be contained in a range of options made available to parties in interest for deployment when justified. Safeguards also include a possibility of converting proceedings. Sanctions may include denial of discharge, longer periods for obtaining a full discharge, other conditions attached to discharge, revocation of discharge granted and disqualification from taking up or pursuing a specific business activity or practising a particular profession. They may be accompanied by sanctions under other law, such as criminal law sanctions where the debtor acted fraudulently.

<sup>164</sup> During the September 2020 informal consultations, it was proposed to explain in the commentary what would be considered the debt under the approved and confirmed reorganization plan, in particular that the original debt will be substituted by the amount owed to creditors under the reorganization plan. If the debtor defaults under the plan and the case is then converted to liquidation, based on the confirmed plan unless there are contractual provisions to the contrary, the debtor owes the creditors after default the non-repaid amount under the plan, not the original debt (i.e., the approval by the creditors of the reorganization plan modifies the debt in conformity with the plan).

<sup>165</sup> In a written submission circulated during the May 2020 informal consultations, it was suggested to emphasize in the text that conversion of a liquidation to a reorganization would be very exceptional and such possibility should not exist at any stage of the liquidation process; and upon such conversion, the effects of the liquidation proceeding should be preserved.

**Q. [Insolvency prevention aspects]<sup>166</sup> [see draft recommendations 83–88]**

**1. Obligations of persons exercising control over management and oversight of the MSE operations in the period approaching insolvency of that MSE**

171. Individual entrepreneurs and persons exercising control over the management and oversight of MSE operations will often be unsophisticated in business, financial and insolvency matters and have no resources to have recourse to regular professional advice on those matters. As a consequence, they may be unaware that in the period approaching insolvency they are expected to act in the best interest of creditors and other stakeholders rather than the owners of the business. They may equally be unaware of the steps that are usually taken to avoid insolvency or to minimize its extent and to avoid civil and criminal liability, including disqualification and longer period of time for discharge, that they may face for causing insolvency or failing to take appropriate actions in the vicinity of insolvency. (See recommendation 256 of the Guide.) Similarly, at the time of financial distress, they may be inclined to collaborate with related persons or powerful creditors (e.g., by repaying the debt to only one bank or transferring business assets to related persons at an undervalue) or to obtain goods or services on credit without any prospect of payment. They may not be aware that such transactions can be avoided and lead to personal liability of persons who agreed to the transaction, regardless of whether the business operates as a limited liability MSE or unlimited liability MSE.

172. The insolvency law providing for a simplified insolvency regime should therefore be explicit regarding all these issues and the obligations of persons exercising control over the management and oversight of MSE operations in the period approaching insolvency of an MSE, adjusting those obligations to the specific context of MSEs. Like in the case of larger enterprises, such obligations will arise when such persons knew or ought reasonably to have known that insolvency was imminent or unavoidable and would include the general obligation to avoid deliberate or grossly negligent conduct that threatens the viability of the business. However, the steps expected to be taken by those persons to avoid insolvency or to minimize its extent should be reasonable and proportionate to the general knowledge, skills and experience expected of a person exercising control over the management and oversight of MSE operations and take into account limited resources that MSEs usually have that may deprive them from the benefits of professional advice usually available to larger enterprises. Those steps may include seeking any pro bono professional advice made available by States specifically to MSEs in financial difficulty, early recourse to mediation or debt counselling services, if available, and timely engagement in informal debt restructuring negotiations where those are permissible. Those steps would thus not necessarily be limited to an early filing for simplified insolvency proceedings under draft recommendation [17].

173. As stated in the Guide, in the period approaching insolvency, all parties exercising factual control over the business may be under a general obligation to act in the best interest of creditors and other stakeholders and take reasonable steps to avoid insolvency or to minimize its extent (see recommendation 255 of the Guide). Such clarification is particularly pertinent in the context of MSE insolvency where strong influence of main creditors on MSEs during the time of financial distress is common, which may make such creditors the de facto managers of MSEs in the period approaching insolvency. As such, those creditors may face liability under insolvency law if their self-serving behaviour prejudiced the position of other creditors. Their behaviour in the vicinity of MSE insolvency may be judged against a higher standard depending on the skills and experience actually possessed by such creditor or its representative, or

<sup>166</sup> See the issues raised with respect to the relevant draft recommendations.

reasonably be expected of a person carrying out the same functions as the creditor or its representative (e.g., a bank officer).<sup>167</sup>

## 2. MSE insolvency prevention measures

174. Putting in place insolvency prevention solutions is a growing trend in insolvency law and insolvency-related law reform around the globe. Those solutions, among other benefits to the economy, often help to maintain jobs or reduce job losses and losses of value for creditors in the supply chain, and preserve know-how and skills. Finally, efficient preventive strategies would enable a better assessment of the risks involved in lending and borrowing decisions and facilitate the adjustment for insolvent or over-indebted debtors, minimizing the economic and social costs involved in their deleveraging process.

175. The earlier an MSE can detect its financial difficulties and can take appropriate action, the higher the probability of avoiding an impending insolvency or, in the case of a business the viability of which is permanently impaired, the more orderly and efficient the liquidation process would be. MSEs may be assisted with tools that would help them to do so.

176. In particular, insufficient knowledge of business management and financial transactions is cited as a common cause of business failure among MSEs, especially first-time starters. Measures aimed at prevention of MSE insolvency should therefore include educational tools to increase financial and business management literacy and skills among MSEs. Training on usual factors that lead or contribute to financial distress, such as the loss of a key customer or supplier or contract, departure of a key employee or adverse changes in rental, supply or loan terms, should be supplemented by training on examination of the viability of the business and changes that may be required in expenditure, business and management practices.

177. In addition, MSEs may be assisted by early warning tools that may be put in place by States or by private entities to detect circumstances that could give rise to the likelihood of insolvency and can signal to an MSE the need to act without delay. Information technology solutions may in particular be helpful in automatically generating alert mechanisms when an MSE has not made certain types of payment, for example, taxes or social security contributions. Non-payment of those contributions may, however, have already caused serious financial distress to the business, to the point that it might be too late to rescue it. Certain professions, such as tax advisers and accountants, may be in a position to identify signals of financial distress considerably earlier; incentives may be built into domestic law for them to flag those signals to an MSE once they are identified.

178. In addition, advisory services provided by public or private organizations, such as chambers of commerce, may assist with analysing financial situations, debt restructuring options and preparation of an application to commence insolvency proceedings where necessary. Mediation and conciliation services may be made available to facilitate resolution of disputes between MSE debtors and creditors and among creditors.

179. To achieve the desired objective, information about all such measures and tools should be made readily available, easily accessible and presented in a user-friendly manner for MSEs, for example on a dedicated website or web page of relevant State authorities in charge of MSE issues.

<sup>167</sup> During the September 2020 informal consultations, it was suggested that further discussion about “shadow directors” should be added in the commentary. It was also suggested to emphasize in the commentary that recommendation 83 sets out the standard of behaviour with the consequence that, if such standard is not adhered to, personal liability may be imposed on persons exercising factual control over an MSE.

### 3. Informal debt restructuring negotiations

180. Informal debt restructuring negotiations may enable MSEs to restructure their debts effectively at an early stage of financial distress without the need to file for formal insolvency proceedings. Unlike formal insolvency proceedings that involve all creditors, informal debt restructuring negotiations usually involve a limited number of creditors, which may accommodate the need for a prompt resolution that is not always possible in formal proceedings, and allow parties to preserve confidentiality, which helps to avoid the stigma attached to insolvency. In addition, they may provide debtors with the benefit of resolving their financial difficulties without affecting their personal credit scores, which is important for obtaining new finance and a fresh start.

181. While in some jurisdictions such negotiations are permitted or required to be exhausted by a debtor and its creditors before they can initiate formal insolvency proceedings, in other jurisdictions debt restructuring agreements or arrangements between a debtor in financial distress and some or all of its creditors cannot occur outside formal insolvency proceedings. In particular, an obligation to file for formal insolvency within a certain period after the occurrence of certain events found in the insolvency legislation of many countries creates obstacles to holding informal debt restructuring negotiations. Disincentives for using informal debt restructuring negotiations may be found in other laws as well. For example, tax regulations may allow writing off only those debts that were discharged in formal insolvency proceedings. They may permit only creditors to claim losses and tax deductions from debt write-offs but impose income tax on debtors whose debts are written off.

182. In the light of the expected advantages of such negotiations in preventing the build-up of non-performing loans and over-indebtedness, States may consider removing any explicit or implicit prohibitions or disincentives for engaging in informal debt restructuring negotiations. A debtor and its creditors should be allowed to freely initiate such negotiations when they deem it will be appropriate to do so without facing a risk of liability for violation of obligations under the insolvency law. Incentives may be built into the law to use such negotiations in particular with MSEs (for example, monthly targets may be imposed on banks to successfully restructure debts of MSEs, or tax incentives may apply for writing off bad or renegotiated debts). Sanctions may be imposed on parties acting in bad faith during those negotiations.

183. In addition, informal debt restructuring negotiations have proved to be efficient when they rely on some features of formal insolvency processes, such as the statutory stay on enforcement and other proceedings against a debtor and its assets. Some jurisdictions provide in their insolvency law for such a statutory stay for the duration of informal debt restructuring negotiations. This allows the negotiations to progress without the threat that any party in interest, including secured creditors, will start insolvency proceedings or proceed with enforcement actions or suspend, terminate or modify existing contracts with a debtor. In many jurisdictions, such statutory stay may only be available in formal insolvency proceedings.

184. As a way out, parties may negotiate a contract-based standstill arrangement, although in some jurisdictions arrangements with all or some creditors that provide for a stay on the payment of debts may trigger formal insolvency. Alternatively, creditors usually agree among themselves rather than with a debtor to operate a stay on their claims against a debtor, and a debtor separately agrees not to take steps which might prejudice the relevant creditors during an agreed period. Contract-based standstill arrangements, although avoiding publicity, may be cumbersome and more difficult to monitor and enforce. In addition, although the period of the standstill may be fixed for a certain period, creditors usually preserve their rights to terminate it at any time

at their discretion. This may bring uncertainty and unpredictability to a debtor and other negotiating creditors.

185. Because informal debt restructuring negotiations are held without supervision by any competent State authority and remain confidential (unless the law requires approval by a competent State authority of an informally negotiated plan for restructuring the debts of a financially distressed person), abuses are possible. For example, debtors may prolong negotiations to delay the liquidation of their business to the detriment of other parties in interest. Creditors may use their bargaining power to refuse to agree to any modifications of their claims or pressure debtors into accepting onerous plans that are not viable and would not be acceptable in formal proceedings. In addition, creditors demanding enforcement of their claims may make negotiations impossible: just one participating creditor may veto a settlement, and unless the law stipulates that passive creditors are bound by a settlement, they often feel free to disregard attempts to participate in negotiations.

186. There should be ways of identifying clearly non-viable businesses with no prospect of survival early in the process so that they could be liquidated as quickly as possible to avoid the acceleration and accumulation of losses to the detriment of creditors, employees and other stakeholders, as well as the economy as a whole. Where the viability of a business is unquestionable, the State may provide support for holding informal debt restructuring negotiations and implementing informal workouts, such as through the involvement of a neutral intermediary with sufficient authority and power to persuade key institutional creditors, such as tax authorities and banks, to participate in debt restructuring negotiations with MSEs and to ensure oversight to prevent abuses. In some jurisdictions, there may already be a State authority in charge of administering negotiations between a debtor and its creditors or authorized to appoint a mediator or conciliator for the process (e.g., a central bank, a central debt-counselling agency, a commission for over-indebtedness or the debt enforcement authority). There may also be an arbitration facility to resolve disputes among the negotiating parties. In other systems, debtors may rely on counselling and negotiation support from semi-private or private sector actors.

187. The involvement of State authorities in informal debt restructuring negotiations should however be limited to situations in which it is necessary and proportionate (e.g., for safeguarding the rights and interests of debtors and of affected parties). It usually takes the form of the approval of the plan resulting from such negotiations. Such approval may be required by law or desired by negotiating parties. Approval of the plan by such authority may be expedited where it can be shown that the rights of unsecured creditors or others who were not involved in the negotiation of the plan would not be affected and the plan was approved by the required majority of affected creditors. Provisions of the Guide on expedited reorganization proceedings are of relevance in this respect. They have been designed to address concerns over inter-creditor agreements negotiated informally without the involvement of all creditors whose rights are modified by those agreements. While providing for the fast-track procedures, they build in procedures to ascertain that creditors that were not involved in negotiations are indeed not affected by the plan and also provide for safeguards for adversely affected creditors. They ensure that a competent State authority will carefully look at the substance of negotiated deals and decide whether to approve the deal or open expedited insolvency proceedings, as a result of which the plan may be imposed over the objection of aggrieved creditors or modified to address the concerns of aggrieved creditors. The usual conditions for approval of the reorganization plan would apply (e.g., that all required approvals were received and that creditors are not worse off than they would have been if liquidation proceedings have been commenced). (See recommendations 160–168 of the Guide.)

188. Initiation of the plan confirmation proceedings with a State authority might however mean the loss of confidentiality – considered to be one of the main advantages of informal procedures – since at least the fact that the procedure took place and the essential terms of the agreed plan, such as new guarantees, new finance and priority ranking, may need to be disclosed.

**4. [Pre-commencement business rescue finance]<sup>168</sup>**

189. The success of any insolvency prevention measure very often depends on whether there are financial resources in place to support the operation of the business.

190. Financial resources for MSEs during insolvency prevention attempts are likely to come from existing lenders, clients or suppliers who are interested in an ongoing relationship with the MSE. Those parties may be interested in advancing new funds or providing trade credit in order to enhance the likelihood of recovering their existing claims. The law should create inducements and incentives for such creditors to make new funding available to MSEs. Without them, an MSE's access to fresh credit is substantially hindered.

191. Creditors usually agree to provide new funding on the condition that priority status will be accorded to the new funding or additional security over the MSE's assets will be given. Those creditors who participate in informal debt restructuring negotiations may agree among themselves that if one or more of them extends further credit, the others will subordinate their claims to enable the new credit to be repaid ahead of their own claims. In those cases, as among those creditors, there will be a contractual agreement for the repayment of new money where the informal debt restructuring negotiations are successful and the business is rescued.

192. If a business rescue fails despite that additional funding and, as a consequence, insolvency proceedings must be commenced, creditors would want to see some protection of their pre-commencement finance in the law, in particular that the provision of such finance would not be declared void, voidable or unenforceable, which could leave the creditor who has provided it with an unsecured claim (unless a security interest was provided) and the creditor would receive only partial repayment along with other unsecured creditors. They would also want to avoid facing civil, administrative or criminal liability for providing such finance on the ground that it is detrimental to other creditors. Encouraging creditors to provide new finance may require further incentives such as, for example, giving such funding priority at least over unsecured claims in subsequent insolvency proceedings. These measures could create a strong incentive to existing creditors to provide fresh finance to MSEs at the risk of being subordinated to new lenders providing such finance.

193. Measures to encourage the provision of new finance to avoid insolvency must be balanced with other considerations, such as the 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 pre-existing security rights and priorities. It is also important to consider the impact on unsecured creditors who may see the remaining unencumbered assets disappear to secure new lending. Such risk must be balanced against the prospect that preservation of going concern value by continued operation of the business will benefit those creditors.

194. Safeguards against abuses may take different forms, including ex ante or ex post controls over such finance by public and private institutions, such as regulatory bodies overseeing the banking and credit sector or those that are tasked with assisting MSEs in raising finance. Such controls should give

<sup>168</sup> See the issues raised with respect to draft recommendation 88.

confidence and comfort that protection from avoidance and personal liability is extended only for new funding provided in good faith and immediately necessary for the rescue of the business and its continued operation or the preservation or enhancement of the value of that business.

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