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CROSS-BORDER INSOLVENCY

Possible issues relating to judicial cooperation and access and recognition in cases of cross-border insolvency

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INTRODUCTION

1. At the present session, the Working Group on Insolvency Law commences its work, pursuant to a decision taken by the Commission at its twenty-eighth session (Vienna, 2-26 May 1995), to embark on the development of a legal instrument relating to cross-border insolvency.[1]

2. The Commission's decision to undertake work on cross-border insolvency was taken in response to suggestions made to it by practitioners directly concerned with the problem, in particular at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century" (held in New York in conjunction with the twenty-fifth session, 18-22 May 1992). The Commission decided at its twenty-sixth session to pursue those suggestions further.[2] Subsequently, in order to assess the desirability and feasibility of work in this area, and to define appropriately the scope of the work, UNCITRAL and the International Association of Insolvency Practitioners (INSOL) held a Colloquium on Cross-Border Insolvency (Vienna, 17-19 April 1994), involving, from many countries, insolvency practitioners from various disciplines, judges, Government officials and representatives of other interested sectors including lenders.[3]

3. The first UNCITRAL-INSOL Colloquium gave rise to the suggestion that work by the Commission should at this stage have the limited goal of facilitating judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings (hereinafter referred to as "judicial cooperation" and "access and recognition"). It was understood that this would not include any attempt at substantive unification of insolvency law, an objective that is widely perceived as unattainable, at least at the present stage. It was also suggested that an international meeting of judges take place specifically to elicit their views as to work by the Commission in this area. Those suggestions were received favorably by the Commission at its twenty-seventh session.[4]

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[1] Report of the United Nations Commission on International Trade Law on the work of its twenty-eighth session (1995), Official Records of the General Assembly, Fiftieth Session, Supplement No.17 (A/50/17), paras. 382 to 393.

[2] Report of the United Nations Commission on International Trade Law on the work of its twenty-sixth session (1993), Official Records of the General Assembly, Forty-eighth Session, Supplement No 17 (A/48/17), paras. 302 to 306. The background note on which the Commission based its discussion at the twenty-sixth session is contained in document A/CN.9/378/Add.4.

[3] The report of the UNCITRAL-INSOL Colloquium on Cross-Border Insolvency presented by the Secretariat to the Commission at its twenty-seventh session (1994) is set forth in document A/CN.9/398.

[4] Report of the United Nations Commission on International Trade Law on the work of its twenty-seventh session (1994), Official Records of the General Assembly, Forty-ninth Session, Supplement No 17 (A/49/17), paras. 215 to 222.

4. Subsequently, the UNCITRAL-INSOL Judicial Colloquium on Cross-Border Insolvency was held in Toronto, from 22 to 23 March 1995. The purpose of the Judicial Colloquium was to obtain for the Commission, as it embarked on work on cross-border insolvency, the views of judges and of Government officials concerned with insolvency legislation, on the specific issue of judicial cooperation in cross-border insolvency cases and the related topics of access and recognition.[5] The consensus view at the Judicial Colloquium was that it would be worthwhile for the Commission to provide a legislative framework, for example by way of model provisions, for judicial cooperation, and to include in the text to be prepared provisions on access and recognition.

5. In taking note of the views expressed at the Judicial Colloquium, the Commission noted that the Working Group would examine a range of matters raised at the Judicial Colloquium relating to the possible scope, approaches and effects of the legal text to be prepared. Particular interest was expressed by the Commission in the possibility that the legal framework to be prepared for judicial cooperation and access and recognition would include a "menu of options" for legislators as to some aspects. Such a "menu" approach would reflect the reality that not only were there distinct differences remaining among States as to substantive aspects of their insolvency laws, but also that States differed as to the extent and manner of judicial cooperation and access and recognition they would be willing to provide for in their legislation. At the same time, given the prevailing lack of such provisions in many States, it can be foreseen that even the less ambitious selections on the menu of options developed by the Commission may bring a significant measure of improvement to the present situation. However, it should be noted that the various options set forth in this note are presented for the consideration by the Working Group to solicit individual expressions of preference.

6. The present note is intended to serve as a skeletal, annotated list of issues and possible solutions that might be covered by the instrument to be prepared by Commission. The note does not presume to be exhaustive, and it is anticipated that issues will be raised in the discussion that have not been addressed in the note. In addition, the Secretariat is continuing its process of consultations with practitioners and other interested circles, for example through INSOL and Committee J of the Section of Business Law of the International Bar Association (IBA), fruits of which may be brought to the attention of the Working Group at the session.

I. GENERAL BACKGROUND REMARKS

7. In the preparation of this note and the selection of issues referred to in it, the Secretariat has taken into account and relied upon earlier efforts and instruments at the national and regional levels dealing with judicial cooperation and access and recognition. At the regional and multilateral level, those include the Convention on Private International Law, Havana 1928 ("Bustamante Code"), the two Treaties on Commercial International Law, 1889 and 1940 ("Montevideo Treaties"), the Convention between Denmark, Finland, Iceland, Norway and Sweden regarding Bankruptcy ("Nordic Bankruptcy Convention", 1933, amended 1977 and 1982), the European Convention on Certain International Aspects of Bankruptcy ("Istanbul Convention", 5 June 1990 (not in force)), and the European Union's

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[5] The report on the Judicial Colloquium presented by the Secretariat to the Commission at the twenty-eighth session (1995) is set forth in document A/CN.9/413.

draft Convention on Insolvency Proceedings of 1992 ("EU draft"), as well as the Model International Insolvency Cooperation Act (MIICA), prepared by Committee J of the Section on Business Law of the IBA.[6]

8. The Secretariat has been guided in its selection of issues for this note by the range of issues dealt with in the above instruments, as well as in national legislative provisions dealing with cross-border insolvency. The Secretariat has also had at its disposal a draft of a study of national laws and multilateral treaty efforts in the area of cross-border insolvency prepared by an expert committee assembled by INSOL.

9. The draft paper of the INSOL expert group summarized the current legal environment in which solutions to cases of cross-border insolvency must be crafted. That environment was characterized by diversity and often inconsistency in legal approaches, including the degree of discretion that might be available to judges in the absence of statutory authorization for dealing with cross-border insolvencies. Such a situation may jeopardize in any given case the possibility of implementing a liquidation or reorganization plan that maximizes the value of the debtor's assets and save as much employment as is possible. For example, some States adhere to a "territoriality" principle which may deny recognition to foreign insolvency proceedings and assert the control over domestic assets, while States in a bilateral or multilateral treaty arrangement might be bound to apply approaches aiming at a single or common administration of the insolvency (e.g., Montevideo Treaties of 1889 and 1940, Nordic Bankruptcy Convention), or at harmonization among any concurrent proceedings.

10. The report described the legislation found in a limited number of States specifically dealing with judicial cooperation and with access and recognition in the insolvency context. Such legislation varies as regards the extent to which cooperation and assistance are mandatory or subject to the discretion of the requested court. For example, in one country recognition and assistance is mandatory for proceedings in certain prescribed countries, based on an assessment as to the nature of the proceedings carried out in those other countries. Another approach is to authorize cooperation and assistance, but to leave the actual extent of cooperation and assistance to the discretion of the court.

11. Also described were various techniques and notions employed in pursuit of judicial cooperation in particular in the absence of a specific legislative or treaty framework for judicial cooperation and access and recognition. Those techniques include: application of the doctrine of comity by courts in common law jurisdictions; issuance for equivalent purposes of enabling orders (exequatur) in civil law jurisdictions; conclusion of ad hoc protocols to establish cooperation among jurisdictions involved in cross-border insolvency cases and to facilitate cross-border administration; enforcement of foreign insolvency orders by way of general legislation on recognition of foreign judgments and procedures such as letters of request (letters rogatory) from foreign jurisdictions. It was further observed that approaches based purely on the doctrine of comity or on the exequatur approach were unlikely to provide the same desired degree of predictability and reliability as would a specific legislative framework for judicial cooperation and access and recognition.

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[6] Additional information concerning the regional and multilateral instruments referred to can be found in the Secretariat note in document A/CN.9/378/Add.4.

12. It was reported that, though there are exceptions, general legislation on reciprocal recognition of judgments, including exequatur statutes, may as a whole be considered particularly unpredictable for dealing with cross-border insolvency cases. This is because such procedures might be confined in a given legal system to enforcement of specific money judgements or injunctive orders in two-party disputes, rather than in collective proceedings typical in the insolvency context. Furthermore, recognition of foreign insolvency proceedings, for example for the purpose of providing ancillary relief to those proceedings, might not be considered a matter of recognizing a "judgment".

13. Rather, decisions or orders of a foreign court might be enforced only if they were considered final and binding under the law of the jurisdiction in which they were issued, and if they were not regarded as unenforceable. Non-enforcement might be the fate of a foreign decision if, for example, the requested court ruled that the foreign court did not have jurisdiction under the principles of the law of the requested court, if the debtor was not given adequate notice in the foreign proceeding, if enforcement would be inconsistent with a previous decision or ongoing proceedings in the requested State, or in case of conflict with public policy (ordre public) type.

14. It was reported that the prospect of successfully utilizing, for the purpose of recognizing foreign insolvency proceedings, statutes on reciprocal recognition of judgments was further limited by the possibility that the declarations or orders of a court in the insolvency context might be considered as declarations of status in the nature of exercise of State power, rather than as true judgments or orders intended to be dealt with by the reciprocal legislation. Additional conceptual obstacles may arise when the insolvency proceedings sought to be recognized had been initiated voluntarily by the debtor.

15. The report as well as the consultations that the Secretariat has held with practitioners and other circles directly interested in cross-border insolvency indicate that work by the Commission, without being so ambitious as to attempt the substantive unification of insolvency law, could make a practical contribution to addressing a variety of needs. The potential utility of work by the Commission is further heightened by the continuing increase in instances of cross-border insolvency, which is a natural by-product of the rapid globalization of economic activity currently taking place.

16. Those needs affect a variety of individuals or entities, including: the debtor, who has an interest in relief from the individual creditors' actions, and perhaps in rescue and rehabilitation of the business; unsecured creditors, whose return on the debts owed to them would be maximized to the extent cross-border cooperation could be instituted as a replacement for the "race to the court house"; employees of the debtor, whose interest lies in payments of wages owed and in maximizing the possibility of saving businesses, and thus jobs; secured creditors, who seek recognition and enforcement of their security interests; Governments, which have an interest not only in enforcing governmental claims but also in saving employment and assuring investors that the applicable legal system will provide some measure of predictability and the possibility of enforcing claims; courts, which require an adequate legal framework for dealing with cross-border insolvency; and insolvency administrators, whose efficacy requires a legal framework that is predictable and efficient.

17. At the same time, the record of cross-border insolvency cases, as well as the colloquia and the consultations that the Secretariat has held, show clearly that States differ as to the extent to which and the manner in which they accommodate judicial cooperation and access and recognition for the purposes of addressing those needs in a cross-border context.

This stems from factors including differences among legal systems as to the degree of discretion afforded to courts and the degree of adherence to traditional territorial notions of the applicability of insolvency law.

18. Prior to proceeding with the detailed consideration of issues, it may be useful to recapitulate how certain basic terms used in this note may be understood. Most legal systems contain rules on various types of proceedings that may be initiated when a debtor is unable to pay its debts. "Insolvency proceedings" is the generic expression used in this note for those types of proceedings. Two types of insolvency proceedings may be distinguished, for which a uniform terminology has not emerged.

19. In one type of proceedings (hereafter referred to as "liquidation"), a public authority, usually a court, and typically acting through an officer appointed for the purpose (referred to here as "administrator", or, in some contexts, "insolvency representative"), takes charge of the insolvent debtor's assets with a view to transforming non-monetary assets into a monetary form, distributing the proceeds proportionately to the creditors, and, at the end of the proceedings, liquidating the debtor as a commercial entity. In some States this is the only type of proceedings used. Other terms that are often used for this type of proceedings are for example, bankruptcy, winding-up, faillite, quiebra, Konkursverfahren. It may be noted, however, that terms such as "bankruptcy" might be understood as having a broader meaning which includes also composition proceedings as described in the next paragraph.

20. The other type of proceedings (hereafter referred to as "composition")is an alternative to liquidation proceedings. The purpose of the alternative proceedings is not to liquidate the insolvent debtor, but to allow it to overcome the financial crisis and resume normal participation in commerce. Such proceedings, also usually carried out under the supervision of a court, are typically aimed at reaching an agreement, or composition, between the debtor and its creditors about relief that should allow the debtor to reorganize and restore its commercial viability. The relief may be in the form, for example, of partial abatement of the claims against the debtor, prolongation of payment periods, or renegotiation of the debtor's obligations. While such relief is being negotiated, the debtor enjoys protection from enforcement actions of creditors over its assets. It may be possible for composition proceedings to be initiated during liquidation proceedings. Other terms used for this type of insolvency proceedings are, for example, reorganization, arrangement, concordat préventif de faillite, suspensión de pagos, administración judicial de empresas, Vergleichsverfahren.

21. For insolvency proceedings to be initiated, a court order is typically needed. The initiative to open such proceedings may be taken by the insolvent debtor itself (voluntary insolvency) or by a creditor or creditors (involuntary insolvency). In some States the same type of insolvency proceedings apply to all insolvent enterprises or merchants, whereas others use two types of proceedings, one for legal persons and another for natural persons.

II. POSSIBLE DECISIVE FACTORS FOR ACCESS AND RECOGNITION

22. The suggested issues contained in this and in the following section focus on some of the main problems a national legislature usually has to resolve when it intends to enact statutory provisions concerning cooperation in the field of cross-border insolvency. The suggestions try to give indications how model provisions which might be attractive for national legislators could be structured.

A. Competence

23. A basic question in many jurisdictions is what connecting factor must exist between the debtor and the State in which an insolvency proceeding concerning that debtor was opened, in order that the recognition of such an insolvency proceeding in another country is to be considered justified. Because of those jurisdictions, this question (sometimes referred to as "indirect competence") would have to be faced in the elaboration of model provisions on the recognition of foreign insolvency proceedings.

24. A variety of possible connecting factors is conceivable, including: domicile, habitual residence, place of a company's registered office, principal place of business, centre of the debtor's main interests, and location of assets.

25. A clear answer to the question of the decisive connecting factor is found in art. 166(1) of the Swiss Private International Law (PILS), which provides that a foreign insolvency proceeding can only be recognized if it was opened in the State where the debtor has its domicile (art. 166(1)), or, in the case of a company, where the debtor has its seat (art. 166(1), in conjunction with art. 21).

26. The advantage of this approach is the legal certainty achievable by its application. A drawback, however, might be seen in the apparent lack of any room for adjustments in exceptional cases in which the application of the generally pre-formulated "centre of gravity" test (i.e., domicile, seat) would not lead, due to specific circumstances, to reasonable results.

27. A compromise solution between the requirement for legal certainty and the possibility of taking into account specific circumstances of the case is provided in the Istanbul Convention (art. 4) and the EU draft (art. 2). Both instruments define the decisive connecting factor with a flexible formula ("centre of the main interests of the debtor"), which is coupled with a presumption for companies ("In the case of a company and legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary").

B. Foreign proceedings emanating from prescribed countries

28. It may be recalled at this point, and when considering the range of options to be reflected by the Commission, that there are a number of jurisdictions that provide for assistance to foreign insolvency proceedings from countries appearing on a list of "prescribed" countries, with the disposition of requests from yet other foreign countries left to the discretion of the court. The statutes of Australia and the United Kingdom are examples of a combination of mandatory assistance with regard to prescribed countries, and discretionary assistance to other, non-prescribed countries.

C. Court discretion

29. To the extent that a statute leaves the decision as to whether to grant assistance to the discretion of the court, that court would be bound to, or at least be free to, take into account in exercising its discretion the question of the connecting factor, for example, if the statute called for the court, in exercising its discretion, to take into account rules of private international law.

30. Section 304 of the United States Bankruptcy Code provides an example of a statute that provides for assistance generally, but leaves every case up to the discretion of the court. It also serves as an example of factors for guiding the court. Those factors include the overriding factor of an economical and expeditious administration of the bankrupt estate, consistent with: (a) just treatment of all holders of claims against or interests in such estate; (b) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (c) prevention of preferential or fraudulent dispositions of property of such estate; (d) distribution of proceeds of such estate substantially in accordance with the order prescribed by the United States Bankruptcy Code concerning the question of priorities; (e) comity; and (f) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

D. Types of proceedings covered

31. In some jurisdictions a filter is applied which limits recognition to foreign proceedings that qualify as "insolvency" proceedings according to the law of the forum (i.e., under the law of the State in which is located the court requested to give assistance). Provisions of this type might have the effect, for example, that foreign proceedings (e.g., reorganization proceedings voluntarily initiated by a debtor not technically declared bankrupt) that did not fall within the definition of insolvency proceedings under the law of the requested court would not receive assistance.

32. The example cited raises a number of aspects of this question that the Working Group may wish to consider, including whether the text to be prepared should distinguish between: liquidation and reorganization proceedings; between voluntary, debtor-initiated proceedings and those initiated by creditors; between judicial and administrative proceedings; between proceedings in which the debtor is fully deprived of control of its assets and "debtor in possession" type of proceedings; and between those that involve a debtor that has actually become insolvent and those in which a debtor in trouble is seeking to avoid insolvency.

33. For the purpose of facilitating the discussion of the above issues, the following definition from Section 101 of the United States Bankruptcy Code is provided:

> "(23) 'foreign proceeding' means proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization".

34. The definition set forth in MIICA (section 6(b)) provides an alternative formulation, with reference to the jurisdiction of the opening forum phrased in general terms, rather than by reference to specific connecting factors:

> " 'Foreign proceeding' means an insolvency proceeding, whether judicial or administrative, in a foreign country, provided that the foreign court or administrative agency conducting the proceeding has proper jurisdiction over the debtor and its estate".

The Working Group may wish to consider whether it would be helpful to include other elements in a definition, for example, a reference to the proceedings being for the collective benefit of all, or of most, creditors.

35. As an additional aspect, the Working Group may wish to consider how absolute should be a requirement that the foreign proceedings be administered by a court or be of an administrative nature. One has in mind here the possibility that there exist under some national laws proceedings of a quasi-insolvency, contractual nature that are initiated by the parties themselves with a view to staving off insolvency.

E. Type of debtor

36. The question may be raised whether the work by the Commission should encompass both debtors that are legal persons, and debtors that are natural persons. An objection to covering natural persons may be that it would raise basic social and other policy issues beyond the scope of the project. At the same time, it may be thought that excluding coverage of natural persons would seriously limit the scope of the legal instrument to be prepared, since it is not uncommon for significant commercial activities and enterprises in international trade to be conducted by a private individual not assuming any particular type of corporate garb. This in turn raises the question whether it would be feasible or, for that matter, advisable to exclude "consumer" bankruptcies from the scope of the work.

F. Authority of foreign representative to act

37. A question that may arise in any number of jurisdictions prior to a decision in favour of granting a request from a foreign insolvency representative is whether the foreign representative has authority under the foreign proceeding to act on behalf of the debtor with respect to foreign assets. The definition contained in MIICA (section 6(a)) may be a helpful reference:

> " 'Foreign representative' means a person who, irrespective of designation, is assigned under the laws of a country outside of this jurisdiction to perform functions in connection with a foreign proceeding that are equivalent to those performed by a trustee, liquidator, administrator, sequestrator, receiver, receiver-manager or other representative of a debtor or an estate of a debtor in this jurisdiction".

G. Public policy considerations

38. States that provide cooperation in cross-border insolvencies typically reserve the right to refuse recognition in the case of incompatibility with their ordre public. The Working Group may wish to consider the feasibility of a model provision on this point. Legislative

examples are for instance art. 14(2)(b) of the Istanbul Convention[7], art. 18 of the EU draft[8], and art. 166(1)(b) (in conjunction with art. 27) of the Swiss Private International Law.

III. EFFECTS OF RECOGNITION

39. The next major question the legislator of a country which is willing to recognize foreign insolvency proceedings has to decide is what legal effects such recognition should create in the "recognizing country". A variety of possible sub-questions flow from that major question, including, but not limited to: Is the debtor, as a result of the recognition of the foreign insolvency proceeding, disinvested as if an insolvency proceeding would have been opened by the courts of the recognizing country? What power does the foreign administrator have in the recognizing country? What is the legal position of the creditors of the debtor? Are they barred from exercising their claims against the debtor in the recognizing country? What is their position if they have already instituted individual legal proceedings against the debtors before the courts of the recognizing country? Are there exceptions for specific categories of claims where already instituted legal proceedings may continue?

40. It is obvious that this list could be prolonged considerably and the Working Group may wish to consider additional questions to be added to the above list, bearing in mind that legislators may be expected to provide as clear answers as possible.

A. Possible legislative approaches

41. A comparison of various national laws and international instruments shows that there exist different methods of addressing the problem.

1. Detailed enumeration of effects

42. One method is to provide an exhaustive list in which, in a detailed manner, all the consequences which follow from the recognition of the foreign insolvency proceedings are enumerated, for example: the acts in relation to the assets situated in the recognizing country that the foreign administrator is entitled to take, including: to obtain information, testimony and records concerning the accounts, assets and other relevant aspects of the debtor; the measures of protection and preservation of the assets the foreign administrator may take (including to seek assistance from the competent authorities of the recognizing State, turnover of property to the foreign administrator and avoidance of preferential transfers executed prior to the opening of insolvency proceedings); the status of the debtor in relation to the assets situated in that State; the position of the debtor's creditors relating to their right to pursue the claims and to commence or pursue individual court proceedings against the debtor, including

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[7] "Limitations to the exercise of the liquidator's powers

"2. The liquidator cannot perform in another Party an act which is:

"b. manifestly contrary to the public policy of that Party."

[8] "Public Policy

"Recognition of insolvency proceedings or the enforcement of a judgment handed down in the context of such proceedings may be withheld by a Contracting State where its effects would be manifestly contrary to the public policy of that State."

whether a stay of such proceedings would result from recognition; and the question of discharge by payment to the debtor or to the foreign administrator.

43. The Working Group may wish to consider other possible effects, or principles related thereto, that could be included in an enumeration approach. For example, according to the principle referred to in some Common Law countries as "hotchpot", and elsewhere as "marshalling", a creditor who has received part payment in one proceeding may not receive a dividend for the same claim in another proceeding until other creditors of the same ranking or category have in that other proceeding obtained an equivalent dividend. That principle, which aims to establish justice between creditors, is embodied in several national laws (e.g., Section 508 (a) of the United States Bankruptcy Code) and international instruments (art. 5, Istanbul Convention; art. 12(2), EU draft). The Working Group may consider whether a model provision on this subject would be feasible.

44. An example of the enumeration approach is found in chapter II of the Istanbul Convention. That Convention does not provide that the effects of the foreign insolvency proceeding are exported in their entirety into the recognizing State (as in the EU draft, described below) or that the insolvency effects of the foreign proceeding (lex concursus) are converted into the effects an insolvency would entail if the proceedings had been opened in the recognizing State (as under the Swiss law, also described below).

45. The Istanbul Convention system contains on the contrary a set of provisions (chapter II, arts. 6-14) which vest in the foreign administrator certain rights that may be exercised in the recognizing State, and which also regulate certain features of the legal position of the debtor's creditors as well as of the debtors of the debtor. It is provided, for example (art. 8), that the foreign administrator may take, in accordance with the local law, measures to protect or preserve the value of the debtors's assets, including to seek assistance from the competent local authorities to that effect. The administrator may take or cause to be taken any act to administer, manage or dispose of the debtor's assets, including removing them from that country (art. 10). The right to commence or pursue individual legal action against the debtor's assets is vested (art. 11) only in certain categories of creditors (public law claims and claims arising from the operation of an establishment of the debtor in that country or from an employment there). The list also contains a provision on the discharge of payment or delivery of assets to the foreign administrator or to the debtor (art. 13).

46. The advantages or disadvantages of that system could not yet be tested in practice because the Convention has not entered into force. It might be, however, that two particular aspects of the Istanbul Convention may affect its eventual fate. The first point is that this system confers on the one hand certain rights upon the foreign administrator to act on behalf of the debtor in relation to the debtor's local assets, but does not on the other hand disinvest the debtor of the right to dispose of the local assets. The second point is that the powers conferred upon the foreign administrator by article 10 (to administer, manage or dispose of the debtor's assets) are suspended during a period of two months commencing after the obligatory publication of the opening of the foreign insolvency decision in the recognizing State (art. 11(1)).

47. The intention behind the suspension rule seems to be to give the creditors the possibility to request the opening of a so-called secondary insolvency proceeding in the recognizing State (chapter III of the Convention) which would bar the exercise of the administrator's powers in that country (on secondary proceedings, see further discussion below, paras. 60 to 91). The non-disinvestment of the debtor coupled with the two-month

suspension period concerning the powers of the administrator might give the debtor, however, ample time to transfer assets into another country. This could only be blocked if the foreign administrator manages to take timely and appropriate protective measures according to article 8.

2. Effects of recognition by reference to applicable law

48. A second, quite different approach is to determine the effects of recognition by application of the law of one of the two countries involved. Here one may provide either (variant 1) that, when the recognition becomes operative, the opening of the foreign insolvency proceeding will have in the recognizing State the same effects as under the law of the State in which the foreign proceeding was opened (subject to certain enumerated exceptions) or (variant 2) that in the case of recognition the foreign insolvency proceeding will have in the recognizing State the same effects as if the insolvency proceeding had been opened in the recognizing State (subject to certain enumerated exceptions). Legislative examples of these two variants are discussed in the following paragraphs.

(a) Recognition imports effects of foreign insolvency law

49. Variant 1 can be found for instance in the EU draft. Its article 9(1) provides: "The judgement opening proceedings taken by a court that has jurisdiction pursuant to article 2(1) shall with no further formalities have the same effects in the other Contracting States as under the law of the State in which insolvency proceedings were opened, unless the Convention provides otherwise and as long as no proceedings are opened in those States by a court which has jurisdiction pursuant to article 2(2)". Article 10 (with the heading "powers of the liquidator") continues to the effect that "[t]he liquidator appointed by a court which has jurisdiction pursuant to article 2(1) may exercise all the powers conferred on him by the law of the State of the opening of insolvency proceedings in another Contracting State, as long as no other insolvency proceedings have been opened there ...".

(b) Recognition triggers application of local law

50. An example of variant 2 is article 170(1) of the Swiss PILS. The provision provides that the recognition of the foreign bankruptcy proceeding produces for the debtor's assets situated in Switzerland the bankruptcy effects of the Swiss law.

51. If one tries to assess the advantages and disadvantages of the two variants described above, it seems that variant 1 is justified from a dogmatic point of view, whereas variant 2 is probably more easily applied in practice. If the legal consequences of the recognition in the recognizing State are governed by the foreign lex concursus (variant 1), it could be necessary in certain situations to ascertain the content of a foreign insolvency law in a time-consuming exercise.

52. Without suggesting that it is an approach the Commission should necessarily follow or offer as an option, it is noted that, as regards the question of the law applicable to avoidance of preferential transfers, there is found in the German law an example of the "combination" of both the foreign insolvency law and the law governing the effects of the transaction. Under that approach, the foreign representative may challenge under the foreign

insolvency law a preferential transfer whose effects are governed by the law of the recognizing State, if that preferential transfer is itself subject to challenge under the law of the recognizing State. The requirement that the challenge have a basis under local law could be met by reference, for example, to the law of torts or to contract law. This takes into account the German conflicts rule subjecting the setting aside of a transaction to the law applicable to that transaction.

(c) Choice of law left to recognizing court

53. It may be noted that it is possible that a legislature would empower the courts to apply either the law that could be applied by the court in the State in which the insolvency proceeding being recognized was opened, or the law of the recognizing State. An example of such an approach is found in Section 426(5) of the Insolvency Act of the United Kingdom, which exhorts courts in exercising such discretion to have regard in particular to the rules of private international law.

3. Court discretion in determining effects of recognition

54. Particularly in legal systems that have a tradition of inherent judicial discretion, the effects of recognition may to one extent or another be left to the discretion of the court. An example of this approach is found in Section 304 of the United States Bankruptcy Code, which provides for discretion at two levels. In the first place, the whole matter of whether to grant a petition for an ancillary, "assisting" proceeding is left to the discretion of the court, which is to be guided by the principles already referred to above (see para. 30). Secondly, as regards specific measures that may be ordered by the court in aid of a foreign proceeding, mention is made of the permissibility of enjoining or staying local creditor action and of turnover of property to the foreign administrator, followed by mention of authorization for the court to "order other appropriate relief".

4. Exclusion of certain types of assets

55. It should be noted that some jurisdictions exempt immovables, and rights in rem of creditors or third parties with respect to local assets of the debtor, from recognition accorded to foreign insolvency proceedings. An example of such an approach is found in article 4 of the EU draft. It may be considered, however, that a general model rule to that effect would not necessarily be desirable.

5. Procedural aspects of effecting recognition

56. If the legal requirements for recognition are met, the question arises by what means this recognition comes into operation. In this respect national laws follow, in principle, two different approaches. There are countries, for example Switzerland (arts. 166 and 167, PILS), in which recognition must be triggered by an express decision of the competent court of the recognizing State. In other systems, the foreign insolvency proceeding may have effects in the recognizing State without any formality.

57. Both types of systems have their merits. The , formal approach may provide greater legal certainty, whereas the "immediate effect-approach" gives the foreign administrator the possibility of quick action in relation to the local assets of the debtor.

58. It may be, however, that the question of which approach to follow would be seen by the national legislators in the broader context of their general procedural law, which differs considerably from State to State. It might be preferable therefore to leave the subject entirely to the discretion of the national legislators, with no model provision or optional provisions presented.

59. Alternatively, the Working Group may wish to consider a solution midway between the two approaches referred to above. This would involve obligating the foreign administrator to cause the publication of the essential elements of the foreign decision (opening the insolvency proceeding) in the recognizing State (see, for example, article 9 of the Istanbul Convention, and article 13(2) of the EU draft).

IV. SECONDARY INSOLVENCY PROCEEDINGS

60. One of the most important questions in the field of cooperation in international insolvency is whether, under what circumstances and with what consequences the effects of the recognition of a foreign insolvency proceeding could be blocked by the opening of a separate insolvency proceeding in the other State. Such proceedings are sometimes referred to as "secondary insolvency proceedings".

61. The attitudes of legislators towards such proceedings may vary, in particular due to policy differences from country to country regarding cooperation in cross-border insolvencies. This section contains a discussion of various techniques a legislator can use when designing statutory provisions on secondary insolvency proceedings in order to bring about results which reflect the prevailing policy considerations.

62. An analysis of various national jurisdictions representing different legal systems reveals that even the countries which do not follow the territoriality principle provide the possibility that under certain circumstances their courts may open a separate territorial insolvency proceeding despite the fact that another insolvency proceeding relating to the same debtor has already been opened in another State to which the debtor has its closest connection. The difference between the various jurisdictions is not whether or not they provide the possibility of separate territorial proceedings, but whether and to what extent the requirements and effects of these proceedings, compared with normal local insolvency proceedings, are limited.

63. The consequences of a separate territorial insolvency proceeding in relation to the extra-territorial effects of the main insolvency proceeding are almost everywhere the same: the extra-territorial effects are blocked; by the opening of the territorial insolvency proceeding, the foreign administrator is barred from exercising in that country the powers it may have had if the territorial proceeding had not been opened.

64. A territorial insolvency proceeding has the most far-reaching blocking effect if it is an entirely separate proceeding, without any difference as opposed to the normal national insolvency proceeding. In such a context, there are neither restrictions on the exercise of jurisdiction to open such proceeding nor are there limitations as to the categories of creditors

entitled to payment from the proceeds of the liquidation of the local assets in the separate territorial proceedings.

A. Possible links to foreign main proceeding

65. A first step in the direction of some coordination between the separate territorial insolvency proceeding and the foreign main insolvency proceeding may be to provide that, because of the existence of the foreign main insolvency proceeding, it is not necessary to prove the insolvency of the debtor as a prerequisite for the opening of the territorial proceeding.

66. Another link between the foreign main insolvency proceeding and the separate territorial proceeding would be established if, in addition to the persons entitled under the local insolvency law, also the foreign administrator would be empowered to request the opening of a territorial insolvency proceeding.

67. If a legislator intends to attach more precedence to the foreign insolvency proceeding in comparison to the above links, this may be accomplished, alternatively or cumulatively, by the following means: (1) restriction of the jurisdiction to open a separate territorial proceeding; (2) restriction of the right of creditors to request the opening of such a proceeding; (3) restriction of the right of creditors to payment from the proceeds of the territorial liquidation of the local assets. Territorial proceedings characterized by one or more of those elements, which are discussed below, are commonly referred to as "secondary insolvency proceedings".

1. Restriction of jurisdiction

68. A far-reaching restriction on the exercise of jurisdiction to open a secondary insolvency proceeding can be found in the EU draft. Pursuant to article 19 (in conjunction with article 2(2)), a secondary insolvency proceeding can only be opened if the debtor has an establishment within the State of the secondary proceeding. In that case, a secondary insolvency proceeding, covering the debtor's assets situated in that State, can be opened without further proof of the insolvency of the debtor.

69. Thus, if there exist only assets and not also an establishment of the debtor in that country, a secondary insolvency proceeding may not be opened. In such a case the foreign administrator cannot be barred from exercising all powers the law of the main insolvency proceeding conferred on it, which may result in the transfer of the local assets to the control of the foreign main insolvency proceeding. Such a transfer is not dependent on an approval of the courts of the States in which the assets are situated.

70. It may be noted that in the context of this system the powers of a foreign administrator are only recognized if the administrator was appointed in an insolvency proceeding opened in the State in which the centre of the debtor's main interests is situated (see above, paras. 23 to 27).

71. In contrast to the EU draft, the Istanbul Convention does not provide any restriction on exercise of jurisdiction to open a secondary insolvency proceeding. Such proceedings can be opened, without further proof of the debtor's insolvency, if the debtor has either an

establishment or assets in that State, without prejudice to additional other grounds of competence which might be provided by national law (art. 17).

72. The approach in the Swiss law is an example of a middle ground between the above two approaches. An entirely independent Swiss insolvency proceeding can only be opened if the debtor has an establishment in that country. If only assets are situated there (or if, in the case of a local establishment, the opening of a separate national insolvency proceeding has not been requested), the foreign administrator appointed in the main insolvency proceeding is not automatically empowered to remove the assets for the purpose of distributing them in the foreign insolvency proceeding (as he could do under the system of the EU-draft). Rather, in such cases, a secondary insolvency proceeding covering the assets situated in Switzerland has to be opened by the competent Swiss court. In such a secondary proceeding, the right of the creditors to payment from the proceeds of the liquidation of the local assets is restricted (see further discussion below, under 3., paras. 76 to 87).

2. Restriction of the right of creditors to request the opening of a secondary insolvency proceeding

73. Any restriction of jurisdiction as discussed above amounts to a reduction of the number of cases where the blocking of the effects of a foreign main insolvency proceeding by the opening of a secondary insolvency proceeding is possible. Another means to reach this result could be to limit the right to apply for the opening of a secondary insolvency proceeding, rather than to make such proceedings available to all the creditors that have the right to request the opening of a normal local insolvency proceeding.

74. In such an approach, the insolvency law of the State of the secondary insolvency proceeding would, due to policy considerations, remain applicable only for certain categories of creditors even in the event that a foreign main insolvency proceeding has been opened. Those creditors might include, for example, the holders of preferential and secured claims, of public-law claims, and of claims arising from the operation of an establishment of the debtor in the State of the secondary insolvency proceeding, in particular the claims of employees of such establishments.

75. The approach of entitling only certain categories of creditors to request the opening of a secondary insolvency proceeding is embodied, for example, in the Montevideo Treaties. According to those instruments, only local creditors are enabled to file a petition for a separate local insolvency proceeding (art. 45 of the Treaty 1940, art. 39 of the Treaty 1889). The "local creditors" are defined as creditors whose claims are payable in the State of the secondary insolvency proceeding.

3. Restriction of the rights of creditors to payment in secondary insolvency proceeding

76. Two types of legislative techniques have been used to determine the privileged categories of creditors entitled to payment from the proceeds of the liquidation of the local assets in the secondary insolvency proceeding. One approach is to provide an exhaustive list of those categories of creditors. Such a technique is used, for example, in the Istanbul Convention, which enumerates in its article 21 the following claims: secured or preferential claims; public-law claims; claims of employees in the State of the secondary insolvency

proceedings; claims from the operation of an establishment of the debtor in the State of the secondary insolvency proceeding (the justification of privileging the latter category of creditors may be seen in the argument that creditors dealing with a local establishment have a right to rely on the assets of the establishment located there).

77. Another approach could be, rather than to provide a positive list of the categories of creditors entitled to have access to the local assets, to give that right to all creditors who would have in the foreign main insolvency proceeding a less favourable legal position than they would have in a secondary insolvency proceeding by the application of the local insolvency law. The policy behind this approach would be that an "unjustified deterioration" (seen from the policy view point of the State of the secondary proceeding) of the legal situation of creditors in the foreign main insolvency proceeding should be counterbalanced by privileging those creditors in the secondary insolvency proceeding.

78. A combination of the two legislative techniques discussed above can be found in articles 173 and 174 of the Swiss PILS. Since Switzerland is one of the few civil law countries with detailed provisions on the recognition of foreign insolvency proceedings, it might be helpful to summarize at first the Swiss system before turning to the two protection rules contained in articles 173 and 174 of PILS.

79. A foreign insolvency proceeding can be recognized in Switzerland if that proceeding was opened in a State in which the debtor has its domicile, or, in the case of a company, where the debtor company has its seat (see above, paras. 25 and 26). The recognition of an insolvency proceeding opened in the State of the debtor's domicile (or seat, as the case may be) can be blocked by the commencement of a normal, entirely separate Swiss insolvency proceeding if the debtor has an establishment in Switzerland.

80. The fact alone that the debtor has assets in Switzerland is not a sufficient ground to exercise jurisdiction for a normal Swiss insolvency proceedings concerning the assets (restriction of jurisdiction, see above, para 72). In such a case only secondary insolvency proceedings can be opened. Those proceedings are governed by different rules (arts. 166-175 PILS) compared with those applicable to the normal local insolvency proceedings. The opening of such secondary insolvency proceedings may be requested by the administrator of the foreign main insolvency proceeding or by any creditor, as there is no restriction of the rights of creditors to request secondary proceedings.

81. The essential difference between this secondary insolvency proceeding and normal local insolvency proceedings consists in a restriction of the right of creditors to payment from the proceeds of the liquidation in the secondary insolvency proceedings. This right is unconditionally reserved to the creditors secured by a lien and to the creditors that have a preferential claim under the Swiss bankruptcy law (enumeration method).

82. This does not mean, however, that the remaining assets are automatically transferred to the foreign administrator. Articles 173 and 174 referred to above enter into play, with the aim of protecting creditors domiciled, or with their seat, in Switzerland against discriminatory treatment in the foreign main insolvency proceeding. Before the remaining proceeds are transferred to the foreign administrator, the distribution plan of the foreign insolvency proceeding must be recognized by the Swiss court that opened the secondary proceeding.

83. In such a context, the Swiss court has to examine whether the claims of creditors domiciled, or with their seat, in Switzerland "have been reasonably taken into consideration"

in the foreign distribution plan (art. 173 PILS). If the foreign distribution plan is not recognized by the Swiss court or has not been submitted to the court, the remaining proceeds are distributed among the rest of the creditors domiciled or with their seat in Switzerland (art. 174 PILS).

84. The policy consideration behind articles 173 and 174 PILS is similar to that behind Section 304(c)(2) of the United States Bankruptcy Code. Both approaches intend to counter-balance an unfavourable treatment (as seen from the protecting country's point of view) that certain creditors would face in the foreign main insolvency proceeding.

85. In that connection it may be noted that the Istanbul Convention does not contain similar anti-discrimination clauses which have to be applied in the secondary proceeding. The Istanbul Convention rather attempts to enhance equality of creditors in the main insolvency proceeding by providing, in its article 24, that creditors in the main proceeding who are entitled to share assets coming from the secondary insolvency proceeding are to be treated equally, regardless of any privileges or other exceptions to the principle of equality between creditors provided by the law of the main insolvency proceeding.

86. It seems, however, that a provision like article 24 of the Istanbul Convention would only work in the framework of a Convention to which both States involved, the States of the main and of the secondary insolvency proceeding, adhere. A national legislator can hardly follow this example because it would be beyond its competence to enact provisions concerning the legal position of creditors in insolvency proceedings conducted in other States.

87. To facilitate the deliberations of the Working Group, the following summary of how the approaches described in section A have been grouped in various legal instruments thus far may be distilled:

> System 1: Jurisdiction to open a territorial (secondary) insolvency proceeding in State B if the debtor has an establishment there (no jurisdiction if only assets are situated there); no restriction of the right of creditors to request a secondary insolvency proceeding in State B; no restriction of the access of creditors to the proceeds of the liquidation in the secondary proceeding (EU draft).
>
> System 2: Jurisdiction to open a secondary insolvency proceeding in State B not only in the case of an establishment but also if only assets of the debtor are situated there; no restriction of the right of creditors to request a secondary insolvency proceeding in State B; restriction of the access of creditors to the proceeds of the liquidation in the secondary insolvency proceeding (Istanbul Convention).
>
> System 3: Jurisdiction to open a territorial (secondary) insolvency proceeding in State B not only in the case of an establishment in State B but also if only assets of the debtor are situated in State B; no restriction of the right of creditors to request the opening of a territorial (secondary) insolvency proceeding; restriction of the access of creditors to the proceeds of the liquidation in the secondary insolvency proceeding, except in the case that the debtor has an establishment in State B what can lead, upon request of creditors, to a quite separate local insolvency proceeding (Swiss law).
>
> System 4: As system 3, but under no circumstances restriction of the access of creditors to the proceeds of the liquidation in the secondary proceeding (Germany, as of 1 January 1999).

B. Ancillary proceedings in aid of foreign main proceedings

88. Another approach that may be considered for inclusion in a menu of options for legislators, one that may be seen as related to the question of secondary proceedings, would be to provide for the possibility of opening ancillary proceedings specifically for the purpose of assisting a foreign main insolvency proceeding. As previously noted, a primary example of this approach is found in Section 304 of the United States Bankruptcy Code. Such type of approach is also encompassed in MIICA.

89. As set forth in those instruments, the purposes of such ancillary proceedings may include: enjoining the commencement or continuation of local insolvency proceedings and the enforcement of judgments against the debtor with respect to its local assets, or consolidation of pending local insolvency proceedings with the ancillary case; turnover to the foreign main proceedings of property or of the proceeds thereof; obtaining testimony or production of books, records or other documents relating to an insolvency; obtaining recognition and enforcement of a foreign judgment or court order; and obtaining any other appropriate relief.

90. It is noteworthy that under the ancillary proceeding approach, in the event that such a proceeding is unavailable or denied, the foreign representative remains free to commence independent local insolvency proceedings.

91. The Working Group may wish to consider other issues that might be dealt with regarding ancillary proceedings, for example, the question of the law to be applied by the court opening the ancillary proceeding. In this regard, MIICA obligates the ancillary court to apply the substantive insolvency law of the foreign court conducting the main proceedings.

V. ACCESS FOR FOREIGN INSOLVENCY REPRESENTATIVE

92. The term "access" may be understood as the procedural mechanism utilized by the foreign representative to seek recognition. The Working Group may wish to consider whether it would be desirable and feasible to include provisions on such procedural mechanisms for achieving access and recognition.

93. As regards categories of procedural mechanisms, the distinction might be drawn between formal diplomatic processes, processes involving direct communications between courts of different States, and an exequatur type of process operating through an administrative or quasi-judicial process. As regards such possible procedures, it might be observed that it is not typical international usage for a letter of request to be sent directly by a court to the corresponding foreign court. Such direct contact would typically require an agreement by the two States involved. In other cases, the letter of request would be transmitted through the diplomatic channel. This typical approach is codified in the multilateral Hague Convention on the Taking of Evidence Abroad (1970), which provides for the transmission of requests through "central authorities" of the two States involved.

94. At the same time, it may be recalled that in various national jurisdictions and in the Istanbul Convention and the EU draft, a foreign insolvency proceeding, including the authority of a foreign administrator, is recognized ipso jure if specific requirements are fulfilled. Thus immediate "access" is provided without any court intervention or other formality.

95. Whether under the rubric of "access" or elsewhere, it may be considered essential to include a provision to the effect that an appearance by the foreign representative seeking recognition would not subject the representative to the full jurisdiction of the court. Other issues that might be considered for treatment include the type of evidentiary material to be provided by the representative seeking access and who the entity should be that applies for recognition.

VI. JUDICIAL COOPERATION

96. While the notion of judicial cooperation may be considered as substantially intertwined with the notions of access and recognition, thus forming a bundle of cooperative activities between jurisdictions involved in a cross-border insolvency, there may be some benefit, at least at this stage, in considering the concepts separately to the extent feasible. Accordingly, the Working Group may wish to consider which aspects or procedures might be presented under the rubric of judicial cooperation. The following items thus do not presume to constitute a comprehensive listing of possible issues in this area.

A. Approval of ad hoc protocols

97. One aspect of judicial cooperation may be approval by the courts from the jurisdictions involved of ad hoc protocols agreed to by the parties concerning various aspects of the administration of a cross-border insolvency and establishing a regime of cooperation. Such protocols may be particularly relevant when a debtor has substantial business activity in more than one jurisdiction, thus resulting in primary jurisdiction vesting in more than one jurisdiction.

98. Notable examples of such protocols being successfully utilized have surfaced in a number of major cross-border insolvency cases. In addition, Committee J of the Section on Business Law of the IBA has recently developed a model for such ad hoc protocols (entitled "Cross-Border Insolvency Concordat"). The purpose of the Concordat, the fundamental approach of which is based on rules of private international law, is to suggest rules, some of which may be applicable in any cross-border insolvency, that the participants or courts could adopt for dealing with a variety of issues. Those issues include, for example, designation of the administrative forum, application of that forum's priority rules, certain rules for cases in which there is more than one administrative forum, and designation of applicable rules for avoidance of transfers of assets that took place in the period preceding the insolvency.

B. Judicial communication

99. Another issue that might be tackled under the rubric of judicial cooperation concerns communication between judges from different jurisdictions involved in a cross-border insolvency case. Such communication may be particularly helpful for the purpose of enabling judges to obtain accurate information and to coordinate their actions, proceedings and orders.

100. Despite their potential utility, communications between judges may raise varying degrees of concern in particular in legal systems that are not accustomed to such initiatives by judges, and also concerns about procedural safeguards for the parties. A variety of

techniques may be contemplated in order to address such concerns, including, for example, one or more of the following: notice to the parties of a forthcoming communication; opportunity for presence during the communication; record of the communication made available to the parties; communication through a third-party intermediary agreed by the parties.

VII. ADDITIONAL ISSUES

101. As noted at the outset, it is assumed that the present note does not touch on all the issues that may prove relevant to the cross-border insolvency project. The Working Group may wish therefore to consider other possible aspects to be dealt with, including perhaps those below, which are presented to spur the discussion.

A. Duty to inform the creditors

102. Creditors often get information about the opening of an insolvency proceeding in another country late, or not at all. It might be desirable and feasible to draw up a model provision to the effect that as soon as an insolvency proceeding is opened the competent authority or the administrator shall inform promptly and individually the known creditors residing in another country. Legislative examples can be found in article 30 of the Istanbul Convention, and in article 32(1) of the EU draft.

B. Duty to communicate information between administrators

103. It presumably would strengthen cooperation in cross-border insolvencies if administrators appointed in a main insolvency proceeding and in a territorial (secondary) insolvency proceeding would communicate to each other any information which may be relevant to the other proceeding (see article 25 of the Istanbul Convention, and article 24 of the EU draft).