

## United Nations Commission on International Trade Law

### Working Group V (Insolvency Law): update on recent developments and future work “Centre of main interests” and the directors’ responsibilities in the twilight zone<sup>1</sup>

On 18 July 2013, UNCITRAL approved several texts on insolvency law. The first, the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), is a revision of the 1997 Guide to Enactment. The purpose of the revision is to provide more information and guidance on the interpretation and application of selected aspects of the Model Law, particularly the concept of the debtor's "centre of main interests" or, more commonly, "COMI", as well as various elements of the definition of "foreign proceeding" under article 2 of the Model Law. These revisions do not in any way affect the text of the Model Law as drafted. The second text is a new part (four) of the 2004 UNCITRAL Legislative Guide on Insolvency Law that addresses directors' obligations in the period approaching insolvency. These two texts were developed between 2010 and 2013 by UNCITRAL's Working Group V (Insolvency Law). The Commission also noted a new edition of the UNCITRAL Model Law on Cross-Border Insolvency: the Judicial Perspective, which is to be updated on a regular basis to ensure its current relevance. These updates include cases decided between July 2011 and April 2013, as well as the new text from the Guide to Enactment and Interpretation of the Model Law.

#### 1. Revision of the Guide to Enactment of the Model Law on Cross-Border Insolvency

Revision of the Guide to Enactment was based upon a 2010 proposal by the United States to address the lack of predictability in the interpretation and application of COMI by providing specific guidance on various aspects of that concept as used in the Model Law. The revisions adopted include:

(a) A shorter, more focused introduction to the Model Law and its key concepts;

(b) Clarification of the use of the term “insolvency” in the Model Law; and

(c) Provision of more information on (i) the elements of what constitutes a “foreign proceeding” for the purposes of article 2, (ii) the characteristics of “main” and “non-main” proceedings, and (iii) the articles dealing with recognition of a foreign proceeding, in particular article 16 and the factors that are relevant to rebuttal of the presumption that the debtor's centre of main interests is its place of registration, as well as the time by reference to which COMI is to be considered in deciding on recognition under article 17.

#### *Use of the word “insolvency” in the Model Law*

The word "insolvency" is used in the Model Law to refer to various types of collective proceedings commenced with respect to debtors that are in severe financial distress or insolvent. The revisions confirm that a judicial or administrative proceeding to wind up a solvent entity where the goal is simply to dissolve the legal entity is not regarded as likely to fall within the definition of a foreign proceeding in article 2(a). Where a proceeding serves several purposes, including the winding up of a solvent entity, it would fall under article 2(a) only if the debtor was insolvent or in severe financial distress and the other requirements of the definition were satisfied.<sup>2</sup>

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<sup>1</sup> Prepared by Jenny Clift, Senior Legal Officer, ITLD/OLA (UNCITRAL Secretariat).

<sup>2</sup> Guide to Enactment and Interpretation, para. 48.

### *Article 2(a)<sup>3</sup> - collective proceeding*

A key consideration in evaluating whether a particular proceeding is a collective proceeding (and thus a proceeding subject to the regime provided by the Model Law) within the meaning of article 2(a) is whether substantially all of the assets and liabilities of the debtor are to be dealt with in that proceeding, subject to local priorities and statutory exceptions and local exclusions relating to the rights of secured creditors. A proceeding should not be considered to fail the test of collectivity purely because a class of creditors' rights is unaffected by it. Examples of the manner in which a collective proceeding might deal with creditors include, providing adversely affected creditors with a right to submit claims, to participate in the proceedings and to receive notice of the proceeding.<sup>4</sup>

It is not intended that the Model Law be used merely as a collection device for a particular creditor or group of creditors who might have initiated a collection proceeding in another State. Nor is it intended that it serve as a tool for gathering up assets in a winding up or conservation proceeding that does not also include provision for addressing the claims of creditors. The Model Law may be an appropriate tool for certain kinds of actions that serve a regulatory purpose, such as receiverships for such publicly regulated entities as insurance companies or brokerage firms, provided the proceeding is collective as that term is used in the Model Law. If a proceeding is collective it must also satisfy the other elements of the definition, including that it be for the purposes of liquidation or reorganization.

### *Article 2 (a) - control or supervision by a foreign court*

The Model Law specifies neither the level of control or supervision required to satisfy this aspect of the definition nor the time at which that control or supervision should arise. Although it is intended that the control or supervision required under subparagraph (a) should be formal in nature, it may be potential rather than actual. A proceeding in which the debtor retains some measure of control over its assets, albeit under court supervision, such as a debtor-in-possession, would satisfy this requirement. Control or supervision may be exercised not only directly by the court but also by an insolvency representative where, for example, the insolvency representative is subject to control or supervision by the court. Mere supervision of an insolvency representative by a licensing authority would not be sufficient.

### *Foreign main and non-main proceedings*

The Guide to Enactment and Interpretation now includes explanatory material taken from the Virgos Schmit Report,<sup>5</sup> which is generally regarded as an aid to interpretation of the concepts of COMI and establishment as those terms are used in the EC insolvency regulation.

### *Rebutting the presumption in article 16(3)*

Article 16(3) provides a rebuttable presumption that the debtor's registered office is presumed to be its centre of main interests.

The Guide notes that where the debtor's centre of main interests is at the same location as its place of registration, no issue concerning rebuttal of the presumption is likely to arise. It is likely that the majority of applications for recognition made under the Model Law fall into this category.

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<sup>3</sup> Article 2(a) defines a foreign proceeding as meaning "a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation".

<sup>4</sup> Ibid, para. 70.

<sup>5</sup> M. Virgos and E. Schmit, Report on the Convention on Insolvency Proceedings, Brussels 3 May 1996. The report was published in July 1996 and is available from <http://aei.pitt.edu/952> (last visited 1 August 2013).

However, when a foreign representative seeks recognition of a foreign proceeding as a main proceeding and there appears to be a separation between the place of the debtor's registered office and its alleged centre of main interests, the party alleging the centre of main interests is not at the place of registration will be required to satisfy the court as to the location of the centre of main interests. In those circumstances, the centre of main interests will be identified by other factors which indicate to those who deal with the debtor (especially creditors) where the centre of main interests is. The essential attributes of the debtor's centre of main interests correspond to the attributes that will enable those who deal with the debtor (especially creditors) to ascertain the place where an insolvency proceeding concerning the debtor is likely to commence. The court of the enacting State will be required to consider independently where the debtor's centre of main interests is located.

It was agreed that two principal factors will tend to indicate whether the location in which the foreign proceeding commenced is (or was at the time the proceeding commenced) the debtor's centre of main interests. The factors are the location:

- (a) Where the central administration of the debtor takes place, and
- (b) Which is readily ascertainable by creditors.

When these principal factors do not yield a ready answer, the court may consider any number of additional factors, some of which are listed in the Guide.<sup>6</sup> A court might need to give greater or less weight to a given factor, depending on the individual circumstances of the particular case. It is noted that in all cases the endeavour "is an holistic one, designed to determine that the location of the proceeding in fact corresponds to the actual location of the debtor's COMI as readily ascertainable by creditors".<sup>7</sup>

#### *Date at which to determine centre of main interests and establishment*

As to the date relevant to the determination of the debtor's COMI (or establishment), courts have adopted one of two alternatives - the date of commencement of the foreign proceeding seeking recognition or the date of the application for recognition. Having considered the case in support of each of those dates, the Commission adopted the solution proposed by Working Group V that the question be considered by reference to the date of commencement of the foreign insolvency proceeding, not the date of the application for recognition of that proceeding.<sup>8</sup>

The Guide notes that where the business activity of the debtor ceases after the commencement of the foreign proceeding, all that may exist at the time of the application for recognition to indicate the debtor's centre of main interests is that foreign proceeding and the activity of the foreign representative in administering the insolvency estate. In such a case, determination of the centre of the debtor's main interests by reference to the date of the commencement of those proceedings would produce a clear result. The same reasoning may also apply in the case of reorganization where, under some laws, it is not the debtor that continues to have a centre of main interests, but rather the reorganizing entity. In such a case, the requirement for a foreign proceeding that is taking place in accordance with article 17, subparagraph 2 (a) is clearly satisfied and the foreign proceeding should be entitled to recognition. Moreover, taking the date of commencement to determine centre of main interests provides a test that can be applied with certainty to all insolvency proceedings.

#### *Movement of COMI*

The Guide acknowledges that a debtor's centre of main interests may move prior to commencement of insolvency proceedings, in some instances in close proximity to commencement and

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<sup>6</sup> Ibid, para. 147.

<sup>7</sup> Ibid, para. 146.

<sup>8</sup> Ibid, paras. 157-160.

even between the time of the application for commencement and the actual commencement of those proceedings. Whenever there is evidence of such a move in close proximity to the commencement of the foreign proceeding, it may be desirable for the receiving court, in determining whether to recognize those proceedings, to consider the additional factors identified in the Guide more carefully and to take account of the debtor's circumstances more broadly. In particular, the test that the centre of main interests is readily ascertainable by third parties may be harder to meet if the move of the centre of main interests occurs in close proximity to the opening of proceedings.

## **2. Legislative Guide on Insolvency Law, part four**

The second text adopted by the Commission deals with the obligations that would apply to a director of a company when (a) insolvency was likely or unavoidable; and (b) the person owing the obligation knew, or ought reasonably to have known, that insolvency was likely or unavoidable. This new part four of the Legislative Guide, developed in response to proposals by the United Kingdom, INSOL and the III, follows the format of that text, including commentary and a set of legislative recommendations.

Two obligations would apply: to have due regard to the interests of creditors and other stakeholders and to take reasonable steps to avoid insolvency or to minimize the extent of insolvency where it is unavoidable. A number of the steps that might be taken are listed in the recommendations and include: directors ensuring that they are fully informed about the affairs of the company; seeking professional advice where appropriate; and ensuring the assets of the company are protected. Liability for breach of such an obligation would be limited to the harm caused, with remedies including payment in full to the insolvency estate of any damages assessed.

The obligations would be owed by any person defined under national law as fulfilling the role of a director, such as a formally appointed director. The text relies upon the commentary identifying the types of functions that might lead to other persons being considered a director, for example, those exercising factual control, performing the functions or undertaking the responsibilities of a director.

## **3. Future work**

Working Group V will now return to the remaining elements of its current mandate, i.e. (a) the applicability of "centre of main interests" to enterprise groups as a means of facilitating the conduct of group insolvencies, (b) the possible development of a model law or provisions on insolvency law addressing selected international issues, including jurisdiction, access and recognition, (c) the insolvency of large and complex financial institutions, and (d) obligations of directors of enterprise group companies in the period approaching insolvency.

The December 2013 session of the Working Group will start with a colloquium (open to participants not generally attending working group sessions)<sup>9</sup> to consider how best to approach that work, as well as topics for possible future work, after which the Working Group will convene to decide (a) how to proceed on the enterprise groups topics; and (b) the topics it will recommend to the Commission as possible future work. Topics proposed include: insolvency treatment of financial contracts and netting; regulation of insolvency practitioners; enforcement of insolvency-derived judgements; insolvency treatment of intellectual property; and a number of issues relating to creditors and claims, including global standards for claims adjudication; ranking of creditors claims and dealing with unusual creditors; relative voting rights of debt and equity holders; and coordinating creditor access to information and collective representation. Since the Working Group has been tasked with assessing, at its Spring 2014 session, the suitability of the UNCITRAL Legislative Guide for addressing micro, small and medium enterprise (MSME) insolvencies, MSME insolvency issues will also be a topic for discussion at the colloquium.

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<sup>9</sup> More information is available at <http://www.uncitral.org/uncitral/en/commission/colloquia/insolvency-2013.html>