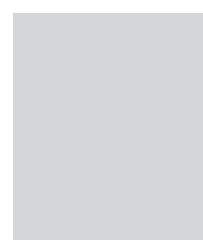
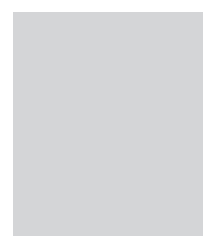


## EBRD insolvency office holder principles

One of the necessary components for the development of a market economy, particularly in the early stages of transition, is the ability to attract substantial levels of direct inbound investment. In this context, it is widely accepted that an efficient, fair and predictable insolvency system including efficient insolvency office holders is essential. This article introduces the set of guidelines prepared by the EBRD to guide transition countries in regulating insolvency office holders.



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A critical part of an effective insolvency system is the insolvency office holder (IOH) and their quality is one of the key aspects to consider in determining whether an insolvency system is efficient, fair and predictable.

IOHs, variously called trustees, administrators, receivers, liquidators or insolvency representatives, are responsible for making the systems of all countries work, including those within the EBRD countries of operations. They are required to act fairly, honestly, professionally and responsibly. Their powers and duties are extensive and they are required, frequently subject to the overall control of the court or the creditors, to:

- collect and have control over the management of the debtor's assets
- establish which parties are creditors and how, when and to whom the proceeds are to be distributed
- decide how the assets are realised and to whom they are sold
- examine pre-bankruptcy transactions and, if necessary, recover assets on behalf of the creditors
- participate in a reorganisation where possible.

Where an insolvency case involves a reorganisation of the business rather than liquidation, the IOH is often

crucial in the preparation of the reorganisation plan and in ensuring that the creditors are sufficiently well informed to decide whether to accept the proposed plan. The assets under the IOH's control can be of considerable value and a properly qualified, trained and regulated cadre of office holders is essential for the transparent, effective and efficient functioning of these systems.

The EBRD regularly conducts assessments and surveys to measure the extensiveness and effectiveness of insolvency laws in its countries of operations. These laws are measured not against arbitrary or abstract factors, but rather against leading international standards and best practices as articulated by, among other things, the UNCITRAL Legislative Guide on Insolvency Law<sup>1</sup> and the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems.<sup>2</sup>

The World Bank's Principles state the following with respect to IOHs:<sup>3</sup>

"The system should ensure that:

- Criteria as to who may be an insolvency representative should be objective, clearly established and publicly available;

- Insolvency representatives be competent to undertake the work to which they are appointed and to exercise the powers given to them;
- Insolvency representatives act with integrity, impartiality and independence; and
- Insolvency representatives, where acting as managers, be held to director and officer standards of accountability, and be subject to removal for incompetence, negligence, fraud or other wrongful conduct.”

The UNCITRAL Legislative Guide on Insolvency Law<sup>4</sup> provides more detailed guidance on issues such as qualifications, selection and appointment, oversight, duties and remuneration, but until now there have been no formalised principles directed specifically at IOHs.

## A need for direction

It is clear that in the development of many of the insolvency laws of emerging and transition economies, adequate attention has been given to the procedural aspects of the law – court proceedings, selection of committees, methods of asset disposal and treatment of claims. In contrast, provisions relating to IOHs have been dealt with superficially with the result that the law fails to provide for the properly trained and qualified IOH necessary to effectively and efficiently handle the day-to-day operations of insolvency cases. Many laws recognise the need for IOHs and while they make basic allowances for them, they fail to make provisions that would ensure that they have the requisite skills and supervision.

In many ways, this is not surprising; bankruptcy is about getting money back to the creditors as quickly and efficiently as possible, while restructuring is about putting assets back into productive use. New laws often focus on creating an environment where realisation of value is possible rather than on the actual means of conducting that realisation.

This was most clearly demonstrated by the recent EBRD Survey of Insolvency Office Holders in South-Eastern Europe,<sup>5</sup> which found that even among the leading regulatory systems there were significant shortcomings regarding many aspects of IOH regulation.

Recognising that the absence of guidance could be contributing to the failure to properly develop the institutional capacity surrounding IOHs, the EBRD has identified a set of principles to guide countries in setting standards for the qualifications, appointment, conduct, supervision and regulation of office holders in insolvency cases – the EBRD Insolvency Office Holder

Principles. This endeavour was made possible by funding from the Swiss State Secretariat for Economic Affairs (SECO).

These Principles, which are set out below, articulate the core elements that should be reflected in those aspects of insolvency law regimes that provide for the appointment of an office holder who will administer the assets and affairs of a debtor upon the opening or commencement of an insolvency case. The Principles are meant as guidelines only. Invariably, the decision of how to apply the Principles will depend on the context of a given country’s legal system.

## The purpose of the EBRD Insolvency Office Holder Principles

The EBRD Principles are intended to add detail to the World Bank and UNCITRAL guidance. They are designed to help law reformers identify issues to be resolved and to ensure that critical elements are not overlooked. They are intended to advance the integrity, fairness and efficiency of the insolvency law system by ensuring that only appropriately qualified professionals hold office in insolvency cases. They are not intended to be exhaustive, nor do they attempt to set out the entire ground work for this aspect of an insolvency law. However, the Principles are a tool to be used by law reformers to make insolvency regimes stronger. They may also serve as a guide for those who comment on legal regimes, providing another measure against which the thoroughness and effectiveness of a system can be examined.

## EBRD Insolvency Office Holder Principles

### Principle 1 – qualifications and licensing generally

Because of the tasks that an office holder might be expected to perform, the responsibilities they will have and the trust that is placed in them, it is only right that they have some fundamental qualifications. These include general ability and intelligence, experience, professional knowledge and good character. Further, most professions are regulated by a system of licensing. Office holders should be regarded as a professional body of persons and licensed accordingly.

The law or regulatory framework should therefore provide for:

#### (a) the qualifications of an office holder

Qualifications should extend to appropriate educational standards, relevant experience, skills and good character. Certain factors (for example, a criminal conviction for a serious offence such as fraud) should disqualify a person from being eligible to apply to become an office holder.

#### (b) an examination in insolvency law and practice and other relevant subjects for office holder candidates

An examination about insolvency law and practice and related subjects (such as accounting) is highly desirable. The function of developing an examination curriculum, conducting examinations and continuing education (see point (e)) may be conducted by a government body or a recognised autonomous professional body.

#### (c) the licensing or registration of a candidate who satisfies the qualification standards

The function of licensing/registration may be conducted by a government body or a recognised autonomous professional body.

#### (d) a register of licensed/registered office holders

This should be a public register to which access should be available to every court having jurisdiction in insolvency cases. It should also be available to the public. This should be maintained by the authority undertaking the licensing function referred to above.

#### (e) a requirement for continuing education for office holders

See comment under (b) above. This is a common feature of most professional bodies and should apply to the office holder profession.

#### (f) the renewal of a licence or registration

This may be set as appropriate. Renewal should be subject to a number of factors, such as satisfactory conduct of insolvency cases and satisfactory continuing educational achievements.

#### (g) the licensing of a corporate body

This should only be permitted if:

- the above qualifications apply to the principals of such a corporate body, and
- those principals are personally responsible and accountable for the conduct of the corporate body.

### Principle 2 – appointment in an insolvency case

There is a need for a predictable and fair process for the appointment of an office holder to an insolvency case.

Accordingly, the law should state:

#### (a) the grounds upon which an office holder may be ineligible for appointment

This is not concerned with the general qualifications of an office holder. It is concerned with whether some factor exists that would make it undesirable or inappropriate to appoint a particular office holder in a particular case. Relevant factors would include that a proposed office holder is a creditor of the debtor, or there is a conflict of interest or an absence of independence from the debtor. This may include factors such as (but not limited to) an existing or recent close connection or professional relationship with the debtor (or, in the case of a corporate debtor, its officers or shareholders) or with a major creditor of the debtor.

#### (b) the body that may appoint such an office holder

This could be a court or other relevant authority or other body (such as the general creditor body or creditors committee).

**(c) in the case of an appointment by a court (or other relevant authority), clear guidelines concerning the manner in which the court should select such an office holder**

This might involve the selection of an office holder according to a strict rota taken from the register of office holders. It might also involve the nomination of an office holder by the party who has the carriage of the insolvency proceedings (for example, the debtor or an applicant creditor). It might also involve the court's referral of the issue of appointment to the general body of creditors.

**(d) in the case of an appointment by the general body of creditors or a committee of creditors, the manner in which such appointment may be made**

This would normally require provision for a formal meeting and determination by resolution according to a required majority vote.

**(e) in the case of an appointment by the debtor or a representative of a debtor, the manner in which such appointment may be made**

This would normally require provision for a formal appointment and notification. In the case of an appointment by a corporate debtor it might require a resolution of shareholders or directors.

**(f) that there is no restriction on the number of cases for which an office holder may be appointed**

This is necessary to remove any doubt that office holders may be engaged in a number of insolvency cases at the same time.

### **Principle 3 – review of an office holder appointment**

It is important that the process for determining an appointment of an office holder to an insolvency case has regard to the need for transparency and impartiality and that both creditors and debtor, who have a real interest in who might be appointed, have the opportunity to oppose or complain about an appointment.

Accordingly, the law should enable the review of a decision to appoint an office holder by:

**(a) providing the grounds upon which an appointment may be reviewed**

The grounds would include conflict of interest or other absence of independence, inability to properly administer the case (by reference to expertise, experience and resources) and so forth.

**(b) providing a process for a review**

In the case of a review of a court appointment, an appeal against the decision to appoint the office holder would be required. In the case of an appointment by the general body of creditors (or a committee of creditors), the review would have to be conducted by a court or other relevant tribunal or authority. The process needs to be one that can be conducted speedily and transparently.

**(c) if an appointment is set aside, providing for the appointment of another qualified office holder**

It is clearly necessary that when an office holder is removed, a replacement should be immediately appointed. The law should specify the means to achieve this. It may impose the same selection rules and procedure as for an initial appointment of an office holder.

### **Principle 4 – removal, resignation and death of an officer holder**

There may be cases in which the interested parties may wish to remove an office holder from office and other cases in which an office holder may wish to retire from office or may die.

Accordingly, the law should provide for:

**(a) the resignation of an office holder from office**

It may be anticipated that, for whatever reason or cause, an office holder may wish to resign an appointment. The law should facilitate that and state the process that must be followed, including the contemporaneous initiation of a process for the appointment of a new office holder.

**(b) the grounds upon which an office holder may be removed from an insolvency case**

These would normally include incompetence, negligence, breach of duty, fraud and undue delay.

**(c) the process for the removal of an office holder**

This should normally involve an application to the relevant court or a relevant authority by a concerned

party (the debtor, creditors or a regulatory authority) and the conduct of a speedy and transparent hearing.

### **Principle 5 – replacement of an office holder**

In the same way that the initial appointment process is important, so also is the process of appointing a replacement.

Accordingly, in any case where an office holder dies, retires or is removed, the law should provide:

#### **(a) for the prompt appointment of a new office holder to replace the former office holder**

For the appointment of a new office holder, see comments under Principle 3 (c).

#### **(b) that the new office holder is entitled, without delay, to the assets, books and records of the debtor in the possession of the former office holder**

This is an important part of the transition/transmission process. The former office holder should be required to account for his/her trusteeship of the estate and affairs of the debtor to the incoming office holder.

#### **(c) that the new office holder is entitled, without delay, to the books and records of the former office holder that concern or are related to the previous conduct of the administration of the insolvency case by the former office holder**

This is directed at records that have been kept in relation to the administration of the estate and affairs of the debtor by the displaced office holder.

#### **(d) that the retiring or removed office holder must cooperate with and assist the new office holder in the transfer and transmission of the conduct of the insolvency case**

This should be provided for as a general and continuing obligation. Enforcement provisions may be necessary.

### **Principle 6 – standards of professional and commercial conduct**

Standards are the most useful way of establishing and measuring the level of performance expected of office holders.

Accordingly, the law should:

#### **(a) through primary legislation, provide basic standards that are critical to proper professional and commercial conduct on the part of office holders**

The purpose is to establish basic standards of conduct for all office holders applicable in every case (for example to act honestly, to act diligently, to comply with professional standards). Then, to regulate and guide an office holder in the conduct of his/her work, a sub-set of professional standards are required. They would normally be made by secondary legislation in the form of rules or regulations, or by a recognised professional body of office holders that requires members of the professional body to comply with them.

#### **(b) through secondary legislation (or otherwise), provide standards relating to:**

##### ■ reports

This should deal with reports on the administration of the insolvency case to creditors and a court or other relevant authority and should detail the contents of and time requirement for such reports.

##### ■ initial collection and safeguarding of assets

This should cover things such as identifying assets, insuring assets, the inventory of assets, taking control of bank accounts and so forth.

##### ■ trading of the debtor's business after insolvency proceedings have been commenced or opened

This should cover such elements as the conditions under which trading may be continued; the liability for continuing obligations of the debtor; the records to be kept; and accounting for taxes on trading.

##### ■ the keeping of records

This should be directed towards the maintenance of records of the administration of the case.

##### ■ convening and conduct of creditors meetings

This should be directed at content, publication of notices and timing of meetings, conduct of meetings, election of chair person, proposal of resolutions, conduct of voting and so forth.

##### ■ sale and other disposal of assets

This should deal with the alternative methods of sale, the conduct of an auction, the conduct of a tender, the conduct of a private sale and so on.

- opening and operation of bank accounts

This should cover the separation of estate funds from those of the office holder, safeguarding, investment and use of estate funds.

- reorganisation plan contents and explanatory memorandum

This should supplement any legislation regarding the information to be contained in the plan and that plan's explanation.

### **Principle 7 – reporting and supervision**

Creditors, the debtor and others with an interest in an insolvency case (for example, a court or regulatory body) are entitled to be regularly informed about the progress of the case and to have relevant information available to them. This may be best facilitated through reports. This also provides a basis on which the work of an office holder and the progress of an insolvency case may be monitored.

Accordingly, the law should provide:

- (a) that an office holder provide regular reports on the work undertaken and progress of the administration of the insolvency case**

Although this is mentioned in relation to standards under Principle 6, it is essential that the principal legislation require appropriate reporting by an office holder to enable those affected by the insolvency case to be kept informed.

- (b) for the appointment, in appropriate cases, of a committee of creditors who may “oversee” the work of an office holder**

This is not to encourage interference in the performance of an office holder's work, rather to enable a group of creditors to consider the progress and quality of the work. It can sometimes be achieved by close consultation between the office holder and the committee on the more important matters that arise. A committee of creditors will not be appropriate in all cases. Factors to be considered in determining whether a committee of creditors is needed include the size of the estate relative to the

expense of a committee, the number of creditors and so forth.

- (c) that the performance of an office holder in an insolvency case be monitored**

This should not be required for every case, but rather would be something that could be instituted on an ad hoc, sample or “for cause” basis.

### **Principle 8 - regulatory and disciplinary functions**

The level of trust, responsibility and work standards required of an office holder requires a commensurate level of potential regulation and discipline.

Accordingly, the law should:

- (a) provide for a government or other body (including a recognised professional association) to have appropriate regulatory, investigatory and disciplinary powers in respect of office holders**

The question to be decided in each jurisdiction is what body should have the power.

- (b) provide for the grounds upon which the conduct of an office holder may be investigated**

It is suggested that rather than provide broad general grounds, such as “for good reason or cause”, the law should detail more specific behaviour, for example a failure to comply with a relevant duty or standard.

- (c) provide for the powers of such a regulatory body, including the power to:**

- investigate the conduct of an office holder upon a referral from a court, upon the complaint of an affected third party or on its own motion

This is intended to apply when the conduct of an office holder should be considered in the context of his/her eligibility to continue as an office holder. It is not intended to usurp the function of a court, for example, in considering a complaint from an affected third party in relation to a particular insolvency case.

- intervene and be heard on any application to a court concerning the conduct of an office holder or for the removal of an office holder from an insolvency case

It is important that a court should have the assistance of a regulatory body (an “industry” view) in cases where an office holder has been alleged to have engaged in misconduct or where a court is asked to consider the removal of an office holder from an insolvency case.

- impose disciplinary measures on an office holder in respect of whom misconduct has been established

It may not be always appropriate that the regulatory body should have the power to impose penalties or sanctions. It might be preferable to refer any findings of the regulatory body to a court for a consideration of the appropriate penalty to be imposed.

**(d) provide that disciplinary powers include a power to:**

- impose a fine on an office holder
- suspend the licence or registration of an office holder
- terminate the registration or licence of an office holder
- require that an office holder compensate third parties who have been affected by the misconduct of an office holder
- require that the office holder undergo further education and training
- The above remedies and sanctions are not intended to be exhaustive.

**(e) provide for a right of appeal from the exercise of a disciplinary power**

The livelihood of an office holder should be respected and any decision that, directly or indirectly, affects that livelihood should be capable of review or appeal.

## **Principle 9 – remuneration and expenses**

Reward: the level and the manner in which it may be determined is a critical part of an IOH regime. Without it there will be no office holders.

Accordingly, the law should provide:

**(a) for the entitlement of an office holder to be remunerated for their work and to recover expenses properly incurred in an insolvency case**

It is axiomatic that a private office holder should be entitled to be remunerated and that expenses

properly incurred in the conduct of the case should be reimbursed.

**(b) that the entitlement for remuneration of an office holder may be determined by a court, relevant authority or other institution (for example, a committee of creditors)**

These can be alternatives or they may create a hierarchy – for example, if creditors fail to resolve the issue, the court may do so.

**(c) the basis upon which the remuneration of an office holder may be calculated**

This needs careful consideration and a balance is needed between remuneration based on “time” and a percentage of realisations and/or distributions.

**(d) an appropriate mechanism for the review/appeal against the determination of the remuneration payable to an office holder**

Depending on the approach taken in (b) above, this may be an appeal to a court or other authority.

**(e) for the payment of such remuneration out of the assets of the estate of the debtor, including payment on account during the progress of the case**

Another possible source is some form of fund established by the government.

**(f) an appropriate level of priority for the payment of such remuneration ahead of other claims**

With the possible exception of secured creditor claims, there should be no claims that have priority for payment over the remuneration of an office holder. To provide otherwise would run the certain risk of deterring office holders from accepting appointments.

## **Principle 10 – release of office holder**

The law should provide that, subject to any objection by a regulatory body or an interested party, an office holder may be released from his/her appointment as office holder in an insolvency case.

The law may provide that this may occur upon the expiry of a term of years (for example, X years from the payment of a final dividend to creditors or from the filing of final accounts or report) or by order of the court upon the application of the office holder.

The effect of such a release is, normally, that it formally terminates the appointment of the office holder to the insolvency case. It may also release the office holder from all claims and liability in respect of things done or not done in the administration of the insolvency case.

### **Principle 11 – insurance and bonding**

The law should require that an office holder must at all times maintain a bond or professional indemnity insurance cover to protect third parties against negligence or breach of duty or fraud by an office holder.

This is necessary and is consistent with the requirement for such insurance in most professions.

### **Principle 12 – code of ethics**

The law should encourage and facilitate the development of a code of ethics for office holders, preferably through a professional body.

Such a code should deal with appropriate conduct, for example:

- the need for impartiality
- the need for integrity and accountability
- the need for independence
- the need to avoid the perception of possible conflicts of interest
- the need for proper conduct between office holders (as, for example, if they are competing for appointment to an insolvency case).

The law could compel the application of a code of ethics, either by setting that code or requiring that a code that has been established by a professional body be recognised as binding on office holders.

## **Endnotes**

1. UNCITRAL, *Legislative Guide on Insolvency Law*, United Nations publication, 2005 (ISBN 92-1-133736-4).
2. World Bank, *Principles for Effective Insolvency and Creditor Rights Systems (revised)*, (2005).
3. World Bank, *Principles for Effective Insolvency and Creditor Rights Systems (revised)*, (2005) p. 21.
4. UNCITRAL Recommendations 115 to 125, pp. 174-187.
5. See previous article in this issue of *Law in transition online: Insolvency office holders in south-eastern Europe*.

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