



# **INSOL International**

**Protocol for International Recognition  
of Insolvency Proceedings Affecting  
Natural Persons**

**June 2017**

## Protocol for International Recognition of Insolvency Proceedings Affecting Natural Persons

Contents	i
Acknowledgement	ii
Preamble	1
High Level Objectives	1
Definitions	2
Initiation of Proceedings	2
Determination of COMI / Residence	3
Stay of Proceedings	3
Voting	4
Ring Fencing	5
Exempt Assets	5
Disposal of Assets in Non Main Jurisdiction	5
Repayment Plans / Required Payment from Income / Proposals	5
Claims Administration	6
Secured Creditors and Novation of Secured Debt Contracts	7
Surrender of Assets	7
Retention of Assets	7
Novation of Debt	7
Other Considerations re Cross - border Problems That Can Occur in Novation	8
Cost of Proceedings	8
Priority and Preference Claims	9
Tax Authorities / Government Debt	9
Discharge of Debt	9
Non - dischargeable Debts	10

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## Acknowledgement

In principle, the Model Law can be used for the insolvency of natural persons. However it is generally the case that it is cheaper to start separate proceedings in multiple jurisdictions where debt is owed rather than administering one proceeding in the affected jurisdictions.

This is contrary to the concept of a collective proceeding which forms the basis for the Model Law and can be uneconomical for participants in small proceedings with negligible assets.

In 2012 the Small Practice Issues Committee of INSOL International undertook the project to draft and promote a protocol that accomplishes the objectives of the Model Law while at the same time recognizing the unique features relating to the insolvency of natural persons.

The Small Practice Issues Committee of INSOL wishes to sincerely thank Bill Courage of BDO Canada Limited, for taking on the task of preparing the protocol with the collaboration of Eric Levenstein, Werksmans Attorneys, Republic of South Africa, Hon. Judge Leif M. Clark Consulting, pllc of USA, Nastascha van Vuuren, Werksmans Attorneys of Republic of South Africa, John Baird, Barrister of Australia and Robert Haenel, anchor Rechtsanwälte of Germany.

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### Preamble

The UNCITRAL Model Law on Cross - Border Insolvency (the “Model Law”) has been adopted in twenty - one jurisdictions. It provides for the recognition of insolvency proceedings and insolvency practitioners in foreign jurisdictions and the determination of the Centre of Main Interest (“COMI”) through an application to court. It sets out basic rules for cross border cases and in the event of cases in multiple jurisdictions, will provide guidance to practitioners.

The Model Law can be used for the insolvency of natural persons however the costs of bringing an application for recognition of a foreign proceeding are generally expensive and currently it may be more cost - effective to commence multiple proceedings in jurisdictions where debt is owed rather than administering one proceeding in the affected jurisdictions. This result is contrary to the concept of a collective proceeding which forms the basis for the Model Law and which is uneconomical for all participants in small proceedings with negligible assets.

Generally the jurisdictions that have established regimes for dealing with the insolvency of natural persons have allowed the proceedings to be expedited and at relatively low cost as a result of the low value of assets and liabilities and the inability of debtors to pay significant fees.

Currently it appears that the most advanced jurisdictions in the area of insolvency systems for natural persons are those whose economies depend on consumer demand. It is axiomatic that if consumers are encouraged to use credit, and the result of this is economic growth, then there should be appropriate safety valves in the event that otherwise well - meaning consumers are not able to repay such debt obligations.

With a more mobile labour force, and a corporate insolvency regime that is increasingly international in focus, it is time to consider a streamlining of processes between jurisdictions that have functioning laws related to the insolvency of natural persons. A by - product of this process may be the development of suggested practices for jurisdictions that are considering the development of an insolvency regime for natural persons.

The Small Practice Issues Committee of INSOL International has undertaken a project to draft and promote a protocol that accomplishes the objectives of the Model Law while at the same time recognizing the unique features relating to the insolvency of natural persons.

### • High Level Objectives

This protocol attempts to address issues related to the insolvency of natural persons with low values of assets and liabilities where such assets and liabilities are situated in multiple jurisdictions. Generally natural person debtors are consumers who have become over indebted and require debt relief. This protocol is not intended to apply to natural persons with either substantial assets or issues that would be better addressed by more robust proceedings in the relevant jurisdictions using the Model Law.

Many of the issues considered will be determined by the *lex concursus* of the jurisdiction where the filing initiated. Notwithstanding, no jurisdiction should attach to provisions in the laws of another country which are manifestly incompatible with major principles of their own domestic law.

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\* The views expressed in this article are the views of the authors and not of INSOL International, London.

In these proceedings the foreign representative may require access to courts, or have the ability to sell assets under a certain value without initiating a court proceeding. The methodology for accomplishing this should be summary in nature.

The Protocol should focus on obtaining results in a cost and time effective way. The ultimate objective is to ensure that all creditors ultimately receive a pro - rata recovery from assets wherever situated.

This protocol should operate in a complementary manner with the Model Law, the EU insolvency regulation and with any other international recognition protocols. The protocol should however be tempered to cater for reasons of materiality and recognizing that proceedings for natural persons may not require all of the safeguards, nor be required to be as robust as those which apply to corporate entities.

Where necessary there should be standardized orders, issued in the originating jurisdiction, requesting aid and recognition in the non - main country. Where possible these orders should be issued at the request of the originating insolvency professionals (“IPs”) and in the lowest possible level of court so as to obtain the recognition necessary at minimal cost. The ultimate objective would be to have foreign jurisdictions recognize the proceeding without having to go to court (due to familiarity with the regulations of the main jurisdiction).

**Proposal:**

*The objective is to achieve streamlined, and if possible, automatic recognition internationally for proceedings relating to natural persons with limited assets and liabilities to avoid the need for expensive supplementary court applications in other jurisdictions. Notwithstanding differences in approach, the objective of the protocol is to promote automatic recognition except where provisions of the initial proceedings are manifestly incompatible with the non main country.*

- **Definitions**

All definitions as set out in the UNCITRAL Model Law on Cross-Border Insolvency shall apply to this document.

Natural Person – A natural person is an individual who has legal status in the jurisdiction, and does not include a corporate entity or other legal construct. While a natural person may be a wage - earner, a trader or sole proprietor, the method of earning an income is not to be determinative in terms of accessing international recognition.

- **Initiation of Proceedings**

There should be only one collective proceeding for a single debtor led from one jurisdiction.

Notification of all creditors worldwide must come from the initiating proceeding and must happen immediately. It may be necessary to develop a document that notifies foreign creditors in the originating language of the contract of the proceeding. It should not however be necessary for the originating jurisdiction to provide full translation of documents.

There may be circumstances where a recognition order is required prior to a proceeding being recognized in other jurisdictions.

**Proposal:**

*There should be only one collective proceeding for a single debtor led from one jurisdiction.*

*A formal process is opened when a court proceeding is opened, or considered by the jurisdiction to be opened. Jurisdictions should provide for recognition of foreign insolvency proceedings, preferably automatically.*

- **Determination of COMI / Residence**

The intent of these proposals is to focus on the majority of cases which are presumed not to involve movement of assets or the insolvent person, fraud or inappropriate conduct. Discussions of COMI will often focus on exceptions to the general rule, or cases where there is strategic movement of debtors or assets, fraud or other circumstances. In such cases it may not be appropriate to use the more summary provisions of this Protocol, and the Model Law provisions may apply.

When determining the residency of a debtor, suggestions have been that the individual must have been ordinarily resident in a jurisdiction for a period of between six months and two years. This refers to actual habitation in the jurisdiction as opposed to the establishment of an address of convenience.

Summary of significant issues include:

- The use of COMI in Europe is well established and there are no significant problems.
- The EU Regulation has already established the issues of COMI but there are grey areas. For example a COMI shift can be used when a wealthy debtor wants to protect assets that may be available to creditors in one jurisdiction, but are not subject to seizure in another.
- The misuse of COMI starts when “recognition of foreign proceedings” is possible.
- It is important to find a balance whereby - if there is *no intention* of fraud, a debtor must be able to go abroad to file for bankruptcy.
- The UNCITRAL Model Law does not establish a minimum period of residence to establish COMI.

**Proposal:**

*To consider applying two different time periods of ordinary residency; when a creditor initiates proceedings, and when a debtor initiates proceedings. The objective would be to discourage insolvency tourism, while at the same time allowing a creditor in a jurisdiction to access a domestic insolvency system if necessary.*

*If the debtor is filing – the debtor has to be in the jurisdiction for six months (or longer?) Prior to the date of filing as an ordinary resident. If the creditor wants to start the filing he can do so at any stage.*

*In a creditor filing the creditor should have the option of opening the proceeding in either the jurisdiction of the debtor or in the country where the creditor - debtor relationship was created during a period when the debtor had established COMI in that jurisdiction.*

*There is a need to recognize that there is a risk of abuse where there is a change of COMI in the period prior to the filing. In cases where there is perceived abuse, parties will still require access to the courts to resolve the dispute. It is recommended that the principles set out in the model law be used for challenges to comi.*

- **Stay of Proceedings**

One of the essential components of an insolvency proceeding is the stay of proceedings that protects a debtor from collection actions of creditors so that a fair and equitable distribution of assets can take place. The implementation of the stay may be automatic, or may require a court order. In either case the objective is to have all jurisdictions recognize the stay.

Some jurisdictions have exceptions to the general stay of proceedings for certain types of debt, such as recovery of amounts payable in respect of support for separated family. Other jurisdictions have made it a criminal offence not to pay such debts, and criminal proceedings are

not stayed by an insolvency filing. The policies of most jurisdictions are such that such payments are not affected by insolvency proceedings.

The debtor should not be able to litigate against his creditors where there is a transfer of a cause of action to an insolvency estate.

Where possible the stay of proceedings should be extended to all proceedings world - wide.

**Proposal:**

*Once a proceeding has commenced all other proceedings that affect the insolvency estate will be stayed. It is mandatory that the administrator of the insolvency proceeding notifies all creditors worldwide immediately.*

*The stay of proceedings should be extended to all proceedings world-wide. For secured creditors, generally the laws of the jurisdiction where the secured asset is located should apply.*

- **Voting**

In some jurisdictions there is a requirement that a restructuring arrangement by a natural person (Proposal, Individual Voluntary Administration) be voted on by creditors. There was general agreement that creditors from foreign jurisdictions who want to be involved in the local proceeding should have their claims recognized and should be involved in the voting system.

Where there is a voting system the method of voting should facilitate participation by creditors. This should include voting by proxy, voting by letter, attendances by telephone or other electronic means and the opportunity to negotiate without requiring the personal attendance of the creditor.

In Chapter 13 proceedings in the US there is no voting requirement. If the plan meets certain requirements then the plan will be approved. This system has operated for a long period of time and works well.

In the US there is no standard set of criteria that apply but it is important to show that a “best effort has been made” by the debtor. The following criteria are also important –

- Proposed plan is to be made in good faith
- Priority must be given to certain creditors (See Priority and Preference Claims below)

If these criteria are satisfied, then the plan automatically is approved subject to any objections made by creditors.

A further question that was raised was whether satisfying the “best effort test” and approval by the appointed trustee was adequate to conclude that the creditors’ involvement was not necessary. In the US, oversight is provided by the US Trustee appointed in the case.

Notwithstanding, it appears that in the US there is an opportunity for creditors to object to a plan, as opposed to a formal voting process.

**Proposal:**

*If a debtor wishes to commence a repayment plan or go into liquidation, a voting process is preferred. It is important that creditors, both domestic and foreign, have the opportunity to be involved in the process and as such they should be able to vote on all aspects relevant to the insolvent estate, or to otherwise express opposition. While the rules may vary by jurisdiction, as long as there is the opportunity for creditor input on a plan, it should be binding in all jurisdictions once the main jurisdiction has approved the process in accordance with its laws.*

- **Ring Fencing**

It was agreed that ring fencing, the practice of paying creditors in a local jurisdiction from the assets in that jurisdiction before remitting proceeds to the foreign main proceeding, is not the objective of this protocol. The objective is to allow creditors to share in assets internationally in a collective proceeding that treats all creditors and debtors fairly.

**Proposal:**

*Ring fencing is not appropriate. Where a jurisdiction, presumably being a non - main jurisdiction, applies ring fencing principles, creditors in that jurisdiction are not able to participate in a dividend in the main proceeding until such time as the dividend in the main proceeding exceeds the amount already received from the ring fenced distribution in the non - main jurisdiction.*

- **Exempt Assets**

Exemptions should be determined by the rules of the main jurisdiction where possible. It should be recognized that certain assets in the non - main jurisdiction may be protected by the laws of that jurisdiction. For example, if the main jurisdiction does not provide protection for pension assets, but the non - main jurisdiction where a pension asset is held protects pensions, it would be unlikely that the non - main jurisdiction would release the pension assets to the administrator in the main jurisdiction.

**Proposal:**

*That lex concursus applies for exempt assets.*

- **Disposal of Assets in Non Main Jurisdiction**

There should be a pooling of assets from all jurisdictions, subject to the rights of security holders in each jurisdiction in accordance with the rights of that jurisdiction.

Currently all jurisdictions require a recognition order in the second jurisdiction in order for an administrator to dispose of assets.

Question: Is it possible to get automatic recognition for consumer proceedings? While automatic recognition exists in some jurisdictions, it is currently not available everywhere. However through the development of a standard request for aid and recognition from the originating jurisdiction, it may be possible to obtain court recognition on a summary basis. The standardization of Orders would assist in this process.

As noted above, ring fencing of assets within a jurisdiction so that domestic creditors have access to proceeds prior to international creditors, is incompatible with the Model Law.

As well, the discussion under Secured Creditors and Novation of Secured Debt Contracts below, will provide additional information on the subject.

**Proposal:**

*There should be a pooling of assets from all jurisdictions in the main proceeding. Any necessary recognition orders should be simplified where at all possible.*

- **Repayment Plans / Required Payment from Income / Proposals**

There are a variety of ways that jurisdictions deal with the income of an insolvent individual. A general breakdown has either a liquidation - based proceeding such as a bankruptcy or sequestration, or a repayment plan arrangement such as a voluntary arrangement, proposal or composition.

In a liquidation proceeding, jurisdictions may impose mandatory payments based on family size and income. Some provide for payments to allow for repayment to end a mandatory period of

insolvency. Some jurisdictions require full repayment of debts prior to discharge and others provide for essentially no payments to be made.

In a repayment plan, the debtor promises, or is required to pay, certain amounts from his / her income into the plan as partial or full payment of debt.

When the treatment of the wide variety of options was considered in developing the protocol, what was very clear was that there was no consensus. Further, there appears to be no way that a foreign jurisdiction can impose its will on a main proceeding, short of refusing to accept the resulting discharge of debt. Accordingly the conclusion was that the rules applicable in the jurisdiction of the main proceeding must apply.

**Proposal:**

*That lex concursus applies for re - payment plans. It may be necessary to obtain an actual court order evidencing the approval of a repayment plan that provides for cram down in order for it to be binding on non main jurisdictions.*

- **Claims Administration**

Generally there is a process for creditors to register claims with the party responsible for administering the proceeding. Whether this is an insolvency practitioner, a claims officer or other party, the filing of a claim to prove a debt was considered to be an essential part of the proceeding.

There is variation with respect to how disputed claims are addressed. In some jurisdictions the IP is responsible for reviewing and admitting claims for voting and distribution purposes. Where a claim is contested by the insolvency practitioner it can be disallowed or modified to comply and litigation may ensue. In other jurisdictions there are cost consequences to litigation involving claims.

The date for determining claims in some jurisdictions is the date of initiation of proceedings. Other jurisdictions use the date of the proof of claim. Conversion of currencies will be determined using the rate applicable between the currencies of the two jurisdictions on the date of determination of claims.

**Proposal:**

*That all creditors, regardless of jurisdiction, are able to file claims in the proceeding. Lex concursus will apply for the date of determining claims. Claims of creditors will be converted to the currency of the main proceeding at the exchange rate in effect on the date of the determination of claims and all creditors, regardless of jurisdiction shall share equally, subject to comments regarding ring fencing above.*

- **Secured Creditors and Novation of Secured Debt Contracts**

These issues involving secured creditors and novation of secured debt contracts garnered much attention. Many jurisdictions have consumer friendly provisions that allow debtors to maintain secured assets in certain circumstances. Some jurisdictions do not contemplate a debtor retaining assets during an insolvency proceeding. Most jurisdictions restrict the ability of creditors to take security on assets that are otherwise exempt, except possibly where the security was taken to finance the purchase of the asset.

Where assets are located in a non - main jurisdiction the complexity increases. The rules relating to security will be driven by the jurisdiction where the assets are located. The desire of the main proceeding to recover value from the assets may be affected by the rules of the jurisdiction where the assets are located.

The proposals have been broken down to address the most common scenarios that appear to occur.

- **Surrender of Assets**

What happens when the secured asset has more value than the outstanding debt? How is the value recovered for creditors? In the event that the asset is surrendered, either the secured creditor or the IP can sell the asset, satisfy the debt and the surplus value becomes available to creditors in the insolvency proceeding.

Where there is an anticipated shortfall, the asset may be surrendered to the secured creditor for realization. In some jurisdictions oversight by the court or the insolvency practitioner may be required. Any shortfall to the secured creditor would generally become a claim in the proceeding and share pro - rata with other creditors. There is often a disclaimer process by the IP to the secured creditor in conjunction with the surrender.

***Proposal:***

*When assets are surrendered to the secured creditor either the IP or the secured lender would sell the asset and apply proceeds to the secured debt. In the event of a surplus realized over the value of the secured debt, the funds should be remitted to the main proceeding for distribution to other creditors. In the event there is insufficient asset value to pay the secured claim in full, the balance owing is to be included as an unsecured claim and will share equally with other creditors for the amount of the shortfall.*

- **Retention of Assets**

All jurisdictions reviewed appear to have exemptions for assets that are necessary for life. Generally these assets are retained as a matter of right and are not available to creditors through the insolvency process. Generally security cannot be taken on these assets.

Security may be taken on immovable property as well as some moveable goods such as automobiles. In an insolvency proceeding, debtors may want to maintain payments to the secured creditor to maintain possession of the assets. The insolvency practitioner's consent may or may not be required for novation. Practitioners will have to be aware of the requirements of the jurisdiction where the asset is located in considering recovery options.

In many jurisdictions, where a debtor wishes to maintain the asset and make payments, this is possible if the secured creditor agrees and the debtor uses earnings that are not required to be paid into the insolvency proceeding to pay the secured creditor. Where there is value in the asset that exceeds the secured amount, or the asset is not encumbered, jurisdictions will allow a debtor to make arrangements to buy back the asset from the insolvency proceeding, again using earnings that are not required for payments into the proceeding.

As well, in a restructuring, where assets are not transferred to the insolvency estate and a repayment plan is in place, it is possible for a debtor to maintain his residence and confirm the debt, so there is no impact on other creditors. Depending on the jurisdiction the creditor and administrator may be required to consent.

There can be an issue where the secured creditor wishes to enforce its security. In some jurisdictions there are restrictions on parties invoking default provisions in a contract, including a security contract, simply for the reason that a debtor has filed an insolvency proceeding. In other jurisdictions secured creditors are able to realize on secured assets as a matter of right. The rules will be determined by *lex sitae*, the law of the jurisdiction where the asset is located.

- **Novation of Debt**

A common problem that arises is where a secured asset has reduced in value and the secured creditor expects to be paid in full if the debtor retains the asset. This appears to be a common problem; while renegotiation of secured debt is common in commercial proceedings (cram down or mark to market) no country appears to have addressed this for consumer debtors. Notwithstanding, many debtors wish to continue making payments to their secured creditors so that they can continue to live in their residence or drive their car.

There are provisions in the insolvency legislation of various jurisdictions that provide that a contract cannot be terminated because of bankruptcy. For example if a debtor has leased a car and he requires that car for travel to work and back, the lease over the car cannot be terminated.

The continuation of a contract that could have been terminated by an insolvency proceeding by a debtor results in the novation or renewal of the contract. Once there is novation in the event of a subsequent default, a debtor will be responsible for any short fall after the secured creditor sells the property and the outstanding debt is settled. Some jurisdictions have considered restricting novation of contracts post insolvency due to perceived abuse. However at this time, the practice appears to be largely permitted.

**Proposal:**

*That assets may be retained by the debtor subject to both *lex sitae* and *lex concursus*. Payments on secured debt must – if not made by a third person – be sourced from income that is not required to be paid to the insolvency estate pursuant to a mandatory repayment plan.*

*Novation of contracts should be permitted in accordance with *lex sitae*, and ensuring that asset value in excess of the value of the secured debt is returned to the main proceeding.*

*On a practical basis dealing with secured assets will be dealt with according to *lex sitae* for non - main jurisdictions and *lex concursus* for assets in the main jurisdiction.*

- **Other Considerations re Cross-border Problems That Can Occur in Novation**

Usually this relates to a second property situated in a foreign country. The position in respect of novation is not very clear with regard to movable property. Question: Is a non - resident debtor able to claim an exemption on assets located in a non - main jurisdiction? If the concept of an exemption is that it relates to goods ordinarily used by the debtor, it would be unlikely that there would be exempt assets in the non - main jurisdiction.

With respect to immovable property outside the main proceedings, *lex sitae* will apply. If there is a court order relating to assets within its jurisdiction, the law of the country where the court order was made will be recognized.

Another question that arises is what happens if there is a short fall of the debt and the secured debt is a movable property that is situated in another country? It may be possible for a debtor to maintain an asset where there is no equity but the debtor must get permission from the administrator if he / she wants to sell that property. Permission of the creditor may be required as well.

- **Cost of Proceedings**

Cost issues are a major consideration relating to the initiation of proceedings, stay of proceedings, and mandatory notification processes. In most jurisdictions, IPs enjoy some level of priority for their remuneration and costs. However there are jurisdictions where the priority is not sufficient to ensure that IPs receive payment.

If IP remuneration is given priority, it would motivate the practitioners to carry out the proceedings efficiently and properly. It is essential that where ever the IPs are based, payment of fees is important. As a matter of practicality, where there is no priority for fees, then no professional will be willing to act in the circumstances and there will be no resolution of financial problems.

**Proposal:**

*Every jurisdiction therefore should ensure that the practitioners' remuneration is paid in priority irrespective from which jurisdiction the money is claimed.*

*Fees should be paid as first priority and this would apply to secured creditors, state officials as well as private individuals.*

- **Priority and Preference Claims**

In preparing the protocol, the working group reviewed the priority schemes from many different jurisdictions. Some jurisdictions have extensive lists of priority claims; others have virtually none, or have provided for other methods for the collection of certain debts than through the insolvency process.

INSOL has published works on many jurisdictions that set out priority in that jurisdiction.

Reciting the various priority regimes explored was not considered to be appropriate as any other jurisdiction may have its own priority scheme.

***Proposal:***

*The lex concursus will apply to preferential claims.*

- **Tax Authorities / Government Debt**

Since the objective of this committee is to try and achieve payment of claims in a single international recovery proceeding, the suggested proposal is as follows:

***Proposal:***

*All preferential creditors should be bound by the lex concursus of the jurisdiction where the proceedings are commenced, assuming that this is consistent with the overall objectives of this process.*

*Where the above proceedings cannot deal with such claims, in such circumstances, those creditors can start parallel proceedings to recover payment if the preconditions for such proceedings apply.*

- **Discharge of Debt**

In addition to the stay of proceedings one of the key components of an insolvency regime for natural persons is the concept of a discharge of debt in a reasonable amount of time so that individuals may continue with their lives without having to earn their living in legal limbo.

Some parties from jurisdictions where a discharge is not a standard component of the insolvency regime have expressed a concern regarding moral hazard; the risk that individuals will incur debt without regard to the potential consequences, or consider ability to repay. Anecdotally this does not appear to be an issue. In North America there is still resistance to filing for bankruptcy proceedings due to stigma, loss of credit rating and embarrassment. Notwithstanding, it is recognized that discharge is not a universal practice.

One of the objectives of this protocol is to provide for the automatic recognition of a discharge from a proceeding and the concurrent release of debts owed. If an application is to be made to court to get debts discharged it is important to get the documents standardized so that the costs involved will be minimal. That would also encourage other countries to recognize the discharge order.

***Proposal:***

*Once a proceeding has been opened and there is recognition, all non main jurisdictions should recognize the discharge in accordance with the provisions of the main jurisdiction.*

- **Non - dischargeable Debts**

The key question is what types of debts, if any, are not dischargeable? Each jurisdiction has set out categories of debt that are not dischargeable. Most relate to obligations under family support regimes, debts arising from criminal activity, tort claims for inappropriate conduct and the like. Some relate to government claims. Often the determination of non - dischargeable debts rests with the Court of the main jurisdiction.

Once a discharge is issued the recognition of the discharge by non - main jurisdictions may be problematic in respect of debts that would be non - dischargeable in that country. There may be circumstances where ancillary proceedings are required to ensure that each jurisdiction can see that its public policy objectives are met.

***Proposal:***

*Non dischargeable debts should be determined by the rules of the main jurisdiction (lex concursus)*

*Suggested best practices:*

- *Non dischargeable debts should be minimized.*



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