Title V Directors' Duty to request the opening of insolvency proceedings and civil liability

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1. Content of the provision

1.1. The Insolvency Proposal introduces in article 36 of Title V an obligation for directors to file for insolvency. Pursuant to this provision, if a legal entity becomes insolvent, its directors are obliged to submit a request for the opening of insolvency proceedings with the court no later than 3 months after the directors became aware or can reasonably be expected to have been aware that the legal entity is insolvent. Further, pursuant to article 37, the directors are liable for the damages incurred by the legal entity's creditors as a result of their failure to comply with this obligation.

1.2. From a Dutch law perspective, the introduction of this provision will be a significant change. At present there is no statutory duty for directors to file for insolvency proceedings. In practice the key guideline for directors of a legal entity in distress is that they should not enter into obligations of which they know, or reasonably should know, that the entity will not be able to satisfy, or for which it could not offer recourse (the so called '*Beklamel*-rule'). Under those circumstances the directors will have to stop trading and file for insolvency proceedings, not because they have a legal obligation to do so, but to avoid the risk of being held liable for wrongful trading by creditors of the entity.

1.3. The director's duty to file for insolvency is already part of the law in a number of Member States and in particular Germany is known for the director's duty to file for insolvency proceedings in case of '*Uberschuldung*' and '*Zahlungsfähigkeit*', including its punitive consequences for directors who fail to do so. We welcome the idea to adopt the obligation for directors to file for insolvency proceedings and to harmonize this obligation throughout the EU Member States. The current differences between the Members States give rise to much legal uncertainty and learning costs for creditors in a cross-border setting as regards the outcomes of insolvency proceedings, in particular in order to understand the different tests in the various Member States compared to those who only operate domestically. Furthermore, there is presently - without an obligation to request for insolvency proceedings in case of insolvency - in our view too much room for abuse by directors to the detriment of creditors. However, as we will explain in more detail below, the Insolvency Proposal should be more specific and clearer about the meaning of, for example, (the actual moment) of 'insolvency', the scope of the term 'directors' and which 'insolvency proceedings' are meant, in order to be sufficiently clear and effective. Below we set out in paragraph 2 the background of the provisions and in paragraph 3 our recommendations.

2. Background

2.1. In the Explanatory Memorandum of the Insolvency Proposal (p. 12) it is explained that Title V forms part of the measures aiming to maximise the value of the insolvency estate. In recitals 32 and 33 it is described that the director's duty to file for insolvency aims to avoid a late filing by directors which may lead to lower recovery values for creditors. To ensure that directors do not act in self-interest by delaying the submission of an insolvency request, Member States should lay down provisions making directors liable under civil law for breach of the duty to (timely) submit such a request. These considerations clearly show that the new provisions aim to protect creditors and avoid entities to continue loss-making businesses. The Netherlands is also home to many 'zombie companies', i.e. overindebted entities without any clear outlook of recovery to continue their operations. This problem is also signalled in the Commission's impact assessment report (p. 143). The introduction of the proposed new provisions aims to protect creditors, whilst directors will be more exposed to risks. According to the Commission's impact assessment report (p. 48) directors may demand higher salaries and insurers will likely demand higher premia for D&O liability insurance. Once the legal entity is in distress the directors will have to monitor closely when the entity becomes 'insolvent' and they should either improve the situation of the entity within the 3 months or file for insolvency proceedings. The Commission's impact assessment report (p. 65) recognizes the need for implementation of better cash flow management systems. The report mentions as an indirect benefit of the obligation to file for insolvency in an earlier stage a higher chance of timely (pre-pack) sales of going concern parts of the business. The Explanatory Memorandum furthermore stresses that the provisions (including articles 36 and 37) are minimum harmonisation rules so Member States may maintain or introduce stricter obligations for directors of companies close to insolvency.

2.2. The Explanatory Memorandum emphasizes that the Insolvency Proposal is coherent with other EU legislation, including the EU Directive on Restructuring and Insolvency 2019, which stipulates in article 19 that in case there is a likelihood of insolvency, the directors are obliged "to take steps to avoid insolvency". Obviously one of such steps could be filing for preventive insolvency proceedings, including the Dutch Scheme (or 'WHOA'-proceedings) in the Netherlands. Although the Dutch legislator has not codified this obligation for directors, it is assumed this obligation can be addressed by the existing Dutch law. This means directors will have to sail between Scylla and Charybdis, i.e. between the obligation in case of likelihood of insolvency to take steps to avoid insolvency proceedings, and the obligation to actually file for such proceedings once the entity has surpassed the brink of 'insolvency'.

2.3. A key question is the question when the entity is (de facto) 'insolvent' within the meaning of article 36. There is no clear guidance in the Insolvency Proposal itself or the Explanatory Memorandum. In recital 37 reference is made to the cessation of payments test and the balance sheet test as the two usual triggers among Member States for opening of standard insolvency proceedings. However, no reference is made as to what the test of insolvency should be in the context of article 36. In the context of microenterprise debtors, the recitals state that the balance sheet test may be unfeasible because of the possible lack of proper

record. For that reason, the inability to pay debts as they mature should be the criterion for the opening of winding-up proceedings for such microenterprises. Furthermore, the recitals state that for such entities Member States have to define the specific conditions under which this criterion is met, as long as these conditions are clear, simple and easily ascertainable by the microenterprise concerned. Again, no such guidance of how to establish de facto 'insolvency' is given for the obligation to file for directors of 'normal' companies.

3. Recommendations

3.1. Although we are mindful of the difficulty of finding a common ground between the Member States, we recommend including in the Insolvency Proposal a definition of 'insolvency'. Otherwise, it is unlikely that the aim of the Insolvency Proposal will be met as the uncertainties and the increased costs to understand the different tests in different Member States will remain. We propose to apply "the inability to pay debts as they mature" as the criterion for the opening of insolvency proceedings also to 'ordinary' entities (and not only to microenterprises). Furthermore, we recommend including in the recitals additional guidance as to when such criteria are met or at least that Members States have to adopt a definition for the sake of legal certainty. As stated in the Commission's impact assessment report (p. 43) it could for example set out that a company that was not in a position to meet its debt obligations within a pre-defined period (e.g. 90 or 180 days) would be deemed insolvent. Court discretion and case-by-case assessment should be limited to exceptional cases. According to this report two thirds of the respondents to the public consultation supported such a harmonized definition of 'insolvency' as the trigger event.

3.2. There is no definition of "Insolvency proceedings" in article 2 of the Insolvency Proposal. The director who is obliged to request for an insolvency proceeding according to article 36 would like to understand what kind of insolvency proceeding he or she is obliged to petition. It would be practical to rely on the European Insolvency Regulation (EIR) and the various insolvency proceedings of the Member States as mentioned in Annex A of the EIR. However, this would include preventive restructuring procedures like the public "WHOA" procedure. Given the background of the Insolvency Proposal we question whether that is the purpose of this Insolvency Proposal. According to the Explanatory Memorandum (p. 3) "preventive restructuring frameworks (...) do not address the situation where a business becomes insolvent and has to undergo insolvency proceedings". Recital 3 states that "Insolvency proceedings ensure the orderly winding down or restructuring of companies". Although the Insolvency Proposal is not entirely clear, we believe that based on these considerations the director in respect of a Dutch entity will have to file for either bankruptcy or suspension of payments to avoid liability under article 36. We recommend clarifying the definition of insolvency proceedings.

3.3. There is no definition of "Director" in article 2 of the Insolvency ProposalInsolvency Proposal. In recital 32 it is described that Member States should define to who the directors' duties should apply and that the notion of "director" should be interpreted broadly to cover

all persons charged with making, or those who do in fact make or ought to make, key decisions with respect to the management of the company. It is mentioned that this in line with the UNCITRAL Legislative Guide on Insolvency, Part four: Directors' obligations in the period approaching insolvency. The core obligation in article 36 is to submit a request for the opening of insolvency proceedings, which can only be done by a statutory director, and not by a de-facto director. In view thereof we question whether a person acting as a de-facto director should be held liable as provided in article 37 if that person in question would not be the legally competent person to submit the request for opening the insolvency procedure. Moreover, under Dutch law a statutory director can file for bankruptcy only after instruction of the shareholders meeting. The articles of association may stipulate that also for suspension of payments such instruction is required. We therefore recommend that the directors are obliged, within this period of three months, to use best efforts to submit a request for the opening of insolvency proceedings.

4. Conclusion

4.1. We welcome the Insolvency Proposal, especially the obligation of the directors to "promptly submit a request for the opening of insolvency proceedings to avoid potential asset value losses for creditors" as laid down in Title V of the Insolvency Proposal.

4.2. However, as we have explained above, we recommend the proposal to be more specific and clearer about the meaning various definitions and terms, including the actual moment of 'insolvency', the scope of 'directors' and 'insolvency proceedings' in order to be sufficiently clear and effective.