The Impact of Emerging Preventive Restructuring Mechanisms on Directors’ Duties to Creditors in the Event of (Pre-)Insolvency in the UK and the Netherlands

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Abstract

Jurisdictions around the world are adjusting their insolvency laws with the aim to offer debtors in financial difficulties instruments that enable them to bring the company to a healthy state as soon as the problems arise. The rationale is that viable companies should have access to procedures that permit them to continue business, in whole or in part, by changing their capital structure as well as carrying out operational changes. Directors’ duties to creditors form a regular part of the laws concerning insolvency and therefore, a change in the insolvency laws will, arguably, have consequences for directors’ duties. In this paper, the impact of new preventive restructuring tools in the Netherlands and the UK on directors’ duties is discussed.

Keywords

preventive restructuring – directors’ duties – creditor protection

1 Introduction

Jurisdictions around the world are adjusting their insolvency laws with the aim to offer debtors in financial difficulties instruments that enable them to bring
the company to a healthy state as soon as the problems arise.\textsuperscript{1} The rationale is that viable companies should have access to procedures that permit them to continue business, in whole or in part, by changing their capital structure as well as carrying out operational changes. Those procedures should help to prevent job losses and the loss of know how and skills, and maximize the total value for creditors compared to what they would receive in the event of the opening of liquidation proceedings in which the company’ assets will be liquidated. Preventive restructuring procedures form an increasing part of insolvency law. Generally, they owe their efficacy to quick, flexible procedures with minimum involvement of judicial or administrative authorities. Some jurisdictions chose to implement these procedures as explicit part of their insolvency law, whereas others include them in their legal frameworks concerned with company law. Evidently, the introduction of these procedures affects the laws of jurisdictions in multiple respects. Securities law and contract law are clear examples of laws that are influenced by emerging restructuring mechanisms. The same can be said about the law pertaining to duties of company directors in the event the company is insolvent or close to insolvency. Directors’ duties to creditors form a regular part of the laws concerning insolvency and therefore, a change in the insolvency laws, arguably, will have consequences for directors’ duties. In this paper, the impact of new preventive restructuring tools in the Netherlands and the UK on directors’ duties will be discussed. The focus will be on recently implemented restructuring procedures in both jurisdictions that deal with the restructuring of the assets and liabilities of the company in distress.

First, a general discussion of directors’ duties to creditors under UK and Dutch law will follow. Afterwards, an introduction is provided on the merits of the new restructuring procedures in UK and Dutch law. Following this, the impact of these procedures on the discussed directors’ duties will be assessed. It will be argued that the new procedures affect directors’ duties in, at least, two ways. First, questions will arise on the need to implement additional

\textsuperscript{1} Examples include Singapore, the United Kingdom and the European Union. For Singapore, see G. McCormack, W.Y. Wan, ‘Transplanting Chapter 11 of the US Bankruptcy Code into Singapore’s restructuring and insolvency laws: opportunities and challenges’, \textit{J Corp Law Stud} (2018) 19 (1) at 69–104; for the European Union, see R. De Weijs, ‘Harmonization of European insolvency law: preventing insolvency law from turning against creditors by upholding the debt – equity divide’, \textit{European Company and Financial Law Review} (2018) 15(2) at 403–444; For a critical analysis of the insolvency reforms planned in the United Kingdom, see E. Vaccari, ‘Corporate insolvency reforms in England: rescuing a “broken bench”? A critical analysis of light touch administrations and new restructuring plans’, \textit{International Company and Commercial Law Review} (2020) 31(12), at 645–667.
provisions regarding directors’ liability. The question pertains to restricting liability. Second, new restructuring procedures give rise to the question if existing rules on directors’ liability suffice to allow directors to trade the company out of the financial trouble by negotiating a restructuring plan on the one hand and protect the legitimate interests of creditors on the other hand.

2 Directors’ Duties to Creditors in the Netherlands and the UK in General

2.1 Different Areas of Law Involved

The matter of company directors’ liability towards creditors constitutes a vast body of rules that encompasses various areas of law in the Netherlands and the UK. Bearing in mind that these systems follow different legal traditions being civil law in the Netherlands and common law in the UK, the following areas of law in respect of directors’ liability can be considered. As company law is concerned with the positing of company organs such as the board of directors, directors’ duties, consequently, are affected by rules enshrined in company law. Duties can also follow from private law since concepts such as the tort of deceit and negligence in both UK law and Dutch law serve as a foundation for directors’ liability for damage caused to creditors. Finally, insolvency law comes in since directors’ duties are considered most prominent in the situation that the company faces financial difficulties as a consequence of which it is uncertain whether it can pay its debts (in time). The variety of the involved areas of law has reflected the ways in which UK law and Dutch law regulate directors’ duties to creditors. The UK, for instance, provides for a rule called ‘wrongful trading’ in its Insolvency Act 1986 for directors’ liability to creditors in the event of insolvency or imminent insolvency. This rule is rooted in insolvency law. However, case law has accepted the tort of deceit and negligence (civil law) and fiduciary duties of directors towards creditors (company law) as sources of duties for directors in the event of (imminent) insolvency as well. In Dutch law, no provisions regarding directors’ liability exist in the Dutch Bankruptcy Act (‘Faillissementswet’). Instead, case law has developed various duties for directors to creditors that are embedded in the civil law concept of the tort of negligence (‘onrechtmatige daad’). In addition, Dutch law provides statutory rules for liability in Book 2 of its Civil Code that is considered part of company law.

Before the relevant grounds for liability are outlined in the following paragraphs, one comment needs to be made regarding the comparative law approach in this paper. In the comparative analysis, the paper adopts
a functional approach. An important characteristic of this approach is the identification of laws that have the same function, in other words do the same job in the legal system. Following this approach of functional equivalence, the paper at times ignores points of difference between UK and Dutch law to make the comparison work. One example concerns the proceedings the liquidators in the respective jurisdictions normally follow in case of breaches of directors’ duties. In UK law, section 212 Insolvency Act 1986 allows the liquidator to bring expedited proceedings based on ‘fiduciary or other duty in relation to the company’ (as opposed to ordinary proceedings). Under this section, the UK liquidator can bring proceedings based on breaches of duties codified in the Companies Act 2006 as well as breaches of tort. In addition, section 213 Insolvency Act 1986 allows for proceedings based on fraudulent trading. Breaches of directors’ duties, including torts, would normally be dealt with following the aforementioned procedures, even though the liquidator can also pursue torts under ordinary proceedings. In Dutch law, there are no proceedings similar to section 212 and 213 Insolvency Act 1986. Instead, the Dutch liquidator will usually bring ordinary proceedings based on the general provision of the tort in the Dutch Civil Code, and the specific grounds for directors’ liability in Book 2 of the Dutch Civil Code. The difference between the commonly followed procedures in respect of breach of directors’ duties, however, does not impede identifying the duties that directors are subject to in respect of creditors of the company during (pre-) insolvency. With the aim of detecting the material duties of directors, the aforementioned points of detail can be disregarded in a functional comparative approach.

2.2 Wrongful Trading, the Tort of Deceit and Fiduciary Duties to Creditors in the UK

In this paragraph, duties of directors to creditors following from wrongful trading, the tort of deceit and fiduciary duties will be outlined briefly. This is not intended as an exhaustive overview. In light of the research question in

2 K. Zweigert and H. Kötz, An Introduction to Comparative Law, Oxford: Oxford University Press 1998, at 32–47.

3 For the purposes of this article, the provisions on fraudulent trading (article 993 Companies Act) and the duties for directors stemming from the Fraud Act will not be considered. These duties pertain to criminal liability, although the court can award damages as well pursuant to conviction. In this article, the focus lies on directors’ liability towards creditors in respect of compensation for damages.

4 An overview of directors’ duties during (imminent) insolvency may be found in P.J.M. Declerq, ‘An English law Perspective on Directors’ Liability in the Zone of Insolvency’, in NACIL-reports 2017: Directors’ liability in the twilight zone, Den Haag: Eleven International Publishing 2018, in particular, at 75–80.
In this paper, the focus lies on rules of director liability that are most likely to be affected by preventive restructuring mechanisms.

Wrongful trading is covered by section 214 Insolvency Act 1986 and stipulates that on the application of the liquidator the court can declare directors to be liable to make a contribution to the company’s assets, when
(a) the company has gone into insolvent liquidation,
(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and
(c) that person was a director of the company at that time.

The current wrongful trading rule was introduced in the Insolvency Act 1986. In the report of the Cork-commission, which lay the ground for revision of the insolvency law in the UK in 1986, it is stated that UK law lacked a rule which declared directors liable for harmful demeanor before and during insolvency. The law before the Insolvency Act 1986 regarding directors’ liability required proof of ‘intent to defraud creditors’ by the liquidator which appeared a significant obstacle to establish liability. In the view of the Cork-commission, the new wrongful trading rule aimed to protect creditors against the continuation of trading by directors when the company was factually insolvent. Initially, section 214 only pertained to insolvency liquidation. In 2005, subsection 6A was implemented pursuant to which for the purposes of wrongful trading the term ‘insolvent liquidation’ includes the procedure of ‘administration’ as well. Whereas the aim of the procedure regarding insolvent liquidation is to liquidate the assets of the insolvent company under supervision of the court-appointed liquidator, the procedure called ‘administration’ primarily intends to rescue the company and preserve its going concern value with the appointment of an administrator.

As follows from the above-cited subsection a, only the liquidator or administrator can invoke wrongful trading and the remedy is only available if the company has gone into insolvent liquidation or administration. If the director is found liable, the court can issue an order for contribution to the company’s

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5 Report of the Insolvency Law Review Committee Insolvency Law & Practice (Cork Report, 1982) Cmnd. 1776–1778.
6 Cork report, supra footnote 5, Cmnd. 1776–1778.
7 See paragraph 3 section 1 of Schedule B1 Insolvency Act 1986 where the aims of administration are listed. It should be noted that according to paragraph 3, Schedule B1 of the Insolvency Act another permitted purpose of administration is enabling greater sums to be made available in liquidation. Usually, this is achieved through a prepackaged business sale.
assets as the courts thinks proper. Generally, the contribution order contains the damages for creditors that have increased after the moment that ‘there was no reasonable prospect’ that the company would avoid going into insolvent liquidation, the so-called increase in the net deficiency of the company. In order to receive a court order, the liquidator should show that before the commencement of the relevant procedure the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. Courts, essentially, have to consider what the financial situation of the company was at the relevant time and what knowledge directors had or ought to have at that time. Pursuant to subsection 4 of section 214 IA 1986 the required knowledge of the director should be assessed by having regard to the knowledge of a reasonably diligent person with the ‘general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company’. If the director in question has more knowledge, skill and experience, this shall be taken into account. It has been argued that the requirement that there is ‘no reasonable prospect’ of avoiding going into insolvent liquidation generally equals the moment that the company is unable to pay its debts when they fall due. In case law, this so-called ‘cash flow insolvency’ has served as a standard to hold directors liable. From this moment, consequently, directors should start considering the interests of the creditors. This can be manifested in the opening of an insolvency procedure (liquidation or administration, for instance), but also making efforts for debt restructuring and attracting new finance. When the conditions regarding the financial

8 Continental Assurance Co of London Plc [2001] BRIP 733. A. Keay, M. Murray, ‘Making company directors liable: a comparative analysis of wrongful trading in the United Kingdom and insolvent trading in Australia’, International Insolvency Review (2005) (14) at 43.

A. Hicks, T.E. Cooks, ‘Wrongful trading – predicting insolvency’, Journal of Business Law (1993) at 338–350; P. Davies, ‘Directors’ creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency’, European Business Organization Law Review (2006) (7) at paragraph 5.1.1. Cf. section 123 Insolvency Act 1986 that provides a definition of ‘inability to pay (...) debts’ in relation to various provisions in the Insolvency Act 1986. In subsection 1(e) it is stated that a company is deemed unable to pay its debts ‘if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due’.

9 See, for instance, Re Purpoint, [1991] B.C.L.C.491 and Re Rod Gunner Organisation, [2004] 2 B.C.L.C. 110.

10 See the apt considerations in Kinsela v Russell Kinsela Property Ltd (in liq) (1986) 4 NSWLR 722, nr. 730 of judge Street: ‘where a company is insolvent the interests of creditors intrude. (...) It is in a practical sense their assets and not the shareholders’ assets that, through
situation of the company and the knowledge of the director are met, the director can avoid liability if the court is satisfied that he ‘took every step with a view to minimizing the potential loss to the company’s creditors’ from the moment he had the above mentioned knowledge (subsection 4). By means of this defense, the director can exonerate himself. The law is not clear on what specific actions can exempt the director from liability. Some case law points out that directors are required to show that in the relevant period they requested competent financial advice, held regular board meetings, kept themselves up to date regarding the financial state of the company and attempted to restructure its debts. If the director can show that he took ‘every step’ to minimize the potential loss to creditors, he will not be liable even if he has not actually succeeded in his objective.

2.2.1 Tort of Deceit, Fiduciary Duties to Creditors
Although the wrongful trading provision is likely the first to come to mind with regard to directors’ duties to creditors in the event of (imminent) insolvency, UK law provides for more insolvency related duties for directors. First, duties can follow from tort law. Especially, in respect of new creditors, that is creditors that enter into a transaction with the company directors can be subjected to a duty to take into account their interests based on, among others, the tort of deceit and the tort of negligent misstatement. The tort of deceit concerns behavior when a person intentionally deceives another to an action that damages him. Interestingly, a considerable amount of cases that have been at the root of the development of the tort of deceit, relate to the director of a company intentionally misrepresenting the affairs of the company. Making intentionally false statements about the creditworthiness of the company to a creditor that enters into a transaction with the latter relying on the false statements, can amount to liability of the director under the tort of deceit.15,16
Second, reference can be made to duties of directors during (imminent) insolvency that are derived from the fiduciary relationship of the director with the company. Especially when insolvency has not manifested itself yet in terms of cash flow insolvency, but is likely to happen, case law seems to confer fiduciary duties to directors towards creditors of the company. It follows that ‘where to the knowledge of the directors there is a real and not remote risk of insolvency...the directors must consider [creditors’, AK] interests if there is a real and not remote risk that they will be prejudiced by the dealing in question’. The rationale for this type of duties is construed as follows: ‘directors are not free to take action that puts at real (as opposed to remote) risk the creditors’ prospects of being paid, without first having considered their interests rather than those of the company and its shareholders’. With regard to the moment that the duty is activated, different standards are considered in case law. Reference is made to when ‘the company is insolvent, or even doubtfully solvent’, ‘where the company is in a parlous financial state’, ‘where the company is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors’ money that is at risk’. Keay, in particular, has argued in favor of fiduciary duties for directors before insolvency (in terms of section 123 Insolvency Act 1986) has occurred.

2.3 Book 2 Dutch Civil Code and ‘Onrechtmatige Daad’ as Foundations for Directors’ Liability in Dutch Law

Dutch law does not contain a specific rule on wrongful trading. Directors are also not obliged to file for the commencement of insolvency proceedings when the company is cash flow or balance sheet insolvent. However, there

Under UK case law, it is not easy to hold directors liable based on this tort. Only in cases where the director would sign contracts without mentioning his capacity as director and without using the letterhead of the company, liability seems likely. See v Fairline Shipping Corp v Adamson [1975] QBD 180, and Noel v Poland [2001] 2 B.C.L.C. 645.

Kalls Enterprises Pty Ltd v Baloglou [2007] NSWCA 191, 25 ACLC 1094.

Brady v Brady (1987) 3 B.C.L.C. 535; [1988] B.C.L.C. 20; [1977] P.C.C. 434.

Facia Footwear v Hinchcliffe [1998] 1 B.C.L.C. 218.

Colin Gwyer & Associates v London Wharf (Limehouse) Ltd [2002] EWHC 2748 (Ch); [2003] B.C.C. 885; [2003] 2 B.C.L.C. 153.

A. Keay, ‘Directors’ Duties and Creditors’ Interests’, Law Quarterly Review (2014) (130) at 443–472.

Pursuant to article 2336/246 Dutch Civil Code a petition from the board of directors to file for bankruptcy proceedings is subjected to approval from the general meeting of shareholders.
are various rules in statute and case law intending to protect creditors of the company against harmful conduct of directors in the event of financial downfall. The most prominent foundations for director liability in this regard form article 2:9, 2:248 and 6:162 Dutch Civil Code.24

2.3.1 Article 2:9 and 2:248
By virtue of article 2:9 Dutch Civil Code directors can be held jointly and severally liable in case of mismanagement for the damage they have caused to the company by their mismanagement. This claim belongs to the company. In case the company is declared bankrupt, the liquidator will bring the claim on behalf of the company. The liquidator needs to show that there has been improper management (‘onbehoorlijk bestuur’), which is only met in case of ‘serious reproach’ (‘ernstig verwijt’).25 The requirement of ‘serious reproach’ serves to ensure that directors are not held liable lightly, for every mistake in the management of the company. The Dutch Supreme Court has provided the following rationale for the ‘serious reproach’ requirement:

“The acceptance of a high threshold for the liability of a director towards the company also serves the interest of the company and the enterprise related to it by preventing that directors allow their behaviour to be defined to an undesirable degree by defensive reasons”.26

When improper management has been established, the liquidator needs to show causation between the improper management and the loss he claims the company has suffered. Individual directors have a specific defense at their disposal. If they can show that their behavior lacks a ‘serious blame’ and they have not been negligent in taking measures to avoid the consequences of improper management, they will not be liable. This will not be easy to establish because it is common understanding that directors bear responsibility for the general course of business, in spite of the facts that specific tasks may have been assigned to individual directors.27 It has been argued that article 2:9 Dutch Civil Code has relevance in case of (imminent) insolvency as well. In this reasoning, the duty to manage the company properly (article 2:9 subsection 1 Dutch Civil Code) transforms into a duty to protect the interests of the creditors ‘when the opening of bankruptcy proceedings, realistically, cannot be avoided’.28 So far,
there is no significant case law in which directors have been found liable for damages following this reasoning.

During bankruptcy proceedings the liquidator can also bring a specific claim against directors on grounds of mismanagement that has caused company’s bankruptcy. Article 2:248 Dutch Civil Code contains the requirements for liability.\(^{29}\) This claim was implemented in the 1980s as part of laws aimed to combat abuse of legal persons. The first requirement of article 2:248 Dutch Civil Code is that the liquidator must establish that there has been manifestly improper management (‘kennelijk onbehoorlijk bestuur’) within a time frame of 3 years prior to the opening of the bankruptcy proceedings. Management is deemed manifestly improper “if no reasonably thinking director would have acted in such a way.”\(^{30}\) Generally, it can be inferred from case law and literature that establishing manifestly improper management requires that the directors knew or ought to know that the way in which they fulfilled their task (or neglected to do so) would harm creditors’ interests.\(^{31}\) The second requirement is that the liquidator must show that the manifestly improper management was an important cause of the company’s bankruptcy. In the event the annual accounts have been published too late or the bookkeeping duties have been neglected, manifestly improper management is established by force of law and there is a presumption that this is an important cause of the bankruptcy, unless the violation of the duties mentioned is ‘insignificant’. Liquidators often rely on these legal presumptions as they alleviate the burden of proof of the liquidator considerably. Directors are still allowed to argue that another circumstance that cannot be attributed to improper management is an important cause of the bankruptcy.\(^{32}\) If this defense fails, directors are jointly and severally liable for the full deficit in the bankruptcy estate.

2.3.2 Article 6:162 Dutch Civil Code – Tort of Negligence

Under Dutch law, a significant amount of claims against directors is initiated based on the tort of negligence. The liquidator as well as individual creditors can bring a tort claim against directors involving a breach of duty of care. A vast body of case law has developed various duties to creditors that directors

\(^{29}\) For public limited companies the relevant article is 2:138 Dutch Civil Code which has similar wordings.

\(^{30}\) HR 8 June 2001, NJ 2001, 54 (Panmo).

\(^{31}\) Van Schilfgaarde, Winter, Wezeman, Schoonbrood, *Van de NV en de BV*, Deventer: Kluwer 2017, at 208; M.L. Lennarts, ‘(Waar) hoort voorzienbaarheid van benadeling van schuldeisers thuis in het toetsingskader van art. 2:138/248 BW?’, *Tijdschrift voor Insolventierecht* (2021) (9).

\(^{32}\) HR 30 November 2007, NJ 2008, 91 (Blue Tomato).
are subject to in case the company faces financial difficulties. For a successful negligence claim against the director the liquidator or an individual creditor needs to show that the director violated a duty of care owed to joint creditors, respectively to the individual creditor that has initiated the claim. It is long-standing case law that a violation of a duty of care can only be established when the requirement of ‘serious reproach’ is met. According to case law, all facts and circumstances should be taken into account when assessing whether or not the director can be ‘seriously blamed’ for the damage that the creditor(s) claim to suffer. For the purposes of this paper, two types of duties will be highlighted.

The first duty concerns the incurring of debts by the director when he knows or ought to know that the company is unable to meet its obligations and will offer no recourse for subsequent damages. This claim pertains to the so-called *Beklamel-norm* that is named after the case in which the duty was established. The Dutch Supreme Court has ruled that the mere knowledge of the director that the company is unable to pay the incurred debt does not suffice for liability. For liability, furthermore, it is imperative that the director knew (or ought to know) that the company will not offer recourse for the damages that followed from the breach of its obligations. In practice, this means that directors are liable for breach of this duty if they can be shown to have foreseen the bankruptcy of the company. Directors can escape liability if they manage to show circumstances that either exculpate them or justify their conduct.

The second duty to point out is concerned with transactions that constitute a selective payment (‘selectieve betalingen’). The concept of selective payments is rooted in the principle of ‘paritas creditorum’(*pari passu* principle) and the related ranking of creditors in bankruptcy. All creditors in bankruptcy should be dealt with equally unless there are reasons provided in statute to deviate from this principle. This principle also has relevance before bankruptcy proceedings are opened. Under some circumstances, directors can be held to a duty to not breach the ranking of creditors – that formally only applies when bankruptcy proceedings are opened – if this inevitably comes at the cost of other creditors. This is the case when the director, before the opening of

33 Starting from *HR* 8 December 2006, *NJ* 2006, 659 (Ontvanger/Roelofsen).
34 *HR* 6 October 1989, *NJ* 1990, 286 (Beklamel). The claim can only be brought by individual creditors that have suffered damage. The liquidator cannot initiate this claim. This was ruled in *HR* 16 September 2005, *NJ* 2005, 311 (De Bont/Bannenberg q.q.).
35 *HR* 5 September 2014, *NJ* 2015/22 (RCI Financial Services/Kastrop).
36 A. Karapetian, *Bestuurdersaansprakelijkheid uit onrechtmatige daad*, Deventer: Wolters Kluwer 2019 (diss. Rijksuniversiteit Groningen), at 106–108.
bankruptcy proceedings, pays a debt as a consequence of which less money is left for distribution to remaining creditors in subsequent bankruptcy proceedings. Case law from the Dutch Supreme Court does not provide for clear guidelines on the circumstances that constitute a breach of duty in this regard. From case law of the lower courts, however, some perspective can be deduced. It seems that lower courts distinguish between selective payments to creditors that are related to the company and selective payments to unrelated creditors. Examples of related creditors are group companies such as subsidiaries. The standard that is used for selective payments to these type of creditors is whether the director ought to seriously account for the ‘serious financial trouble’ that the company was enduring. For payment to unrelated creditors the standard used is more lenient to directors. Only payments that are conducted at a time that the director knew or ought to know that bankruptcy (‘faillissement’) was inevitable. Although in some case law the inevitability of ‘insolvency’ is adopted as a standard as opposed to inevitability of ‘bankruptcy’, it is clear that the courts refer to the commencement of bankruptcy proceedings under Dutch law and not a material understanding of ‘insolvency’. Following from case law, directors can try to avoid liability by showing circumstances that justify the selective payment. Rescue operations have showed to be an important justification ground that is capable of freeing the director from liability.

2.4 What Interests are Involved in Defining Directors’ Duties to Creditors During (Pre-)Insolvency?

It follows from the above mentioned that UK and Dutch law use different standards for directors’ liability towards creditors of the company during (pre-) insolvency. Interestingly, the legal-political considerations that have laid the ground for the various duties in statute and case law in the discussed jurisdictions show significant similarities. In general, the interests that require consideration in defining directors’ duties to creditors in the event of insolvency or imminent insolvency are the following. There is the interest of existing and new creditors to be informed on their debtor’s financial situation that will

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37 Even the selective payment of debts that were due can amount to liability of the director. Transaction avoidance provisions (actio Pauliana) in article 42–47 Dutch Bankruptcy Code address these payments – so called preferences – as well. In the light of the research question of this paper, this will not be discussed.
38 Karapetian, supra, at 360–364.
39 Karapetian, supra, at 360–362.
40 Karapetian, supra, at 364.
41 Karapetian, supra, at 364.
42 Karapetian, supra, at 369–370.
enable them to define their position and to make an informed judgement on their (potential) business relationship with the debtor. Existing creditors may have the intention to safeguard their rights and interests by, for instance, exercising security rights before the encumbered assets devaluate. Information about the company’s financial situation will enable new creditors to change the modalities of the transaction (by demanding higher interest rates for example) or to make a decision to not deal with the company at all. This interest of the creditors, generally, competes with the interest of business rescue. Business rescue prioritizes the maintaining of value in the company by allowing the directors to trade the company out of financial trouble and take business risks for that purpose. Broadly taken, the interests of the creditors are considered private interests while the interest of business rescue arguably has a public nature. In the core, this is an accurate qualification because the relationship between the debtor and its creditors and that among creditors is by definition a private relationship. Business rescue, on the other hand, has a public character since job preservation and the preservation of business value in terms of capital are public matters. This is not to say that there is no overlap between the identified interests. Private interests of creditors (to be informed) include public aspects as well in terms of business confidence and deal certainty. Business rescue as a public matter, on the other hand, will be in the interest

43 For UK law, see the considerations in the Cork report, supra, footnote 5, Cmnd. 1776–1778.
44 Generally, because there will be cases where the interests of creditors are aligned with business rescue. Different creditors have different positions with corresponding preferences, which can point in the direction of preservation of the debtor’s business against debt reduction.
45 For UK law, see for example the Government White Paper, ‘A revised framework for insolvency law’, 1984, Command paper 9175 where it is stated that a revised wrongful trading provision would constitute severe duties for directors which was deemed undesirable from the viewpoint of business rescue. In addition, see S. Mortimore QC (ed.), Company Directors, Duties, Liabilities and Remedies, Oxford: Oxford University Press 2017 (3), at 12.61 and 12.62. For Dutch law, reference can be made to case law of the Dutch Supreme Court in which it reiterates that the public interest requires that directors should not be guided by defensive behavior, which merits a high standard for directors’ liability against creditors. See hr 20 juni 2008, ecli:nl:hr:2008:BC4959, NJ 2009/21; HR 5 september 2014, NJ 2015/21.
46 Cf. the following consideration in the Cork report, supra, footnote 5 with regard to public interests surrounding insolvency: ‘[insolvency] Never (has) been treated in English law as an exclusively private matter between the debtor and his creditors; the community itself has always been recognized as having an important interest in them’, Cmnd. 1734. For Dutch law, the express stating of ‘public interests’ in case law, referred to in footnote 45, can serve as illustration.
47 See G.P. Fletcher, ‘Juggling with the Norms: the conflict between collective and individual rights under insolvency law’ in R. Cranston (ed.), Making Commercial Law: Essays in
of the creditors as well. Job and value preservation will evidently benefit the creditors of the debtor. This analyze of the involved interests explains why it is difficult for legislators and courts alike to define directors’ duties in (pre-) insolvency. In striking a balance between the mentioned interests, one interest cannot be said to have an evidently higher weight than the others.

3 Emerging Preventive Restructuring Tools in the Netherlands and the UK

3.1 Changing Landscape Insolvency Laws

Jurisdictions around the world are adjusting their legal frameworks to implement various types of mechanisms for distressed debtors to restructure their debts.48 Mechanisms for early debt restructuring have become an important part of the (pre-) insolvency laws of states. Different frameworks of debt restructuring can be distinguished. For the purposes of this paper, reference can be made to restructuring tools that are part of regular insolvency proceedings, such as the possibility to realize a restructuring plan involving some creditors within bankruptcy proceedings under Dutch law.49 Throughout the years, many jurisdictions have felt the urge to implement restructuring mechanisms outside regular insolvency proceedings that are primarily aimed at liquidation of the assets of the debtor. As liquidation proceedings are considered detrimental for the debtor in terms of devaluation of its business, new restructuring tools are intended to prevent this by offering instruments to restructure viable businesses at an early stage. These so-called preventive restructuring frameworks should enable debtors in financial difficulties to continue business by changing their capital structure in terms of adjusting the composition, conditions or structure of the assets and liabilities. The EU Preventive Restructuring Directive seeks to realize a minimum standard in Member States for preventive restructuring frameworks for debtors in financial trouble.50 The Directive points out that preventive solutions are a growing trend in insolvency law.51

honour of Roy Goode, Oxford: Clarendon Press 1997, at 393 who states that the provision of credit as part of trading ‘relies on assumptions, expectations and beliefs such as that the parties are acting in good faith and debts will be repaid’. This is a public matter as well.

48 Supra, scholarship mentioned in footnote 1.
49 See Articles 138-172a Dutch Bankruptcy Code.
50 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.
51 EU Preventive Restructuring Directive, Preambule, nr. 4.
This trend supports an approach that is unlike the traditional approach of liquidating a business in financial difficulties. Instead, its aim is to restore the business to a healthy state or at least save the units that are still economically viable. By virtue of the Directive, Member States that did not provide for a procedure that enables debtors to restructure their debts outside liquidation proceedings are obliged to design such in their national legal system. In light of the objective of this paper, the relevant aspects of the recently introduced restructuring mechanisms in Dutch and UK law will be outlined briefly hereafter.

3.2 The ‘Act on Court Confirmation of Extrajudicial Restructuring Plans’ under Dutch law

Until recently, Dutch law did not contain a framework for preventive restructuring. Only restructuring from bankruptcy proceedings and informal restructuring mechanisms without regulation that had developed in legal practice were available. Per 1 January 2021 the ‘Wet homologatie onderhands akkoord’ – Act on Court Confirmation of Extrajudicial Restructuring Plans – (hereafter: WHOA) entered into force. The WHOA introduces the possibility of a court-confirmed restructuring plan to restructure the debts of a company and consequently, to prevent the debtor from going into bankruptcy proceedings or to accommodate a controlled liquidation and distribution of the (insolvent) debtor’s assets to its creditors. The new procedure entails a so-called debtor-in-possession which means that the debtor (i.e. its board of directors) remains in charge of the affairs of the company. The procedure is intended as a flexible, quick and efficient mechanism for debt restructuring. The WHOA provides for a wide range of options to restructure a debtor’s assets and liabilities. These include deferring or partially releasing payment obligations, amending the terms of debt instruments or offering debt for equity swaps. Under the WHOA the debtor is also allowed to amend the terms of onerous contracts, involving, for instance, lease or long-term supply agreements. It is possible to include all creditors and shareholders of the debtor in a restructuring plan, however, the plan can apply to a certain category of creditors (for example secured creditors) as well. Aside from employees’ claims, the restructuring plan may constitute an amendment of the rights of any creditor or shareholder, including preferential and secured creditors, guarantors etcetera.

52 For a while, it was unclear whether the Dutch legislator regarded the WHOA as the implementation of the EU Preventive Restructuring Directive. On 2 February 2021 the government submitted a draft bill to the Dutch Parliament (‘Tweede Kamer’) in which it states that it considers the WHOA as the implementation of the EU Preventive Restructuring Directive. See Kamerstukken II 2021/22, 36040, nr. 3.

53 Explanatory Memorandum WHOA (Kamerstukken II 2018/19, 35 249, nr. 3), p. 21.
When the restructuring plan is approved by the relevant percentage of creditors and confirmed by the court, it will be binding on all creditors and shareholders involved in the restructuring plan. Upon certain safeguards, creditors and shareholders who have voted against the restructuring plan can be (cross-class) crammed down. This means, first, that creditors within a certain group can be overruled by their peers and second, that a group of creditors that has voted against the restructuring plan can be overruled as well.

3.3 New Restructuring Tools in the Corporate Governance and Insolvency Act 2020 under UK law

UK law already provided for a mechanism outside regular insolvency proceedings that enables distressed debtors to offer a restructuring plan to its creditors and shareholders involving the change of its capital structure. This so-called scheme of arrangement is set out in Part 26 of the Companies Act 2006 and is available to both solvent and insolvent companies. A scheme is an arrangement is a court-approved mechanism that enables a company to enter into an arrangement with its creditors and/or shareholders involving inter alia a restructuring of its debts. Subject to the receipt of certain voting requirements the scheme can be sanctioned by the court and consequently binding on the involved creditors and/or shareholders. Within the framework of a scheme under Part 26 of the Companies Act 2006 a cross-class-cram-down is not possible to the effect that dissenting classes of creditors and shareholders cannot be bound (only minority creditors and shareholders within a class can be overruled). With the recent enactment of the Corporate Insolvency and Governance Act 2020 the UK legislator, among other reforms, seeks to fill this void in an attempt to boost UK’s position in corporate debt restructuring.\(^5\) By virtue of the Corporate Insolvency and Governance Act 2020 a new restructuring tool is introduced that is modelled on the UK scheme of arrangement and similarly incorporated within the Companies Act 2006 rather than the Insolvency Act 1986. The tool is widely referred to as the ‘restructuring plan’ and implements a cross-class-cram-down by means of which the court has the discretion to impose the plan on dissenting classes of creditors or shareholders subject to certain safeguards.\(^5\) There is no insolvency test for court confirmation of the plan, however, for a company to be eligible for a restructuring plan

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\(^5\) Presumably, also to not fall behind the reform of restructuring laws within the EU due to Brexit. See J. Payne, ‘The Government announces radical changes to the UK debt restructuring regime’, Oxford Business Law Blog 2018, https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/government-announces-radical-changes-uk-debt-restructuring-regime.

\(^5\) Such as that the court should deem the plan fair, meaning that ‘none of the members of the dissenting class would be any worse off than they would be if the Plan were not...
it must have encountered, or be likely to encounter, financial difficulties that affect, or threaten to affect, its ability to carry on business as a going concern’ and ‘the purpose of the plan must be to eliminate, reduce, prevent or mitigate those financial difficulties’. A degree of existing or perceived financial distress is, therefore, necessary. Similar to the Scheme of Arrangement, the debtor (i.e. its board of directors) remains in charge of the affairs of the company during the preparation of the plan and no insolvency practitioner is appointed to administer, supervise or monitor the process. Due to its flexible nature and the benefits it offers compared to the scheme of arrangement, the restructuring plan is expected to become an important restructuring implementation tool in UK practice.

4 The Impact of New Restructuring Mechanisms on Directors’ Duties to Creditors During (Pre-)Insolvency

4.1 EU Restructuring Directive and Envisaged New EU Instruments
The EU Preventive Restructuring Directive, aside from minimum requirements in Article 19 that are to be discussed shortly after, does not provide for detailed rules on directors’ liability in the event the debtor faces financial difficulties. In considerations 70 and 71 of the Preamble, however, regard is had to the interests that are at stake in defining the position of directors of distressed companies. It is stated that for the sake of promoting a culture that encourages early preventive restructuring ‘it is important to ensure that directors are not dissuaded from exercising reasonable business judgment or taking reasonable commercial risks, particularly where to do so would improve the chances of a restructuring of potentially viable businesses’. On the other hand, it is acknowledged that when the debtor is close to insolvency ‘it is also important to protect the legitimate interests of creditors from management decisions that may have an impact on the constitution of the debtor’s estate, in particular where those decisions could have the effect of further diminishing the value of the estate available for restructuring efforts or for distribution to creditors’. The juxtaposition of the involved interests is consistent with the sanctioned’ (comparing it with what is likely to happen to the company otherwise).

Section 901G, subsection 3 Companies Act 2006.

See section 901A, subsection 2 Companies Act 2006.

The restructuring plan has already been used in a number of cases. For instance, Virgin Atlantic and Pizza Express have recently been restructured though a restructuring plan.

Preamble, consideration 70.

Preamble, consideration 71.
various, seemingly contradictory, interests discussed in paragraph 2.4 that set the stage for defining directors’ duties. As argued in that paragraph, the balancing of the various interests is an intricate exercise, which is presumably the reason why the EU Preventive Restructuring Directive expressively states that there is no intention to establish any hierarchy among the identified interests that require due regard.

As already mentioned, there are no clearly defined rules for directors in the EU Preventive Restructuring Directive. Article 19 provides that when there is a likelihood of insolvency, Members States shall ensure that directors have due regard to
(a) the interests of creditors, equity holders and other stakeholders;
(b) the need to take steps to avoid insolvency; and
(c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business.

Against the backdrop of these wordings, Member States retain much freedom to define directors’ duties in their national frameworks. Due to its open and vague character, article 19 is not expected to change the relevant laws of Member States in a significant way. For Dutch law, for instance, it has already been pointed out that article 19 will hardly affect national rules on directors’ liability.60 Interestingly, in recently issued documents on insolvency law in the context of a Capital Markets Union, the European Commission seems to anticipate on future regulation enhancing the convergence of insolvency laws that will encompass directors’ duties during (pre-) insolvency as well.61 It remains to be seen in what respect and how the European Commission’s plans regarding the convergence of insolvency laws will entail directors’ duties of distressed companies.

4.2 The Impact of New Restructuring Instrument on Directors’ Duties
Under Dutch and UK law
Aside from the EU Restructuring Directive, arguably, the rise of new restructuring instruments in the Netherlands and the UK will influence directors’ duties

60 Lennarts has argued this in 2017 with regard to the previous draft of article 19 which was even more detailed. See M.L. Lennarts, ‘Preventive Restructuring and Directors’ Duties and Liabilities in the Twilight Zone: The Dutch Perspective’ in NACIL-reports 2017: Directors’ liability in the twilight zone, Den Haag: Eleven International Publishing 2018, at 27–28.

61 Inception impact assessment d.d. 11 November 2020 (https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment) and Commission’s press release d.d. 25 November 2021. https://ec.europa.eu/commission/presscorner/detail/en/IP_21_6251.
to creditors during (imminent) insolvency. In this respect, these developments give rise to at least the following questions.

First, following the introduction of new restructuring procedures questions will arise on the need to implement additional provisions regarding directors’ liability. The question pertains to restricting liability. There are legitimate reasons to restrict directors’ liability in the context of restructuring procedures. As has been pointed out before, the rise of new restructuring instruments is driven by the desire to rescue viable businesses and thus avoid damage to the creditors and the public in general. In light of this, directors should be encouraged to initiate rescue activities at an early stage by using available restructuring mechanisms. If they have reason to fear personal liability too much, the set out policy goal will likely be undermined because directors will file for liquidation proceedings too early. The Dutch legislator has decided not to implement a specific provision on directors’ liability in the WHOA. Presumably, this is based on the reasoning that the doctrine of ‘ernstig verwijt’ which is the standard for directors’ liability provides for enough room and flexibility to deal with questions of directors’ liability in the context of the WHOA. It is true that the standard of ‘ernstig verwijt’ which is characterized by its highly open and adaptable nature enables courts to account for the specific circumstances of a restructuring procedure in respect of directors’ conduct. It is an open norm with a holistic assessment of directors’ conduct in a sense that his conduct, culpability and potential justification grounds are subjected to an overall assessment. From the viewpoint of directors, however, it can be argued that the standard is rather too vague and that more defined liability-restricting rules in the context of restructuring are preferable. In the UK, interestingly, the legislator had implemented a temporary suspension of the ‘wrongful trading’ rule under section 12 of the Corporate Governance and Insolvency Act 2020 which was related to the COVID-19 pandemic. The suspension was explicitly related to the COVID-19 pandemic and has already been ended, but it is interesting to see that for the sake of continuation of trade the UK legislator was ready to suspend the effect of wrongful trading based on the reasoning that directors of companies which are in essence viable but encounter cash flow problems should be helped to navigate through the economic uncertainty (due to the pandemic). To some extent, this reasoning can just as much be applied to directors trying to navigate a company out of financial trouble by means of a restructuring plan if the company is in fact viable. Similar to the Dutch WHOA, however, no specific rule under UK law has been adopted

62 Discussed in paragraph 2.3 of this paper.
63 The suspension ended on 30 June 2021.
restricting directors’ liability in the context of restructuring undertakings. The regular provisions thus remain in force.

Second, new restructuring instruments give rise to the question if existing rules on directors’ liability suffice to allow directors to get the company out of the financial trouble by negotiating a restructuring plan on the one hand and protecting the legitimate interests of creditors on the other hand? Whilst the first question discussed above is concerned with reasons to restrict liability, this question pertains to extending directors’ liability in the event new restructuring mechanisms are used. The issue of extending liability is legitimized by the fact that, even though the new restructuring mechanisms are intended to prevent insolvent liquidation, creditors’ interests are clearly at stake. For both discussed restructuring mechanisms under Dutch and UK law, the debtor is only eligible to benefit from the procedure if he endures financial problems. Under the WHOA it must be ‘reasonably likely that the debtor cannot continue to pay its debts’.

For the restructuring plan under the Corporate Governance and Insolvency Act 2020 the debtor must ‘have encountered, or be likely to encounter, financial difficulties that affect, or threaten to affect, its ability to carry on business as a going concern’.

In both jurisdictions, it is acknowledged that in case of imminent insolvency creditors interests intrude. As discussed in paragraphs 3.2 and 3.3, both restructuring mechanisms provide for the imposition of the restructuring plan on creditors and classes of creditors that have voted against the plan. It can be argued that creditors’ interests are sufficiently protected in the discussed restructuring mechanisms as both the UK restructuring plan and the Dutch WHOA contain provisions that aim to safeguard creditors’ interests. In particular the requirement of court approval of the plan, and the fact that in assessing the plan the court should have regard to the so-called ‘no creditors worse off’ test or its functional equivalent can

64 A jurisdiction that explicitly has adopted rules regarding directors’ liability within restructuring frameworks is Australia. It falls outside the scope of this paper to discuss this, but reference can be made to the so-called safe harbour reforms in 2017, which subject to certain requirements offers the director a safe harbor if he is undertaking a restructuring of the company.

65 Article 370 subsection 1 Dutch Bankruptcy Code.

66 Section 90A, subsection 2 Companies Act 2006.

67 For UK law, see e.g., Re Idessa (UK) Ltd (in liquidation) (Burke v. Morrison) [2011] EWHC 804 (Ch). For Dutch law, see the scholarship mentioned in footnote 28. In addition, J. van Bekkum in his commentary on HR 23 May 2014, JOR 2014/229 (Kok/Maas q.q.): “The more insolvency looms, the more a director must fulfil his duties in the interests of the creditors of the company.”
be regarded as warranties of creditors’ interests.\textsuperscript{68} There is truth to the argument that these requirements will function as safeguards of creditors’ interests in the discussed restructuring procedures. However, the question is if this is satisfactory in light of the following. First, directors’ conduct can easily harm creditors’ interests in the time prior to the commencement of a restructuring procedure by, for instance, paying certain creditors by means of a preference to the effect that less assets are available to include in the subsequently initiated restructuring plan under the WHOA or the restructuring plan. In the same vein, prior to the onset of the procedures, directors can incur debts of the company that will be cut or reduced in the subsequently enacted plan. The aforementioned safeguards in both restructuring procedures are not concerned with this situation. In addition, in both restructuring frameworks, the debtor remains in charge of the affairs of the company and no insolvency practitioner is appointed to monitor, supervise and investigate the dealings of the debtor before the commencement of and during the procedure such as is the case in liquidation proceedings.\textsuperscript{69} In sum, creditors’ interests are at risk given the financial situation of the debtor, the option to impose a plan on dissenting creditors and the lack of supervision and investigation of the dealings of the debtor prior to the entering of the restructuring procedure.

It is questionable if the current rules on directors’ liability strike the right balance in light of the implementation of new restructuring mechanisms. Under Dutch law, rules on directors’ liability traditionally focus on liquidation proceedings as has been pointed out in paragraph 2.3. A common requirement for liability is that directors know or ought to know that creditors’ interests will be infringed and this condition is generally met when directors know or ought

\textsuperscript{68} The ‘no creditor worse off’ (or best interest of creditors) test in the Dutch WHOA can be found in article 384 section 3 Dutch Bankruptcy Act and reads that on request of one or more creditors or shareholder who have dissented the court can reject the plan if these creditor(s) or shareholder(s) are worse off with the plan than in the event the assets of the debtor would have been distributed in liquidation proceedings (‘faillissement’). Regarding the UK restructuring plan, reference can be made to section 901G section 3 Companies Act 2006 which states that a cross-class-cram-down is possible if the court is satisfied that ‘none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative’. According to section 4 ‘the relevant alternative’ is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned by the court.

\textsuperscript{69} Under the Dutch WHOA the court can appoint a so-called ‘restructuring expert’ but his powers are limited. See articles 373, 376, 378 en 379 Dutch Bankruptcy Code. In liquidation proceedings under Dutch and UK law the insolvency practitioner has powers to avoid harmful transactions that the debtor has entered into before the opening of the proceedings.
to know that liquidation proceedings will be opened against the company. The aim of the WHOA is, generally, avoiding liquidation proceedings. However, as examined before, this does not mean that creditors’ interests are not at issue in the period leading up to and during the WHOA. In fact, their interests are at stake. With the existing standards for liability, directors can in principle avoid liability even if they show negligent behavior towards creditors’ interests in the period leading up to the WHOA as long as they are considered not to have foreseen liquidation proceedings. Similar remarks can be made with regard to the wrongful trading rule in the UK. The rule focuses on insolvent liquidation and administration, while the restructuring procedure that is introduced in the Corporate Insolvency and Governance Act 2020 is none of two. It is a restructuring procedure similar to the WHOA within which a restructuring plan can be imposed on dissenting creditors and classes of creditors of a debtor that is close to insolvency. In light of this, it is questionable if the wrongful trading rule provides sufficient protection to creditors’ interests. In the UK, additional protection might, arguably, be found in other sources of law, such as tort law and fiduciary duties discussed in paragraph 2.2, but these rules do not aim to prevent ‘insolvent’ trading in general, rather they aim to protect creditors’ individual interests.

5 Conclusion

New preventive restructuring mechanisms in Dutch and UK law affect various areas of law in the respective jurisdictions. Directors’ duties to creditors are not spared of their influence. Traditionally, rules on directors’ liability focus on preventing the debtor from trading while liquidation proceedings are unavoidable. In this situation, it is evident that creditors’ interest should have a dominant place in the mind of the director. With the emergence of preventive restructuring mechanisms, a new dynamic is created between the desire to rescue viable companies through restructuring its debts on the one side and protecting the legitimate interests of creditors on the other side. This new dynamic is characterized by the fact that liquidation proceedings are prevented

70 There is also section 213 Insolvency Act 1986 regarding fraudulent trading but the standard of proof here quite high since the liquidator must show that ‘the business of the company has been carried on with the intent to defraud creditors’. Carrying on a business for a fraudulent purpose requires that there has been dishonesty in the running of the business, see Re Bank of Credit and Commerce International S.A (No. 2), Banque Arabe et Internationale D'Investissement S.A v. Morris [2000], All ER (D) 1437.
in the event a restructuring is undertaken under the WHOA and the Corporate Governance and Insolvency Act 2020. However, liquidation proceedings out of sight does not mean creditors’ interests are out of sight as well. Different features of the discussed restructuring mechanisms indicate that the relevance of creditors’ interests remains unimpaired. Without prejudice to the reasoning that creditors’ interests are not exclusively protected through directors’ duties, this paper argues that the purpose of preventive restructuring combined with its potential of harm to creditors’ interests, in both jurisdictions gives rise to the question if the balance of interests defining directors’ duties is still proper.