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INSTITVTO IVRIDICO
FACULDADE DE DIREITO
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A NOVA PROPOSTA DE DIRETIVA SOBRE DIREITO DA INSOLVÊNCIA

HARMONIZAÇÃO DO DIREITO E DESENVOLVIMENTO ECONÓMICO

Coordenação **Alexandre de Soveral Martins**

A Nova Proposta de Diretiva sobre Direito da Insolvência

Coordenação:
Alexandre de Soveral Martins

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Índice

A hazy Passage between Scylla and Charibdys: Liability under the Proposal for an Insolvency Directive

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Resumo: Neste capítulo são examinados dois artigos da Proposta de Diretiva Europeia sobre a harmonização de certos aspetos do direito da insolvência, nomeadamente os artt. 36 e 37, que introduzem o dever dos administradores de uma entidade legal de iniciar tempestivamente um processo de insolvência e a correlacionada responsabilidade civil para o caso de incumprimento deste dever. Serão enfrentadas várias dificuldades interpretativas derivantes do significado incerto das normas contidas nestas disposições que dificultam grandemente a compreensão do âmbito aplicativo e a possível implementação destas regras a nível nacional. Conclui-se no sentido que estes artigos não irão alcançar sequer os objetivos de harmonização mínima da Proposta devido à própria incerteza e que ainda precisarão de uma considerável clarificação para contribuir eficazmente ao desenvolvimento do emergente direito da insolvência Europeu.

Palavras-chave: Deveres dos administradores; Processos de insolvência; Responsabilidade.

Abstract: In this chapter, we are going to focus on several interpretative difficulties stemming from the nebulous meaning of Articles 36 and 37 of the Draft Directive harmonising certain aspects of insolvency law (COM(2022) 702 final – hereinafter: the "Proposal" or the "Proposed Directive") which deal with the duty of the directors of a legal entity to file for an insolvency proceeding in a timely manner and the related civil liability for the breach of this duty. Our opinion is that these rules will fall short of even the minimum harmonisation goals of the Proposal because of their vagueness and the fact that they still need a great deal of clarification before they can contribute effectively to the development of the emerging European bankruptcy law.

Keywords: Directors' duties; Insolvency proceedings; Liability.

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In this chapter, we are going to consider a few aspects of the Draft Directive that sets out to harmonise certain aspects of insolvency law (COM(2022) 702 final – hereinafter: the "Proposal" or the "Proposed Directive") by focusing in particular on several interpretative difficulties stemming from the uncertain meaning of Articles 36 and 37, which deal with the directors' duty to file for insolvency proceedings in a timely manner and the related liability in the case they do not comply.

1. Just a preliminary note: the purpose of the legislative intervention, the European competence in the issue, and the relationship between the Proposal and European Company Law

While looking at the subject we are going to present, it is our belief that we must pay due attention to the very purpose of the proposed legislation. As has been explicitly stated in the preliminary documents – in particular the Impact Assessment Report – and in the text of the Proposal itself, the legal basis for adopting such an act is Art. 114 TFUE, which aims to approximate the legislations of Member States with a view to the "establishment and functioning of the internal market". This means that the Proposed Directive should offer a minimum of harmonisation, allowing the Member States which have implemented a more demanding or stricter legal framework on the same issues to maintain them; of course, this is naturally true also with respect to the directors' duty to "submit request for the opening of insolvency proceedings with the court no later than 3 months after the directors become aware or can reasonably be expected to have been aware that the legal entity is insolvent" (Art. 36).

This implies a series of preliminary questions on how the concept of "stricter" should be interpreted. For instance, it can definitely be related to the possibility that a Member State decides to shorten the deadline for the opening of the insolvency procedure, requiring the directors to file the request within 60 days of their awareness of the company's insolvency. This is surely justified by the wording of Art. 36, which only sets the maximum deadline of three months, with no reference to a minimum.

While this possibility seems admissible without great difficulty, it would be complicated to delve more deeply within possible modulations or specifications of the directors' duties. According to the European prospective rule, it is clear that they have to submit the request for the opening of the insolvency procedure; this should not hinder the Member States from imposing on them also additional duties of a different nature (such as the duty to prevent the crisis and avoid it by entering "voluntary" restructuring procedures), provided that *de facto* these additional duties do not thwart the directors from requesting the opening of the insolvency procedure. And, again, would a Member State's regulation which vests the standing to enter an insolvency procedure not only in the directors, but also in shareholders be compatible with the Proposal?

Furthermore, there are also strictly interpretative issues that might be dealt with in a different way from State to State: how are the directors deemed to be legally aware of the insolvency of the entity they manage? Is there a harmonised concept of an "insolvency proceeding"? and so on.

From these basic and preliminary observations, it is rather clear that even the minimum harmonisation goals of the Proposed Directive can be greatly endangered and frustrated by the vagueness of its undefined assumptions and also by the different interpretations that are likely to be given in the Member States, based upon the distinct legal traditions established in each country. And this might happen in an even more serious way if the substantive freedom left in these issues to the Member States turns out to become, at the end of the day, a race to the bottom, generating undesired discrepancies and hindrances to the rights of the creditors.

From a completely different perspective, but again at a preliminary stage, the question arises as to whether it is entirely sound that the European Union has a specific competence over the subject the Proposal deals with, and especially from the point of view of the articles we are considering.

If we agree with the general remark that the intervention of the European Union in the field of economy should aim to promote the single internal market and its development, and that this occurs in particular when the issues tackled have a cross-border character, we must immediately point out that in the Proposed Directive cross-border matters are barely detectable, in sharp contrast to Reg. (EU) 2015/848 (Insolvency Regulation). This conclusion is strongly supported by the Opinion of the Economic and Social Committee, where it is clearly stated that "the amount of insolvencies with a cross-border provision of credit does not exceed 20% of all cases and that data for the G20 countries show that an effective legal rights system only increases the level of Foreign Direct Investment (FDI) from 2 to 3% of GDP. Furthermore, a significant portion of FDI is due to corporate mergers and acquisitions of existing corporations rather than investment in new enterprises".

The Proposal is allegedly based on Art. 114 TFEU and the explanatory memorandum clearly states that Art. 81 TFEU, specifically focused on cross-border implications, was not suitable precisely because this piece of forthcoming legislation is not intended to regulate only cross-border insolvencies. The idea is, however, that disharmonies in the insolvency proceedings are likely to create barriers to the free movement of capital and well-functioning of the internal market. This brings us back again to the issue we have just mentioned: the lack of a stricter definition of the basic terms and instruments available during an insolvency proceeding makes the Proposal – in its current form – inadequate to reach the goals it should achieve.

Finally, if we scrutinize Articles 36 and 37 of the Proposed Directive more closely, it is clear that they relate to directors' tasks and duties and to more general issues of corporate governance, with a specific reference to the direction of the company during a situation of insolvency. The European Union traditionally has been having great difficulties in dealing with these aspects: it might suffice to think about the failure of the Fifth Draft Directive on Corporate Governance, proposed in 1972 and withdrawn in 2001, and about the fact that European legislation only tackles corporate governance issues in a limited number of documents, and generally only for larger enterprises.

In addition, it is worth mentioning the fact that the relationship between European Company Law and European Insolvency Law is rather peculiar, and even more so when compared to the analogous situation in the USA. In the United States, in fact, it is well known that each State has

its competence in the matters dealing with general company law, and that this situation has triggered a regulatory competition among the legislations of the States, which has resulted in Delaware emerging as a sort of a champion, at least when specific business sectors are at stake. Conversely, Insolvency Law – as well as Capital Markets Law – belongs expressly to the Federal level (Art. 1, sec. 8, clause 4, US Constitution), and therefore it is subject to a uniform law throughout the whole nation.

In the European Union the state-of-the-art is rather different, even if with some peculiarities. Indeed, we cannot say that there is uniform Company Law in the European Union, while there is a single Bankruptcy Code in the US. Nevertheless, it is widely known that European Company Law is mostly harmonized, at least when it comes to larger companies, while not only is Insolvency Law left to the regulation of each Member State, but even a unified notion of insolvency is lacking in the EU: again, this supports the conjecture that insolvency is highly prone to the possibility of competition – and not necessarily virtuous competition – among domestic legislations.

If we combine these two observations, the picture that we may infer is that the European lawmaker seems interested in indirectly promoting the adoption of some specific elements of corporate governance by means of insolvency law. Namely, the Proposal includes the already mentioned duty for the directors – and for the directors only, excluding any other corporate body – to submit the request for the opening of the insolvency proceeding. This means that a specific duty for the directors – which is of course a corporate governance issue – would be introduced by means of an insolvency law-related directive; and this would be applicable to any company … and even to business organizations other than companies, as we are going to highlight in a moment, since the Proposed Directive broadly speaks of "legal entities", and therefore not just companies (public and private), but also partnerships, cooperatives, and so on.

2. The legal entity

Should the Proposal be approved, Art. 36 is very clear in stating that it would be the duty of each Member State to ensure that the directors of legal entities which have become insolvent are obliged to submit a request for the opening of insolvency proceedings. The first issue we encounter is that it is not clear what the wording "director of a legal entity" actually means, and in particular what is meant by "legal entity".

Actually, the notion is anything but clear in its definition, and depends very much on the jurisdiction of reference. We believe that the overall language of Art. 36 is meant to rule out natural persons from the scope of the Proposed Directive, since not only does it comprise "legal entities" (and this concept, obviously may have different meanings in every jurisdiction), but mainly because this notion is tied to the action of one (or more) director(s): this persuades us to think of an organization established by the law which operates through one (or more) physical person(s) who compose a representative body.

So, even if, for instance, section 69.3 of the Austrian Insolvency Code dictates that natural persons are also subject to insolvency proceedings (without specifying that they must be an

entrepreneur), the fact that Art. 36 of the Proposal mentions directors should be sufficient to exclude natural persons from the entities considered by the Proposed Directive. In such a scenario, natural persons will be subject to insolvency proceedings, but the provisions set by the Proposal, if approved, would not be applicable to them, unless the national lawmakers freely decide to make them so, thus locally expanding the positive scope of the European rule.

Broadly considering legal organizations, we should distinguish between those fully devoted to business activities, and those that may perform a wider array of activities, with business as just one of them. Business entities are certainly covered by the Proposal, as bankruptcy (and, of course, insolvency, its prerequisite) is a remedy primarily linked to the entrepreneurial ecosystem: that stated, we deem that partnerships and companies are clearly included in the concept of legal entity used in the Proposed Directive. For entities not exclusively devoted to business activities, conversely, once again everything depends on the relevant national law in force: whether this piece of legislation will be applicable, for instance, to associations, foundations, consortia, *agrupamentos complementares de empresas*, *groupements d'interêt economique* and other similar organizations and, from a European standpoint, to European Economic Interest Groupings, is an issue for national lawmakers and the courts. Once again, we encounter a feature of absolute relevance, as the definition of the entities subject to the Directive-to-be seems to lie dangerously outside the scope of harmonisation.

In any case, another rule set out in the Proposal should always be kept in mind: Art. 56 lays down that when the entity is a sole entrepreneur or a microenterprise and enters a simplified winding-up proceeding, the entrepreneur, the founders, the owners and the members of such an enterprise "who are personally liable for the debts of the microenterprise are fully discharged from their debts in accordance with Title III of Directive (EU) 2019/1023". Naturally, this safe harbour gives great relief to the members of the entity even when the entity form itself would not protect these individuals' personal patrimonies. However, looking at the situation through the creditors' eyes, they would most probably not be satisfied with the personal patrimony of the micro-entity's members in any case. Therefore, practically speaking, the inclusion or the exclusion of these entities among those covered by the Proposal does not seem to be overdramatized, as non-micro entities are often (reasonably) incorporated as companies. Of course, for the remaining cases of non-micro entities, not established as companies or partnerships, once again we can find room for regulatory competition or divergence which frustrates harmonisation.

3. The concept of insolvency

Both Articles 36 and 37 refer several times to the case of a legal entity being insolvent, and the directors' duty to submit a request for the opening of insolvency proceedings; once again, however, we face a problem of definition, as Art. 2 of the Proposal does not specifically define what insolvency is. This has also been criticized by the Economic and Social Committee in its Opinion: "The proposal falls short of providing a harmonised definition of insolvency grounds and the ranking of claims, both of which are key to achieving greater efficiency and limiting the

existing fragmentation in national insolvency rules". Basically, the Proposed Directive has left this task to each Member State. This is evident in Art. 23 where it grants every EU legislator the possibility to define a situation of insolvency or likelihood of insolvency during the preparation phase of a pre-pack proceeding, in which a debtor can benefit from a stay of individual enforcement actions. This is similar to what has already happened with the "Insolvency 2 Directive" (dir. (EU) 2019/1023 on preventive restructuring frameworks), which explicitly stated that the concepts "insolvency" and "likelihood of insolvency" should be understood as defined by national laws (Art. 2, par. 2, dir. (EU) 2019/1023).

Actually, the Proposal supplies a partial definition of insolvency only in Art. 38 while dealing with the rules concerning winding-up microenterprises. Pursuant to such a notion, the (micro)enterprise is deemed insolvent "when it is generally unable to pay its debts as they mature". Clearly, it is a very broad definition, further extended by the adverb "generally" which adds to the lack of clarity. The decisive element, however, is not just the ambiguity of the definition *per se*, but the fact that its scope is explicitly limited (by Art. 38 itself) to "the purposes of simplified winding-up proceedings" applicable to microenterprises, and therefore it has no general applicability.

In addition, the definition in Art. 38 only describes some symptoms of one of the many possible variations of the notion of "insolvency" that can be found in the Member States' domestic legislations. Furthermore, the interpretation of this term varies broadly from one court to another even if the phrasing of the national definition of insolvency corresponds to that of another Member State: inability to pay debts when due, likely inability to pay debts, inability to regularly satisfy one's obligations…).

While some States define insolvency as a cessation of payments – along with the idea behind the notion present in Art. 38 – and therefore base their definition on a notion of illiquidity (or imminent illiquidity) which considers the entity's cash flow, other Member States adopt a definition grounded on the performance of a balance sheet test, and therefore linked to the indebtedness of the entity. But this is not the whole picture, since other domestic Bankruptcy Laws combine these two factors. In this respect, we can easily affirm that the most relevant definition for the entire subject discussed here – i.e.: "insolvency" – is ambiguous throughout the European Union, and this becomes all the more uncertain if we take into consideration the extent of the powers that insolvency courts are given under every jurisdiction which naturally vary from country to country. This is another extremely significant factor, as the Impact Assessment Report of the Proposal also correctly points out.

In any case, and this is the most relevant general contribution offered by Art. 38 and its definition, we can argue that the inability to pay mature debts by the (micro)entity should be always held as a symptom of insolvency, irrespective of the definition adopted by the individual Member State. If such a definition is cash-flow-based, then the notion will be already coherent and thus sufficient to identify an actual insolvency. If, on the contrary, the State adopts a balance sheet/ /indebtedness-based approach, then the inability to pay could be considered as an indicator that has to be eventually confirmed by the economic results. This combination, then, is present when the domestic definition of insolvency relates to both cash-flow and balance-sheet tests.

Lastly, although the idea of the cessation of payments of the mature debts looks rather simple to assess theoretically speaking, it is not necessarily so in practice, and therefore the Member States must set out the conditions for such an evaluation, and these conditions must be "clear, simple and easily ascertainable" by the (micro) enterprise concerned. Of course, the same principle should work when it comes to entities that are not micro-enterprises, but once again this depends on the Member States. A positive – even if somewhat unintended – fallout of the Proposal, if approved, might therefore be that, as the Member States are called on to ensure these "clear, simple and easily ascertainable" indicators for the cessation of payments of mature debts where a microenterprise is concerned, they will most probably also apply the same notion to larger entities. By this means they may achieve if not full harmonisation, which is not possible due to the different concepts of insolvency present from State to State, at least a (more) level playing field when it comes to the interpretation of cessation of payments.

4. … and the related concept of an "insolvency proceeding"

At the risk of being repetitive, we have to point out another fundamental missing piece of the puzzle contained in Art. 36 of the Proposed Directive: the meaning of the expression an "insolvency proceeding". This notion is, at best, fuzzy if not inconsistent, even within single jurisdictions, and avoiding the quest for its definition undermines any possible effort towards harmonisation.

In fact, while it could be easy for the scholar to outline a conventional umbrella definition of an insolvency proceeding as a collective enforcement procedure aimed at liquidating the estate of a debtor and distributing the proceeds to the creditors, the multifaceted and ever growing landscape of legislative realities that can be observed across the EU will immediately render impracticable – or, anyway, extremely difficult – any attempt to apply this theoretical concept to jurisdictions where there are several proceedings whose purpose is the liquidation of the estate of a debtor. It is true that these proceedings are sometimes blended with other functions to a greater or lesser extent (this is the case of Italy and France, for example), or to jurisdictions where one can find a single complex of proceedings which can fulfil all purposes (as is well known, this happens in Germany).

Leaving abstract definitions aside, it seems on the one hand that no further clues to the meaning of "insolvency proceedings" can be inferred from other pieces of EU legislation and, on the other, that a series of hints present in the Proposed Directive could probably lead to a narrower, although problematic, connotation of this expression.

At European level, the systematization of insolvency law is increasing considerably, but it is still at a very early stage and the two main pieces of legislation in this field, the (recast) Insolvency Proceedings Directive – reg. (EU) 2015/848 – and the "Insolvency 2" Directive, are not connected with each other despite the fact that the latter should be "fully compatible with, and complementary" with the first: recital no. 13 of the "Insolvency 2" Directive. In addition, they leave a huge unregulated space between them that the Proposal is supposed to fill up: Art. 1 of the Insolvency

Proceedings Directive contains an all-encompassing description of the proceedings that fall within its scope, which also includes those whose purposes are to avoid the debtor's insolvency or the cessation of the debtor's business activities through the adjustment of debt, the rescue or the reorganization of the business entity. Annex A of the Insolvency Proceedings Directive reflects this fundamental choice and thus exhibits a long list of proceedings from each EU jurisdiction that must be deemed "insolvency proceedings" (Art. 2, par. 1, no. 4). But setting aside the fact that these proceedings are so heterogeneous that it has been seriously questioned that they could belong to a single category, they are merely put together with a view to allowing their automatic cross-border acknowledgment by other Member States (which is also explicitly extended to restructuring proceedings).

Hence, the specific function and goals of the Insolvency Proceedings Directive make it impossible to lean on the definition of its positive scope or on its Annex to shed some light on Art. 36 of the Proposed Directive. This applies also to other special definitions of insolvency proceedings provided only for the purposes of the regulation or directive that employs them (such as the protection of workers – Art. 5, par. 1, Directive 2001/23/EC or Art. 2, par. 1, Directive 2008/94/EC –, the reduction of legal risks associated with the participation in settlement systems – Art. 2, par. 1, lett. j, Directive 98/26/EC – and so on…) and to sectorial provisions like those dealing with banks, insurance undertakings and other financial institutions.

Having refuted the possibility of reconstructing the notion of insolvency proceedings through a systematic analysis of EU law, we will engage in a closer examination of the Proposal to discover those clues that could suggest the adoption of a somewhat narrower concept of an insolvency proceeding, namely a concept which is surreptitiously limited to (involuntary) collective liquidation proceedings only.

First of all, it should be noted that with the "Insolvency 2" Directive the EU made its first move to "prevent job losses and the loss of know-how and skills, and [especially] maximize the total value to creditors". This quotation is taken from recital no. 2 of the Directive, but the augmentation of the returns to all types of creditors and investors is also paramount in recital no. 15. The "Insolvency 2" Directive supports the view that preventive solutions – and particularly early restructurings – (should) ensure a higher recovery rate for creditors in comparison to what they would receive after a (usually piecemeal) liquidation of the debtor's estate. Time is of the essence too, since it is acknowledged in the remarks on the consistency with existing policy provisions of the Proposed Directive that "there is a much greater chance of saving ailing businesses when tools for restructuring their debts are accessible to them at a very early stage, before they become definitively insolvent".

This line of thought has implicitly come to consider liquidation proceedings a wasteful solution to insolvency-related problems and this becomes clear when their expected results are systematically used as a term of comparison to establish whether a better outcome could be offered to creditors through (voluntary) restructuring proceedings. So, instead of making collective liquidation procedures more efficient, the EU legislator has subtly considered them to be a part of the problem and then turned its attention to a strenuous attempt to prevent them.

This option was coherently upheld in the Proposal, in which one can read the following remarks: "Preventive restructuring procedures (Title II of Directive (EU) 2019/1023) are schemes which are available for debtors in financial distress *before they become insolvent*" and "they do not address the situation where a business becomes insolvent and has to undergo insolvency proceedings".

Besides this, the Proposed Directive does not deal only with the regulation of certain aspects of the liquidation proceedings, but also – once again – with their avoidance by means of pre-pack proceedings which predetermine the results of a subsequent collective liquidation assuming that "more value can be recovered in liquidation by selling the business (or part thereof) as a going concern rather than by piecemeal liquidation" (recital no. 22). This assumption can be easily proven wrong since many jurisdictions already impose that the insolvent debtor business should be preferably transferred as a whole, rather than on a piecemeal basis. Nor do pre-packs necessarily provide for a universal sale of the business of the debtor since it is explicitly admitted that only "a part thereof" can be the object of such proceedings. It is unfortunate then that there is no general guidance or limitation on the possible partitions of the debtor's business that can be realized via a pre-pack procedure: they only have to pass the best-interest-of-creditors test (Articles 2, par. 1, lett. h, and 22, par. 2, lett. d, of the Proposal), which seems quite easy to satisfy, because the term of comparison is the estimated level of satisfaction of a creditor if the normal ranking of liquidation priorities were applied in the event of a piecemeal liquidation. There is also a risk that pre-pack proceedings may be misused since they can be started in a situation of mere likelihood of insolvency as a manoeuvre to force the creditors to accept a lower level of recovery, that nevertheless is "certified" to be higher than the hypothetical recovery expectation from a liquidation.

The same skepticism about liquidation proceedings that is inherent to pre-pack proceedings is even more evident in the regulation on the winding-up of insolvent microenterprises (Title VI of the Proposed Directive), that was conceived to mitigate the costs and reduce the duration of the proceedings regarding these entities.

Without lingering on the shortcomings of the winding-up procedures, it should be reiterated that the problem that the EU legislator seems most concerned about is the combined untimeliness and (redistributive) inefficiency of ordinary liquidation proceedings rather than the consequences of insolvency itself. In fact, one can infer that precisely these types of proceedings are taken into consideration when the explanation of Title VI of the Proposal states: "In many Member States, no orderly *liquidation* of such businesses takes place as standard *insolvency proceedings* are not accessible or the opening of such proceedings is rejected".

So, if based on these observations one has to assume that voluntary restructurings (whose commencement has been significantly anticipated by the "Insolvency 2" Directive) are the proceedings that systematically pay off the most to the creditors of an entrepreneurial entity, it is almost inescapable to reach the ancillary conclusion that the (late) opening of liquidation proceedings is *per se* prejudicial for the creditors and that the directors should bear the liability for the delay, as stated in Art. 37 of the Proposed Directive (closely tied to recital no. 33, which unambiguously

declares: "Directors should compensate creditors for the damages resulting from the deterioration in the recovery value of the legal entity compared to the situation where the request would have been submitted on time"). Also, if both restructuring and liquidation proceedings can be triggered by a situation of insolvency, the former appear to be on the whole preferred by the EU legislator because of their (presumed) higher recovery ratio. Nevertheless, after (a maximum of) 90 days of insolvency the horizon of potential choices narrows down to one possibility: filing for insolvency (see recitals nos. 32 and 33).

Finally let us focus on the expression "insolvency proceedings": it is consistently used throughout the text of the Proposal to refer only to liquidation proceedings, and this is corroborated by the remarks that we have quoted earlier and, in addition, by its appearance in the explanatory comments to Art. 6: "These are legal acts that benefited a creditor (or a group of creditors) and were carried out within 3 months before the *filing for insolvency proceedings* or after the filing ('suspect period')". Avoidance actions can be pursued only within liquidation proceedings, so it is coherent that the suspect period is calculated retroactively from the beginning of the proceedings in which these actions can be brought on behalf of a debtor's estate. This argument is not weakened by the fact that the suspect period could be backdated to the beginning of a previous restructuring proceeding because this implies that the (failed) attempt to rescue the business has been followed by a liquidation procedure during which the avoidance actions can be used.

The conclusion that seems to be drawn, then, is that the Proposal implicitly conceives liquidation proceedings as an inferior and potentially detrimental alternative for creditors, a scenario which can only become worse as time goes by, thus justifying the directors' liability for the delay. All these reasons support the view that when Articles 36 and 37 of the Proposed Directive mention "insolvency proceedings" they refer more precisely only to liquidation proceedings, leaving aside voluntary restructuring proceedings (and also the pre-pack proceedings). This observation is also consistent with the regulatory perspective, as other European legal instruments specifically deal with restructuring tools.

This preconception does not take into account the fact that restructuring proceedings can also be untimely or that they can result in a fractional liquidation or that, on the other end of the spectrum, liquidation proceedings can be instrumental in the preservation of a business as a going concern and that most jurisdictions give preferentiality to the transfer of the whole business over a piecemeal liquidation. Hence, if any liquidation is initiated in a timely manner and it is structured to be as swift as the protection of the rights of all participants allows, its recovery level should not be worse off than a restructuring procedure.

Lastly, it is our opinion that if the 90-day term applies only to the opening of collective liquidation proceedings, it may set off an involuntary consequence: on one side of these three months stands the last chance of restructuring, while, on the other, there is only insolvency, meaning the loss of the possibility for the debtor to remain in possession of its estate and direct its liquidation.

On a positive note, if the local jurisdiction uses the situations of insolvency and of likelihood of insolvency interchangeably as triggering prerequisites for both its restructuring and liquidation proceedings (as happens in Italy), this specific temporal watershed may indirectly restore a

residual order among the proceedings that can be initiated by (or against) a distressed entity. One main problem however remains: the ambiguity and polysemy of the concept of "insolvency" that we have pointed out in the previous paragraph makes it extremely difficult to determine when this 90-day term starts (and all the more so on a cross-border basis, with the additional possibility of some Member States shortening this time frame).

5. The notion of "directors"

The last definitory observation deals with the notion of directors, as the duty to submit the request for the opening of insolvency proceedings explicitly refers to them in Art. 36, and according to Art. 37 they also face a specific civil liability in case of noncompliance. Recital no. 32 of the Proposed Directive does not help very much in reducing the range of possible interpretative options, when it states that "the notion of 'director' should be *interpreted broadly*, to cover all persons who are in charge of making or do in fact make or ought to make key decisions with respect to the management of a legal entity" (a formula almost literally borrowed from the UNCITRAL Legislative Guide on Insolvency Law) since as we are about to explain, not all directors who manage an entity can also act on its behalf. An excessively broad interpretation may also turn out to be harmful to those persons who can take fundamental decisions for an entity, but are not responsible for its management (as may happen, for example, for the shareholders who can decide to voluntarily dissolve the company they belong to, but cannot generally be held responsible if they fail to do so in a timely manner, since they lack the powers – and the duty – to ascertain if the entity is approaching insolvency or has become insolvent altogether).

Naturally, the issue is also closely linked to the already examined aspect of defining the legal entities subject to the Directive-to-be: as the legal entities might have several different forms, with different rules when it comes to their management, the notion of director should be interpreted, in a case-by-case approach, looking at the rules applicable to each one of such forms. This turns out to be not particularly easy even if we only take into consideration partnerships and companies.

In fact, if it is true that in the majority of the European Member States the directors of public or joint-stock companies are given exclusive managerial power, which would be completely in line with the provision on the duties according to Art. 36, and that relating to the liabilities, referred to in Art. 37, this is not always the case in private companies, and even less so in partnerships, which are nevertheless to be considered as legal entities, falling within the scope of the Proposed Directive.

In these circumstances, in fact, directors and one or more members of the entity often share the management of the organization; and this happens not only when the member or the partner is a *de facto* director, but for the (legislative or voluntary) allocation of managerial powers also to people that are not appointed as directors. In these cases, who would be responsible for starting an insolvency proceeding pursuant to Art. 36? For sure, it will be up to the formally appointed directors, even if it would be extremely relevant to consider the way in which the will

of the board of directors is expressed towards third parties (and especially whether each one of the directors has this authority or if they have to take a preliminary decision within the board, etcetera). As regards this particular situation, it should be stressed that the (already) uneven level of harmonisation established by the former First and Second Company Law Directives (now restated in the Directive (EU) 2017/1132) has been frustrated by the Insolvency 2 Directive, which allowed Member States to forbid equity holders the right to vote on a restructuring plan (provided that they would not receive any consideration if the normal liquidation priorities were applied) and to derogate from the requirements concerning the obligations to convene a general meeting and to offer shares on a pre-emptive basis to existing shareholders (especially Articles 68 and 72 of Directive (EU) 2017/1132), to the extent and for the period necessary to ensure that shareholders do not abusively frustrate restructuring efforts (recitals nos. 57 and 96 of Insolvency 2 Directive). Along these lines, a series of provisions of the Directive (EU) 2017/1132 was accordingly rendered modifiable by Member States pursuant to Art. 32 of the Insolvency 2 Directive, generally making it easier for directors to proceed independently of the shareholders or even without consulting them at all.

Anyway, the true question is: is there an obligation to submit the request for the opening of insolvency proceedings on the other managing parties as well?

Actually, the issue should be dealt with considering not only the managerial/executive power, which might lie with all the people we have mentioned so far, but, more broadly, taking into consideration the power to represent and act on behalf of the entity, which is usually linked to the managerial authority, but is conceptually distinguished from it. As the request for the opening of insolvency proceedings (and this is true for every lawsuit) is made on behalf of the entity, it has a specific relevance outside the entity itself, and, to this purpose, we are dealing with legal standing, i.e. with the legitimate possibility for the party to validly act in a court of law on behalf of the entity when submitting such a request.

Again, this is a topic that is partially harmonized in European Company Law, specifically when it comes to companies. This has been the case since 1968 and the First Company Law Directive – whose rules, as previously pointed out, are now codified in the Directive (EU) 2017/1132, for instance in Articles 3 and 9. The harmonisation deals with both the possibility for third parties to be aware of who the persons are, within the company, who have the power to represent it; and the substantive extension of such a power. In the other organizations, partnerships, associations, and so on, such a harmonised framework is not available. In spite of the wording of Art. 36, which seems to be quite straightforward, this is very likely to create doubts about the actual powers (and especially about the legal standing) vested in the people and bodies for the submission of the request, therefore triggering a further lack of substantive harmonisation.

Lastly, we are inclined to think that also *de facto* directors should be liable for the untimely opening of an insolvency proceeding, even if they cannot directly file for it: in fact, since they are not formally vested with any power to act on behalf of the entity they factually run, they are also deprived of legal standing. This does not mean that their hands are tied, because they can try to persuade any other *de jure* director(/s) to request the opening of these proceedings, or

else they can address a petition to a public officer who has the power to apply for a court decision in the public interest. Anyway, by choosing to manage an entity without a formal investiture, they shall bear all the drawbacks of the power that they have informally seized and it will be much more difficult for them to be discharged from their liability.

6. The directors' liability for the late filing for insolvency

All of the tesserae of this indistinct mosaic that we have so far taken into consideration separately should be finally combined in order to grasp the nature of the problem that the Proposal is tackling and how effective the remedy intended to solve it actually is.

First of all, we must point out that the Proposed Directive does not add anything new to the kind of response that every jurisdiction in the EU already sets forth for the case of the delayed beginning of insolvency proceedings: even if with a variety of legal prerequisites and an assorted array of judicial interpretations, the directors (and also other officers) of an entity reasonably face the risk of turning into the target of several actions to force them to compensate creditors and other parties for the damages suffered.

Secondly, the Proposal does not contribute in any way to harmonizing these differences that can be found across jurisdictions in respect to direct and derivative actions that may be filed against the directors: on the contrary, it expressly refrains from interfering with national rules on civil liability for the breach of the duty for the timely opening of insolvency proceedings that are stricter towards directors (Art. 37, par. 2, Proposed Directive).

In a nutshell, we may affirm that Art. 37 does not really change anything in the legal context of the EU Member States, except that it adds a maximum time limit for filing for insolvency (which, incidentally, is longer than most deadlines already in place in some major EU jurisdictions: Belgium – one month; France – 45 days; Germany – three to six weeks; Netherlands – 30 days; Poland – 30 days; Spain – two months). Therefore, it may be relevant only for those States whose legislation does not define any deadline.

However, besides the fact that there can be significant variations from State to State regarding this deadline, we have already argued that it may not be particularly useful to introduce a time limit if the situation of insolvency at the very beginning of the countdown is not defined.

Nevertheless, the fact that beyond this indefinite moment in time directors will become liable for their failure to act might cast some doubts on the extent of their liability for not having reacted earlier to the situation of distress that the entity they manage may have previously faced: in other words, if they are to compensate creditors for the "damages resulting from the deterioration in the recovery value of the legal entity" (recital no. 33) caused by their delay, why should this liability arise only after 90 days of being aware of the situation of insolvency? On the other hand, how can we be sure that the premature initiation of a restructuring/insolvency proceeding is not detrimental for the creditors?

One may think that the directors' inaction during the period prior to this deadline is left in a shadow cone which can lead to opportunistic behaviours and may not be coherent with the

general trend which supports early restructurings and the widespread persuasion that conceives a gradual shift in the directors' duties towards the protection of the interests of the creditors in the vicinity of insolvency.

By contrast, the clear light that Art. 37 of the Proposed Directive shines on the directors' liability for their protracted inaction after the 90-day deadline may be read in some jurisdictions as a form of strict liability, which merely stems from the failure to make a timely filing for insolvency proceedings, without any possibility of exoneration for the directors.

We support the idea that both of these conjectures should be rejected, but the vague text of the Proposal is not helpful to its own cause, since it does not introduce a serious incentive for the directors to promptly tackle a situation of distress, crisis or insolvency. In addition, a liability issue becomes absolutely irrelevant when it comes to directors who are already jointly and severally liable for the obligations of the entity they belong to: they will be most likely indifferent to this stimulus to (re)act promptly.

To put it differently: if the goal here was to urge the directors to act in the best interest of the creditors and preserve the recovery value of the legal entity, then it has not been remotely achieved.

Alternatively, if the Proposed Directive purpose was to boost the limited recovery value of liquidation proceedings by fishing into the directors' pockets, it is not at all innovative and it can be questioned under another perspective.

In fact, we believe that the directors cannot always and automatically bear the responsibility for the entire deterioration in the recovery value of the legal entity referred to by recital no. 33 of the Proposal: the paramount problem of defining the amount of the compensation was avoided by the Commission, but it has been the core of several court decisions and scholarly contributions, which over time have highlighted the manifold conundrums and inconsistencies that lie behind oversimplified (and often presumptive) criteria proposed to quantify the damages in such complex situations. It is unquestionable that dishonest directors should not benefit from their own wrongdoing, but most times these criteria tend to be far more comprehensive than the actual (and direct) consequences of the directors' behavior would justify.

Before summing up the results of this research, we would like to draw the attention of the reader to one last obstacle, that may now be more relevant for the EU Legislator, than it actually is for entrepreneurial entities.

As we said in the section 1 above, there have already been a few failed attempts at reforming corporate governance issues by altering the civil liability of the directors and the indirect intervention represented by Art. 37 of the Proposed Directive could become another example of these failures: first of all, the question of the duties of the directors falls outside the limits of the competences that have been conferred upon the EU and, secondly, it can be seriously doubted that the principles of proportionality and subsidiarity can justify a very specific modification of the duties of the directors – and of the directors alone – of insolvent legal entities at the EU law level. There is also a serious risk in dealing with such a delicate subject using a sectorial approach: the result could be a special hypothesis concerning directors' liability which is not only different from other cases ordinarily covered by national company laws, but may also risk creating a

serious disruption in respect to the overall legal framework of legal entities, whatever their activity and their economic and financial conditions might be.

7. Final remarks

In this short essay, we have briefly highlighted the main critical points that we believe can be found in Articles 36 and 37 of the Proposal, dealing with the Directors' duty to request the opening of insolvency proceedings and their civil liability in case of noncompliance.

The main issue, which undermines the very purpose of the Proposed Directive, is the lack of many relevant definitions. In the Proposal not only do we not find a definition of insolvency, which is *per se* rather troubling for a Directive aiming at "harmonising certain aspects of insolvency law"; but also key definitions such as "legal entity", "insolvency proceedings", and even "directors" are missing. Insofar as this is possible, a possible suggestion would be that the European lawmakers might try to clarify at least some of these profiles, possibly by cross-referencing other pieces of legislation, and extrapolating, where feasible, the guiding principles of such rules.

A second relevant aspect is the lack of coordination between this Proposal and the "Insolvency 2" Directive. Clearly, the Proposed Directive discussed here has to do with an insolvency that has already taken place, which is not necessarily the case for the "Insolvency 2" framework, where the situation is the vicinity of the insolvency. Nevertheless, the problem is the fact that insolvency in some cases might also be a reversible situation; in this eventuality, the efficacy of the solution we can find in Art. 36 depends on the meaning of an "insolvency proceeding", which is among the undefined concepts, as we have already pointed out when trying to offer a solution. At this point, a better coordination of the two Directives might be more than desirable for the sake of the best outcome of the crisis.

Again, and very closely related to this last observation, we have some concerns regarding the directors' duty when they become aware of the entity's insolvency. More specifically, it seems at best debatable that the most appropriate solution is a duty to submit the request for insolvency proceedings, and, for instance, not just to take the "most appropriate" measures. In this respect, the suggestion is to maintain here the same approach the Proposal has used in general, i.e. leaving the Member States more wiggle room. In fact, we cannot rule out that some of the alternative measures available in the different Member States may be more adequate and effective for solving a problematic situation than "insolvency proceedings". Nevertheless, the wording of Art. 36 might prevent directors from using them, as the only possible choice would be an insolvency proceeding. And this is even reinforced – and improperly reinforced if the outcome of our view is shared – by the directors' liability in case of their failure to submit the request for the opening of insolvency proceedings, which nevertheless raises doubts in its actual applicability in the different Member States with different director liability frameworks.

Finally, we have seen that this entire system puts the burden of liability on the directors, but keeps out of the equation, for instance, the unlimited members of partnerships, and in general the parties who have not been formally appointed as directors. The solution is understandable

from the legal policy standpoint, but the role of such members risks being severely underestimated, and so possibly the difference itself between the forms of legal entities could be evened out. And this looks to be far beyond the scope of intervention of the Proposed Directive.

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