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"Directors' fiduciary duties in proximity of insolvency, in Europe and the USA "

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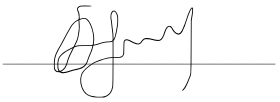

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Abstract

In the modern corporate governance, directors bear a complex array of responsibilities, balancing moral obligations with legal duties. This thesis explores the complex framework of types of directors and fiduciary duties, especially as companies move toward the critical threshold of insolvency.

Focusing on the legal scholarship surrounding fiduciary duties and insolvency law as well as preventive restructuring frameworks in the US and EU, enriched by detailed case analyses and discussions of relevant directives, this thesis sheds a light on the complexity of directors' fiduciary roles, providing a understanding into the challenges and obligations they face when steering companies through financial turbulence. Central to this examination are benchmark court cases, such as the North American Catholic Educational Programming Foundation, Inc. v. Gheewalla (or,simply, the 'Ghewalla case') and the Athilon Capital Corp and Indenture Agreements (or, simply, the 'Quadrant case') in the United States, and Grant v Ralls, 'BTI 2014 LLC v Sequana SA' , Re Noble Vintners Ltd. (or, simply, the ‘Sequana’ case) in UK.

This graduation paper aims to offer a comprehensive analysis of legal principles and practical examples, the research aspires to make a significant contribution to the discourse on corporate governance, offering practical recommendations for directors, policymakers, and stakeholders involved in managing financial distress. As it will be argued, those aspects can only be measured after a comprehensive assessment of a variety of country-specific factors that will affect the optimal design of insolvency law. Therefore, any global index seeking to measure and compare the “desirability” of different insolvency systems will inevitably face various flaws and methodological limitations that might affect the accuracy of the index.

I Introduction

The concept of corporate governance exhibits variations across different countries, jurisdictions, and individual companies, shaped by a complex interplay of social, economic, historical, and cultural factors. As indicated in what could be addressed as the first example of corporate governance code, addressed to UK public limited companies, the specific definition and application of corporate governance principles can diverge significantly based on the unique legal frameworks, societal norms, and cultural influences present in each context. A number of definitions refer to a corporate system by which the companies are directed and controlled.[1]

Monks and Minow, in their famous "Corporate Governance" textbook define corporate governance as: "the relationship among various participants in determining the direction and performance of corporations". The primary participants are (1) the shareholders, (2) the management (led by the chief executive officer), and (3) the board of directors...Other participants include the employees, customers, suppliers, creditors, and the community.[2]
These definitions represent various viewpoints regarding the functions and role of corporate governance. As observed by Vessler, Kaen, and Sherman:

> "One perspective approaches the corporate governance debate as part of the larger question of how to organize economic activity to achieve more fundamental societal objectives related to equity, fairness, freedom and citizen responsibilities. The other perspective is more narrowly concerned with economic efficiency objectives and, at the risk of exaggeration, considers economic efficiency to be an end in itself rather than a means to non-economic societal objectives".[3]

From a traditional standpoint, effective corporate governance aims to maximize the wealth of shareholders ("SWM"). In contrast, a more recent and expansive viewpoint, often termed the "stakeholders" perspective of corporate governance, emphasizes companies' social responsibility, sometimes assuming that shareholders' profit maximization purpose should be placed secondary, with respect to other socially and environmentally oriented ends. Consequently, the corporate governance discourse is inherently tied to some crucial questions: On behalf of whom do directors govern? Is their governance primarily for shareholders, or does it encompass a wider array of creditors and other stakeholders?

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[1] Committee on the Financial Aspects of Corporate Governance (chaired by Sir Adrian Cadbury), Report (1992), at paragraph no. 2.5.
[2] Monks, R. A. G., & Minow, N. (1996). Watching the watchers: Corporate governance for the 21st century. New York: Wiley.
[3] Vessler, K., Kaen, F. R., & Sherman, A. (1998). Going public: A corporate governance perspective. Boston: Harvard Business School Press.

Such crucial issues will be further explored in the next discussions (Chapter III)

In addition, it should be pointed out that the primary objective corporate governance, as implemented within each company's organizational structure, is to reduce conflicts of interest and address agency issues within the organization, with the view of minimizing them. Various conflicts that could emerge in companies can be pinpointed. For instance, according to Reiner Kraakman *et Alii*, these conflicts would be likely to occur between and among:

A) shareholders (as a group) and directors;

B) different groups of shareholders (namely majority shareholder(s) and minority shareholder(s)), and

C) shareholders (namely majority shareholder(s)) and company's creditors.[4]

For example, creditors, shareholders, directors, and the CEO may engage in conflicts over issues such as, *e.g.*: the disbursement of excessive dividends; undertaking excessive risk, especially in situations where shareholders are motivated to invest company resources in risky projects. Even if the investment proves successful, the returns are distributed among shareholders as dividends, exposing both shareholders and creditors to the risk of failure, and possibly, insolvency; minority shareholders may face equity claims dilution attempts and other kinds of opportunistic behaviours by majority shareholders; moreover, shareholders and non-executive directors and/or managers may experience disputes related to the expected degree of loyalty from them.

Furthermore, creditors may encounter disputes, especially *vis-à-vis* shareholders (namely majority shareholder(s) within closely held corporations and LLCs), and/or between secured and unsecured creditors. In addition, companies' top managers (including the CEO) may have economic incentives that could conflict with directors – as agents of the shareholder group; and this may occur especially between managerial staff and non-executive directors, regarding matters such as determining the appropriate level of compensation.

The theoretical exploration of this thesis begins a comprehensive review of the historical evolution of corporate governance, tracing back to the origins of directors' responsibilities. Corporate governance, as a field of study, has undergone significant transformation over the years, influenced by economic, social, and regulatory factors. Understanding the historical

[4]Kraakman, R. H., Hansmann, H., (2000). The end of history for Corporate Law MA: Harvard University Press. Available at : https://ssrn.com/abstract=204528 or http://dx.doi.org/10.2139/ssrn.204528

antecedents of directors' roles is crucial in contextualizing their contemporary duties within the broader corporate governance.

In the following chapter, an in-depth analysis of "trust" will be provided, including its modern interpretation as a part of corporate governance and fiduciary duties, as well as the types of directors entrusted with these duties. Moreover, Chapter Three examines existing legislation and legal interpretations in the US, UK, France, Italy, and Ireland. A comparative analysis of these jurisdictions, supported by relevant court decisions, offers a deeper understanding of fiduciary duties and the legal standing of these countries in relation to directors' duties when a company is: a) in financial distress or facing balance sheet or cash flow insufficiency; b) factually insolvent or on the verge of insolvency; or c) formally insolvent.

The differences in these countries' approaches to all three phases provide solid grounds for tailoring distinct regulatory models that can optimize the insolvency process, make it easier to determine when insolvency occurs, set trigger points, and address these issues in a timely manner.

The US Bankruptcy Code, with a deep focus on Chapter 11, will be examined as one of the benchmark restructuring frameworks. It offers valuable insights into how to timely identify and "save" viable enterprises experiencing financial challenges. One significant aspect of the research is the examination of pre-packaged restructuring cases, which have proven their efficiency through remarkable examples, such as one-day Chapter 11 cases, or simply "pre-packs," exemplified by the Belk bankruptcy case.

In Chapter Four, the existing mechanisms of restructuring and debt discharge, their evolution, and successful adaptation in certain Member States will be discussed. The EU Commission and Council Directive of 2019 offers a strong legal framework that has the potential to impact and modernize current insolvency proceedings, while providing viable companies in Member States with relatively fast, comprehensive, and effective guidelines in both pre-insolvency and insolvency stages.

This final paper will conclude with a brief discussion on the importance of balanced debtor-creditor frameworks, the need for a restructuring-friendly environment, and a conclusion summarizing the research findings.

Chapter II. The role of directors in corporate governance

2.1 Evolution of corporate governance. Historical analysis of “trust”

The historical evolution of trust and first elements of fiduciary duties can be traced back to ancient civilizations, where rudimentary forms of corporate organization existed. However, it wasn't until the emergence of modern capitalism and the rise of joint-stock companies that formalized governance structures began to take shape. The establishment of corporate charters and the separation of ownership and control laid the foundation for the development of corporate governance principles. Key milestones in the evolution of corporate governance include the advent of shareholder activism in the 20th century and the subsequent proliferation of governance codes and regulations in response to corporate scandals. These events underscored the importance of effective governance mechanisms in ensuring accountability, transparency, and the protection of stakeholders' interests.

The legal system of England, evolving from the twelfth to the sixteenth century, shaped the foundation of modern law. Common law, applied in England’s royal courts, was central to this system. Traditionally, it was believed that English common law during its formative centuries did not recognize trusts or fiduciary duties, which instead developed in the separate court of chancery, a court of equity that enforced trusts independently of common law. This separation persisted until the fusion of law and equity about a century and a half ago.

Chancery enforced trusts, whereas common law did not recognize trusts or their predecessors known as uses. The emergence of fiduciary duties and the law of trusts in chancery, which developed later and was sometimes seen as adversarial to common law courts, further reinforced their distinct origins. There was an argument during the early sixteenth century that uses were not recognized in common law but were considered tools of fraud and collusion.

Early English common law earned a reputation for its strictness — applying rules uniformly even in challenging situations that seemingly warranted exceptions. Those familiar with the rules could exploit them to their benefit, while common law judges often attributed losses to the failure of individuals to protect themselves. The equity jurisdiction of the chancellor developed partly to mitigate the rigidity of common law rules. Consequently, fiduciary duties

associated with the chancellor's oversight of trusts were seen as contrary to the ethos of early common law.[5]

Examples of common law rules reflecting an aversion to trust and fiduciary relationships include those that appear to oppose such relationships.

In early contract law, if a debtor was created through a written, signed, and sealed promise (a bond), and subsequently the debt was fully repaid, it was expected that the bond would be destroyed, cancelled, or a written release provided. If none of these actions were taken by the creditor, they could then be sued in the king's court for the original debt, disregarding any proof of full repayment. Such evidence could only be acknowledged outside the common law, specifically in the equity court of the chancellor, where proof of repayment could be demonstrated and legal action prevented from being taken again at common law for the same debt.[6]

If the formality of a sealed document was waived and a debtor was created through a solemn oral promise and handshake, mutual trust was implied regarding the commitment to fulfill the oral promise. However, if the debtor reneged on the obligation, common law allowed the presentation of a sworn oath, known as "wager of law," as conclusive evidence that the money was not owed. By doing so, it was implied that they were willing to risk damnation by lying under oath, and could even enlist eleven others, called oath helpers; to swear they believed the oath. Only the church courts could prosecute for the breaking of a promise and impose penance by requiring the debtor to pay the debt as a means of reconciling with the church.[7]

These rules suggested that early common law favored those who understood and could manipulate its procedural intricacies. Early English criminal law similarly seemed out of sync with everyday trust and fiduciary relationships. Crimes like robbery and burglary were initially defined as acts committed by strangers using force and violence. It took centuries for the law to extend criminal liability to include embezzlement, fraud, and forgery — acts where wrongdoers exploited the trust placed in them by their victims, often as their servants or agents.

Fundamental aspects of early common law were heavily shaped by procedural, jurisdictional, and evidentiary rules. These examples from early contract and criminal law illustrate the adversarial nature of common law courts, where strict rules of pleading and procedure governed

[5] Baker, J. H. (2002). An introduction to English legal history (4th ed.). Oxford: Oxford University Press; 3, 212-220.
[6] Barton, J. L. (1973). Equity in the medieval common law. In R. A. Newman (Ed.), Equity in the world's legal systems (p. 147). New York: Oceana Publications.
[7] Press Baker, J. H. (2002). An introduction to English legal history (4th ed.). Oxford: Oxford University Press; 3, 212-220.

proceedings. [8]A poorly pleaded case received no leniency from the opposing party or the judge. However, the lack of trust inherent in medieval courtrooms did not necessarily reflect attitudes toward trust in the broader world or in the application of law beyond the courtroom.[9]

The common law's disregard for concepts of trust and fiduciary duty was most evident in property law[10]. Early common law was characterized by strict rules governing inheritance and feudal obligations. A landholder nearing death could not freely devise land through a will to anyone of their choosing (except in London and certain English boroughs with specific local customs), but was obligated to pass it down to the eldest male heir. If the heir to land held under the high social status of knight service was under the age of twenty-one, the feudal lord of the heir assumed guardianship over both the heir and the land. This guardianship allowed the lord, who provided for the maintenance of the heir, to retain all profits from the heir's land until the heir reached twenty-one years of age. Consequently, wardship represented a significant financial gain for lords who otherwise received fixed feudal services or rents that had become increasingly insignificant over time. Furthermore, the lord could sell the right to arrange the marriage of the underage heir, which also resulted in financial gain for the lord. However, the lord could only exercise these valuable rights if the land was inherited upon the death of the tenant, not if it was gifted during the tenant's lifetime. In this legal context, starting in the 1320s, a social practice emerged allowing landholders to avoid – what later royal lawyers would call "evade" – these feudal obligations. Landholders would transfer the legal title of their land to a small group of individuals who would hold the land (subordinate to the same feudal lord) for the benefit of the original landholder. [11]This arrangement allowed the landholder to designate beneficiaries by will, thus bypassing the rule against land wills. It delayed transferring the land to an heir until they reached the age of twenty-one, avoiding the feudal incidents of wardship and marriage. Landholders could make provisions for daughters and younger sons and provide more generously for a surviving spouse than the common law dower and curtesy allowed. Conversely, a landholder could use this method to deprive a surviving spouse of common law entitlements. Additionally, if a landholder wanted to bequeath land to the church, this arrangement circumvented the 1279 statute of mortmain, which would have otherwise prohibited such gifts or required an expensive license from the king.

[8] Joseph Biancalana, (1998) The Medieval Use, in Trust and Treuhand in Historical Perspective. Duncker & Humblot, Berlin.
[9] Bean, J. M. W. (1968). The decline of English feudalism: 1215–1540. Manchester University Press, Manchester.
[10] Palmer, R. C. (1993). English law in the age of the Black Death, 1348-1381: A transformation of governance and law. University of North Carolina Press, Chapel Hill.
[11] Barton, J. L. (1965). The medieval use. University of Pennsylvania Press, Philadelphia.

Earlier legal historians believed that the concept of uses predated the 1320s. The term "trust" is generally believed to have supplanted the term "use" for this type of landholding arrangement following the enactment of the Statute of Uses in 1536. However, lawyers and judges prior to 1500 often used the word "trust" to describe feoffments to uses. The word "trust" entered Middle English from Old Norse and is commonly found in religious, literary texts, and correspondence dating back to after 1200.They wrongly assumed that the roots of the use and trust could be traced back to the fideicommissum of Roman law, the “salman” or “treuhand” of Germanic law, [12] and the “waqf” of Islamic law[13]. However, the historical sources show that the medieval use was uniquely an English invention. [14]The Domesday Book, a survey of English landholding from 1086, recorded lands held "ad usum" (for the use of) specific individuals. These instances likely involved land temporarily placed in the custody of others, such as when a landholder embarked on a pilgrimage. In the thirteenth century, landholders experimented with various custodial arrangements. [15]Uses were also preceded by conditional grants, where the terms of the feoffee’s intent, such as the obligation to transfer the land to the feoffor’s heir upon reaching twenty-one, were explicitly stated as conditions of the feoffee’s title. These arrangements were addressed by chapter six of the Statute of Marlborough, enacted in 1267, which invalidated feoffments intended to deprive lords of their wardships, though those made in good faith were upheld.[16]

Uses in England evolved and spread for several decades, initially without regular enforcement by any courts. Feoffors established these arrangements relying solely on the goodwill of their feoffees, who were expected to honor the feoffor's wishes based on personal bonds of friendship. However, feoffees did not always comply with these expectations.

Due to the insufficient protection for beneficiaries under common law, other courts started addressing this issue. England's ecclesiastical courts were the first to do so, operating with a jurisdiction distinct from the royal common law courts. These church courts managed wills concerning personal property, which were permitted across England, despite the general restriction on bequeathing land by will. [17]They oversaw the executors of wills, appointed administrators for the personal property of those who died intestate and arranged guardians for

[12] Holdsworth, W. (1945). A history of English law . Sweet & Maxwell, London. (3), 410-411.
[13] Verbit, G. P. (2002). The origins of the trust. Xlibris Corporation, Cambridge, U.K.
[14] Baker, J. H. (2002). An introduction to English legal history (4th ed.). Oxford: Oxford University Press; 3, 248-249.
[15] Biancalana, J. (2001). Thirteenth century custodia. Journal of Legal History, 22(1), 14-16.
[16] Statute of Marlborough, 52 Hen. 3, ch. 6 (1267), in Statutes of the Realm, 1, 19. London: George Eyre and Andrew Strahan.
[17]Helmholz, R. H. (2004). The Oxford history of the laws of England. Oxford University Press, Oxford.

orphaned children. Additionally, they dealt with various trust-like arrangements where land was held by one individual for the benefit of another.

While scholars have not yet examined all surviving records of medieval ecclesiastical courts, research by R.H. Helmholz, focusing on two courts in Kent with the best surviving records, revealed that obligations of feoffees to uses were enforced in these church courts as early as 1375 and frequently during the first half of the fifteenth century. [18]By the 1460s, however, such cases were diminishing in church courts because the king's court of chancery had begun to enforce these uses.

In 1402, the House of Commons requested a legislative remedy against "disloyal" feoffees who sold or mortgaged lands instead of fulfilling the wills of their feoffors. Although no statute was enacted in response, this request indicates that feoffment to uses had become widespread and the issue of enforcement had gained the attention of both the king and Parliament.

Instead of legislation, the remedy came from the chancellor, one of the king's principal officers. Almost all chancellors before 1530 were bishops or archbishops, who oversaw the royal writing office issuing process for common law courts. By the 1375s, chancellors were also addressing petitions about deficiencies and lack of remedies in common law courts. By 1460, chancellors were acting on complaints that feoffees to uses were not adhering to their feoffors' instructions. [19]Petitioners argued that feoffees ignored their moral obligations by failing to execute the deathbed wishes of the feoffors who had entrusted them with land titles.

While the extent of the chancery's involvement in enforcing uses during the mid-fifteenth century is unclear, it is known that feoffees who breached their feoffor's trust could be compelled by the chancellor to follow their consciences. In the chancellor's court, later known as equity, feoffees were recognized as having a fiduciary duty to fulfill the feoffor's intentions for the benefit of the "cestuy que" use.

The medieval use was not invisible to the common law and its judges and lawyers, nor was it beyond their knowledge and expertise. While it is true that common law courts did not enforce uses and offered no remedies for beneficiaries against feoffees who did not honor their feoffors' expectations, the concept of uses was still recognized. In common law, feoffees held the full legal title, leaving beneficiaries with no legal claim. This is exemplified by Thomas Littleton,

[18] Helmholz, R. H. (1979). In The early enforcement of uses. Columbia Law Review,. Columbia University Press, New York. 79(8), 1503-1513.
[19] Helmholz, R. H. (1979). In The early enforcement of uses. Columbia Law Review,. Columbia University Press, New York. 79(8), 1503-1513.

a Justice of Common Pleas, who wrote a book called "New Tenures" [20]between 1450 and 1460, detailing various types of landholdings known to English lawyers but omitting any chapter on uses. A chief justice in a 1502 case estimated that by Littleton's time, the majority of England's land was already held by feoffments to uses, yet Littleton's treatise did not reflect this.[21]

The chief justice also remarked that, under common law, a feoffor had no more rights to the land held by feoffees than any complete stranger would, illustrating the extreme formalism of early common law. Littleton did mention uses briefly, late in his treatise, in a chapter on releasing future interests in land to current possessors. He described them as feoffments made "upon confidence to perform the will of the feoffor," indicating that the law presumed the feoffor could occupy the land according to the feoffees' will. Littleton also noted that a beneficiary of a use could meet the property qualification for jury service if the land was of sufficient value. The chief justice in the 1502 case was referring to this jury qualification issue when discussing how much of England was held to uses in Littleton's era.[22]

2.2 The types of company directors and the challenges they face.

Directors confront a broad range of challenges in today's business environment, ranging from financial volatility to emerging risks and opportunities. Financial distress poses a particularly formidable challenge, requiring directors to make difficult decisions to ensure the company's survival while protecting the interests of shareholders, creditors, and other stakeholders.

Globalization has brought about new complexities, including supply chain disruptions, regulatory harmonization, and cross-border legal issues, which directors must navigate adeptly. Technological advancements have transformed business models and operational processes, presenting both opportunities for innovation and risks of cyber threats and data breaches.

Moreover, shifting stakeholder expectations demand greater transparency, accountability, and sustainability from corporate boards. Directors are more and more being held accountable for the social and environmental impact of their decisions, necessitating a holistic approach to governance that considers the interests of all stakeholders.

[20] Littleton, T. (1903). New tenures (E. Wambaugh, Ed.). John Byrne & Co., Boston. at §§ 462-64.
[21] Dod v. Chyttynden, Y.B. Mich. 15 Hen. 7, pl. 1, fol. 13a, 13b (C.P. 1502).
[22] Littleton, T. (1903). New tenures (E. Wambaugh, Ed.). John Byrne & Co. Boston. Note 41, at §§ 462-64.

However, the term "director" covers a wide scope. To gain a clearer understanding of the duties and authority of directors, it is essential to explore the various types of directors that exist in today's corporate landscape.

In essence, directors can be categorized based on their level of involvement in the company's day-to-day operations, their independence, and the specific functions they oversee. Understanding the different types of directors is essential for grasping how companies are managed and governed. This understanding also helps in appreciating how strategic decisions are made, how risks are managed, and how regulatory compliance is ensured.

The distinctions among directors often relate to their responsibilities, their relationship with the company, and the perspective they bring to the board. For instance, executive directors are typically involved in the daily management of the company, while non-executive directors provide independent oversight and advice. Other specialized roles exist to address specific needs within the board's operations, such as ensuring financial integrity, technical advancement, or stakeholder representation.

In many jurisdictions, companies are required to have a certain number of directors to ensure proper governance. These legal frameworks are designed to prevent conflicts of interest, promote transparency, and protect the interests of shareholders and the public. Additionally, the board of directors is often tasked with setting the company's strategic goals, evaluating the performance of senior management, and making critical decisions that affect the company's future.

The roles and types of company directors can vary depending on the jurisdiction and the specific structure of the company. However, here are some common types of company directors:

1. Executive Directors
2. Non-executive directors (NEDs)
3. Other directors.[23]

The table below illustrates the main distinctions between the first and second types of directors. It compares their functions, representation, appointment process, level of independence, and other relevant factors.

[23] Difference Between Executive and Non-Executive Director, Tulonga Erastus October 8, 2021

BASIS FOR COMPARISON	EXECUTIVE DIRECTOR	NON-EXECUTIVE DIRECTOR
Meaning	An Executive Director is the one involved in the routine management of the firm as well as he/she is the full-time employee of the company.	A Non-Executive Director is a member of the company's board, but he/she does not possess the management responsibilities.
Represents	Internal Directors	External Directors
Appointment by	Letter of Employment	Letter of Appointment
Appointment to board	By Nomination committee or By shareholders (as the case may be)	By shareholders
Independence	Not independent	Independent
Remuneration	Salary	Service Fee
Strategy	Formulation and Implementation	Consideration and Review
Includes	CEO, MD, CFO, etc.	Chairman

[24] Difference Between Executive and Non-Executive Director, Tulonga Erastus October 8, 2021

In contrast, the third category, known as "other directors," includes roles such as Chairman, Deputy Chairman, Lead Independent Director, Shadow Director, Inside Director, Outside Director and etc.

In Uk, according to the Companies Act of 2006, there is no legal distinction between the status of executive directors and non-executive directors (NEDs); both are subject to the same responsibilities and liabilities.[25] The UK Corporate Governance Code further specifies the roles expected of NEDs, including constructively challenging the board's work and participating in strategic decisions. [26]The Code also requires NEDs to evaluate management's performance, manage systematic risk, and ensure the integrity of financial information. Additionally, NEDs are expected to participate in several committees, often representing the majority, such as the remuneration committee, which sets executive pay, the nomination committee, and the audit and risk committees.[27] Furthermore, NEDs should constitute either the majority of the Board of Directors or at least half of it.

The role of non-executive directors (NEDs) has been subject to increased scrutiny, especially following significant corporate collapses globally and the 2007-08 financial crisis. In the UK, considerable efforts have been made to reassess the role of boards of directors to enhance accountability, with a particular focus on NEDs as the most effective means to achieve this goal. The rationale for greater commitment from NEDs lies in their independent status, which

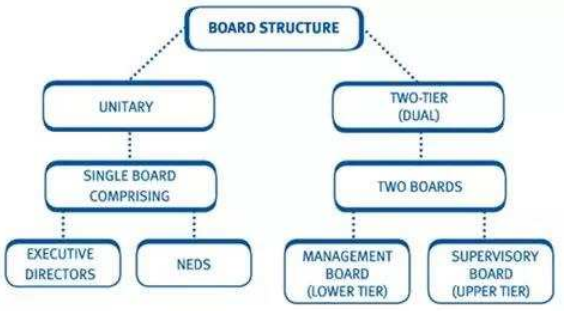
[24] Difference Between Executive and Non-Executive Director, Tulonga Erastus October 8, 2021 https://keydifferences.com/difference-between-executive-and-non-executive-director.html#ComparisonChart
[25] The UK Corporate Governance Code 2012.
[26] UK Companies Act 2006.
[27] UK Corporate Governance Code (2023) – Financial Reporting Council (FRC).

positions them as better monitors of boards, more effective defenders of shareholders' interests, and promoters of the company's long-term goals, thereby expected to improve overall performance[28].Despite the emphasis on the distinct role NEDs should play, legally, there is no statutory separation between the responsibilities and liabilities of executive and non-executive directors.

The main concerns regarding the current role of NEDs involve their active participation in decision-making and strategic involvement, which are further complicated by the processes defining their nomination and remuneration. [29]Some of these issues have been addressed through various amendments to the UK Corporate Governance Code, albeit with limited effect.

The prevailing belief is that NEDs, coming from diverse backgrounds compared to executive directors, bring additional expertise, skills, and knowledge, both generally and within specific industries, thereby fostering better management decisions.[3031]

The structure of a company's board of directors can significantly influence its governance and management. Two common models are usually used worldwide: unitary ,or the one-tier board, and the two-tier board systems. Each system has its unique features, advantages, and challenges. The structure of these two board structures is depicted on the chart below:



[3233] The key differences between executive and non-executive directors

The prevailing consensus in the literature is that the primary objective of two-tier boards is to ensure a clear separation between management and control functions. [34]Unlike supervisory boards in two-tier systems, non-executive directors (NEDs) in unitary board systems are expected to undertake functions akin to those of executive directors, participating in

[28]R. Gilson and R Kraakman, 'Reinventing the Outside Director: An agenda for Institutional Investors' (1991) . Stanford Law Review 863
[29] Walker, D. (2009). A Review of Corporate Governance in UK Banks and Other Financial Industry Entities. HM Treasury, 55.
[30] K Keasey and R Hudson, 'Non-executive Directors and the Higgs consultation paper, 'Review of the Role and Effectiveness of Non-executive Directors' ' (2002), 10(4) Journal of Financial Regulation and Compliance 363.
[31] Berghe and Baelden, (CUP 2015) Company Law and Sustainability: Legal Barriers and Opportunities, B. Sjåfjell and B.J Richardson (eds), 61.
[32] https://kfknowledgebank.kaplan.co.uk/acca/chapter-3-the-board-of-directors
[33] https://keydifferences.com/difference-between-executive-and-non-executive-director.html#ComparisonChart
[34] Keasey, K., & Hudson, R. (2002). Corporate governance: Accountability, enterprise, and international comparisons. Oxford University Press, Oxford, 364.

management decisions while simultaneously monitoring those decisions. This dual role of NEDs introduces several practical challenges. The most straightforward of these challenges is the lack of a credible guarantee that NEDs can effectively control decisions they are involved in making. [35]In the context of two-tier boards, it is generally accepted that supervisory boards provide independent accountability to investors. However, within unitary boards, the accountability role of NEDs is more vulnerable to criticism due to their dual involvement in both decision-making and oversight. The primary touted advantage of unitary boards is that both executive directors and non-executive directors (NEDs) are supposed to have equal access to company information. NEDs are empowered to ask questions and request additional details when issues are unclear. However, upon closer examination of board operations, it becomes evident that a similar information gap exists between executives and NEDs in unitary boards as it does between management and supervisory boards in two-tier systems. Despite the theoretical premise that NEDs should receive the same information as executives, critics argue that the information provided to NEDs may be filtered in terms of quantity or tailored in terms of quality by CEOs or other executives. [36]This concern becomes more pronounced as NEDs are increasingly expected to play a more active role in the management process.

The primary touted advantage of unitary boards is that both executive directors and non-executive directors (NEDs) are supposed to have equal access to company information. [37]. In theory, NEDs have the right to ask questions and request additional information to clarify any uncertainties. However, a closer examination of how these boards operate reveals a similar issue of information asymmetry that is found in two-tier board systems. Despite the intention that NEDs receive the same information as executives, critics argue that the volume of information may be limited or the quality adjusted by CEOs or other executive directors. This concern becomes more significant as NEDs are increasingly expected to take on a more active role in the management processes of the company.

Mechanisms that play an important role in corporate governance:

Directors' and officers' legal duties. These duties are designed to ensure that directors and officers conduct themselves with honesty, due care, and diligence, always prioritizing the best interests of both shareholders and the company.

[35] Keasey and Hudson (2002), 364.
[36] Kemp, S. (2010). Driving strategy or just going through the motions: An empirical study of boardrooms in the UK. International Journal of Business Administration .
[37] M. Nowak and M McCabe, 'Information Costs and the Role of the Independent Corporate Director' (2003) Corporate Governance 11(4), 304.

The structure of the Board of directors. The configuration of the Board of Directors is crucial, including considerations such as the proportion of independent directors within the board. An essential inquiry revolves around whether independent directors are more effective at monitoring the company's performance and its employees compared to executive directors.

Auditors. Auditors play a vital role in monitoring by verifying and attesting to the accuracy of a company's financial statements, contributing to financial transparency and accountability.

Institutional investors. Institutional investors serve as an effective monitoring mechanism for companies in which they invest. The increasing presence of institutional investors is noteworthy, especially as they have emerged as predominant owners of public equity in many OECD countries.[38] For instance, the Australian Investment Managers' Association manages or owns nearly 45% of the capital of companies listed on the Australian Stock Exchange. [39]Similarly, in the United States, public companies often share the same group of institutional investors as their largest shareholders. While European firms traditionally have high ownership levels by founding families, corporations, and governments, there is a growing trend of institutional investors becoming more prevalent in European companies.[40]

Disclosure of information by companies. Both mandatory and voluntary disclosures may be important for the effective monitoring of managers and directors

Ownership concentration. Greater concentration of share ownership provides stronger incentives for shareholders with substantial stakes to actively engage in monitoring. This alignment ensures that those with significant holdings are motivated to safeguard their interests and contribute to the company's overall success.

Corporate financial policy. The company's financial policy, especially the management of debt, serves as a significant mechanism binding directors to shareholders. This approach helps prevent directors from making unwise reinvestments of profits, promoting responsible financial management.

In a recent study, a group of four economists investigates the connection between legal safeguards for investors and ownership concentration across 49 countries. [41]Their findings reveal a significant inverse relationship; specifically, countries with inadequate legal protection

[38] OECD Principles of Corporate Governance (2015).
[39] Azar, O., Smith, J., & Johnson, L. (2018). Corporate governance in practice. Business Press : New York.
[40] Thomson, A., Smith, J., & Lee, C. (2006). Corporate Governance in the 21st Century. Business Press.
[41] La Porta, R., López-de-Silanes, F., Shleifer, A., & Vishny, R. W. (1996). Law and finance (NBER Working Paper No. 5661). National Bureau of Economic Research. Retrievable from: https://doi.org/10.3386/w5661

for investors in corporate entities tend to exhibit high levels of ownership concentration. The authors interpret high ownership concentration as a compensatory measure in the absence of robust investor protection. They underscore that their research underscores the importance of legal regulations in shaping corporate governance and emphasizes that companies must adjust to the constraints imposed by the legal frameworks within their operational environments.

The findings from these studies carry significance for the responsibilities of directors in corporate governance. Corporate governance mechanisms have the potential to work in harmony with each other, and in certain situations, they might function as alternatives. If we consider corporate governance mechanisms as potential substitutes, having well-crafted directors' duties, coupled with robust enforcement, could result in reduced dependence on other corporate governance mechanisms.

Corporate Governance and Directors. To understand corporate boards, one must first explore the functions of directors. The role and functions of directors, serving as the primary decision-makers in companies, are integral to corporate governance. [42]Observing directors directly through fieldwork is one approach to understanding their roles. There exists an extensive body of literature describing board activities, with contributions from authors such as Mace (1971), Whisler (1984), Lorsch and MacIver (1989), Demb and Neubauer (1992), and Bowen (1994). Mace's key findings indicate that directors primarily provide advice and guidance, enforce discipline, and intervene during crises, especially when a CEO change is necessary. However, the specifics of their "advice and guidance" remain somewhat vague. Mace proposes that boards function mainly as a consultative body for the CEO and senior management, offering specialized knowledge when unique challenges arise. Conversely, Demb and Neubauer's survey revealed that nearly two-thirds of directors view "defining the strategic direction of the company" as a part of their responsibilities, with 80% acknowledging their involvement in strategy formulation. Additionally, 75% of respondents from another survey by Demb and Neubauer reported their role as setting the company's strategy, policies, overall direction, mission, and vision, a view more commonly held than overseeing or monitoring top management and CEO (45%), managing succession and executive appointments (26%), or acting as a guardian for shareholder interests and dividends (23%). [43]However, determining the appropriate role for directors and identifying the types of directors that best suit the needs of companies are matters not without controversy. [44] Key issues in this context include ongoing

[42] Tolmie, "Corporate Social Responsibility" (1992), University of New South Wales Law Journal 268.
[43] Adams, R., Hermalin, B. E., & Weisbach, M. S. (2009). The role of corporate governance in financial markets. Journal of Finance. 64(1), 5-33.
[44] Dodd, E. M. (1932). For whom are corporate managers trustees? Harvard Law Review, 45, 1145.

discussions surrounding corporate social responsibility and the optimal structure for the board of directors.

The question of whether directors have responsibilities extending beyond the mere maximization of shareholder wealth is a familiar topic, and for the purpose of this discussion, an in-depth analysis is warranted. Despite having been part of the discourse for over 70 years, the debate has recently resurfaced in the examination of non-shareholder constituency statutes in the United States and the significant business restructurings witnessed in recent years, often involving substantial employee layoffs. In the context of our focus, the critical aspect is that directors play a central role in this discourse. Although commonly referred to as the corporate social responsibility debate, directors are tasked with navigating the interests of various stakeholders and, inevitably, prioritizing certain interests when conflicts arise among stakeholders. But the common responsibility attributed to directors involves overseeing the process through which senior executives,including the Chief officers, are recruited, advanced, evaluated, and, when needed, terminated.

2.3 Fiduciary duties as a key component of corporate governance

The role of directors within organizations carries a profound responsibility , often encapsulated by the concept of fiduciary duties. These duties represent a key aspect in the ethical and legal framework governing managerial actions, outlining the obligations and expectations that managers owe to the entities they serve. As “stewards” of shareholder interests and “custodians” of corporate resources, directors are entrusted with decision-making powers that necessitate the utmost integrity and loyalty. Due to a recent surge in corporate bankruptcies and public company scandals, corporate managers are facing increased challenges. Understanding and managing directors' fiduciary duties has never been more crucial, especially during times of corporate distress.

Fiduciary duties are present in various fields such as family law, surrogate decision-making, agency law, employment, pensions, banking, financial institutions, corporations, charities, non-profit organizations, medical services, and international law. The principles of fiduciary duty also influence disciplines like economics, psychology, moral norms, and pluralism. This type of law has historical roots, being acknowledged in both Roman law and British common law, and has been a part of Jewish, Christian, and Islamic religious laws for many years. Additionally, fiduciary principles are found in the legal systems of Europe, China, Japan, and India.

The most effective fiduciary services are provided voluntarily, as compulsory services can be hazardous for recipients who may lack the understanding or ability to assess them. Fiduciary law aims to

(i) promote the use of professional services,

(ii) attract experts to offer their expertise, and

(iii) prevent experts from exploiting the power imbalances inherent in these relationships.

Power can be used for both beneficial and harmful purposes. When recipients are unable to evaluate the power and quality of expert services, it can lead to distrust and withdrawal from these experts, which is detrimental to society. Essential systems like finance, healthcare, law, and education depend on the exchange of expertise. Fiduciary law addresses this by establishing a duty of care, ensuring the quality of expert services, and a duty of loyalty, preventing conflicts of interest that erode trust. This legal framework encourages and protects those who rely on expert services, fostering reliance and trust. The less capable recipients are of assessing experts' skills and integrity, the greater the fiduciary duty of the experts and the harsher the penalties for any abuse.[45]

There are two core fiduciary categories.

Category I. First category of fiduciary duties can be defined by the cases where the fiduciary has a control over a property, which is legally the property of another person. This category differs from trusts because it includes all relationships where the property legally and beneficially belongs to the principal. Sealy used "control" to mean that the fiduciary has the power to dispose of the property, regardless of whether they have the authority to do so. Examples include company directors managing company assets, bailees handling bailors' property, agents managing goods for sale, and individuals using cash for purchases. These fiduciaries can use the property for both authorized and unauthorized purposes. Sealy determined that fiduciaries in this category must keep the property separate from their own and cannot use it for personal benefit. If they fail to follow this rule, they face the same consequences as trustees, such as the principal's right to trace the property, assert proprietary remedies, and recover equitable compensation for unauthorized losses caused by the fiduciary.Sealy noted that while some experts believe the rules for fiduciaries in Category I should also apply to intentional wrongdoers like thieves, he disagreed. He believed that even

[45] Frankel, T. (2018). The rise of fiduciary law. Boston University School of Law Blog.

though the owner can still trace their property back to the thief, this does not make the thief a fiduciary.

Sealy's reasoning is that in fiduciary relationships, equity (fairness) steps in to protect the interests of the person who owns the property because the relationship depends on it. However, with thieves, this special protection isn't needed because the victim already has strong legal claims against the thief and anyone who receives the stolen property. Additionally, any profits made by the thief from the stolen assets are better pursued by the state rather than treated as a breach of a fiduciary duty.[46]

II Category broadly includes agents or any situation where "the plaintiff entrusts the defendant with a job to be performed." This broad definition covers employees, Crown servants, solicitors, agents, partners, directors, and promoters. While those in Category I are likely to fall under Category II, the reverse is not always true. However, the extensive classification of "all those with a job to do" can be misleading.

One important lesson from Sealy's categorization of fiduciary duties is the risk of relying on simple labels. The term "fiduciary" can have varied meanings depending on the context. Each category defined by Sealy has its specific rules. Being identified as a "fiduciary" within one category does not imply that the same duties automatically apply in other categories.

Directors are required by their fiduciary duty to the company, officially acknowledged as a responsibility based on their position (whether as a director or agent), to carry out their responsibilities without prioritizing their personal interests. [47]Fiduciary duty is based on the concept of trust and confidence between two parties, where one party (the fiduciary) is entrusted with the responsibility to act in the best interests of the other party (the beneficiary). This relationship involves a heightened level of trust, loyalty, and good faith. The fiduciary is obligated to prioritize the interests of the beneficiary above their own and to avoid any conflicts of interest that could compromise the well-being of the beneficiary.

The foundation of fiduciary duty as was mentioned , rests on principles such as loyalty, care, and prudence. The fiduciary is expected to act with undivided loyalty, making decisions that are solely in the best interests of the beneficiary. They are also required to exercise a high standard of care and diligence in managing the affairs or assets entrusted to them. Additionally,

[46] Sealy, L. S. (2010). "Fiduciary relationships." ,Oxford University Press, Oxford.
[47]York and North-Midland Railway Co v Hudson (1845) 16 Beav. 845, 51 E.R. 866. (2011) 252 FLR 462 at 472 [83].

fiduciaries are often expected to avoid conflicts of interest and to disclose any potential conflicts if they arise.

In a financially sound corporation, directors have fiduciary responsibilities to the corporation and its stakeholders. However, when a corporation becomes financially distressed and enters the "zone of insolvency," directors' fiduciary duties extend to include the corporation's creditors. Consequently, directors of a corporation in the zone of insolvency must navigate the sometimes conflicting interests of shareholders and creditors, which heightens the directors' risk of personal liability.

But what is the “zone of insolvency” and how to recognize that the company is in the zone of insolvency?

According to the U.S Bankruptcy Code, the "zone of insolvency" refers to the period when a company is teetering between solvency and insolvency. Although there is no exact definition for when a solvent company enters this zone, fiduciaries should consider themselves in it if the failure of a proposed transaction is likely to push the company into insolvency, or if it is foreseeable that the company will struggle to pay its creditors as a whole. This concept is highlighted in cases such as *In re Healthco Intern., Inc.*, 208 B.R. 288, 301-302 (Bankr. D. Mass. 1997). Fiduciaries must continually evaluate their company's financial health and seek professional advice to determine if they are operating in this precarious zone.

For example, a company might consistently breach covenants without missing any payments on its senior loan. As long as lenders are cooperative and grant waivers, the company can continue operating, but future defaults might lead to the acceleration of the loan, resulting in insolvency. Similarly, if a major customer threatens to withdraw business due to a minor technical default, the company could face insolvency if the customer follows through. These scenarios illustrate the complexity of determining whether a company is in the "zone of insolvency" or simply facing normal business risks.

To determine whether directors have fulfilled their fiduciary duties, courts typically apply the business judgment rule. This rule presumes that directors make business decisions with proper information, in good faith, and with an honest belief that the decisions serve the corporation's best interests. Proving a breach of fiduciary duty requires overcoming this presumption by showing that the director acted with gross negligence, failed to act in good faith, or had an improper self-interest.

Duties owed to creditors of an insolvent corporation evolve significantly compared to those in a solvent corporation. Directors typically do not owe fiduciary duties to creditors in a solvent company. However, upon insolvency, the rights of creditors expand because the fiduciary duties of directors increase to include creditors[48]. Therefore, when a corporation becomes insolvent, directors are obligated to act in the creditors' best interests. The change in the focus of directors duties occurs because directors may take extreme risks in an attempt to improve stockholders' position to the detriment of the corporation's creditors[49]. Defining when a corporation falls within the "zone of insolvency" is crucial due to the clarity it provides on directors' duties in an insolvent state. Determining insolvency can be challenging as corporations may not formally acknowledge insolvency unless through written admission or in a board meeting. Therefore, the term "zone of insolvency" has been coined by courts to denote the uncertain period when a corporation experiences financial distress but hasn't definitively reached insolvency. Courts use various tests such as the Equity test or the Balance Sheet test to determine insolvency, considering the specific circumstances of each case. The Delaware Chancery Court, for instance, may apply one or both tests based on business realities and evolving corporate strategies. The Court noted that an insolvency test needs to take into account business realities, and that to define insolvency merely as a corporation's liabilities exceeding its assets fails to take into account emerging corporations that take advantage of business opportunities. emphasizing that a simplistic definition of insolvency based solely on liabilities exceeding assets may not adequately capture the complexities of modern business ventures[50].

Contemporary perspectives on fiduciary law revolve around two primary viewpoints concerning fiduciary relationships. The prevailing academic stance asserts that the fiduciary relationship is difficult to define precisely. In contrast, the prevailing judicial standpoint maintains that the presence of such a relationship is a prerequisite for fiduciary liability. This paradox creates a conflict, as judges emphasize the conceptual centrality of the fiduciary relationship in determining liability, while influential academics challenge the coherence of this concept[51].

When a corporation enters the "zone of insolvency," Delaware courts have emphasized that directors have a heightened obligation not only to shareholders but also to the broader community of interests that sustain the corporation's wealth-creating capacity, including its creditors. This expansion of fiduciary duties aims to protect creditors from having to predict potentially harmful transactions by directors that could lead to insolvency and unfairly

[48] Geyer v. Ingersoll, 621 A.2d 784, 787 (Del. Ch. 1992).
[49] Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).
[50] Postalia AG & Co. v. On Target Tech., Inc., C.A. No. 16330 (Del. Ch., December 24, 1998).
[51] Smith, D. G. (2002). Corporate Governance: Principles, Policies, and Practices. Oxford University Press, Oxford.

disadvantage creditors. The intention is to encourage directors to act in the best interests of the entire corporate enterprise rather than solely prioritizing shareholders' wishes during this critical period.

However, in Steinberg v. Kendig[52], the Illinois Bankruptcy Court clarified that while directors in the zone of insolvency must consider creditors' interests, they are not necessarily obligated to prioritize creditors above other stakeholders. Directors are not mandated to immediately liquidate assets and pay creditors if they can, in good faith, identify viable alternatives to avoid liquidation. The duty of care owed to creditors of a corporation approaching insolvency is primarily focused on safeguarding creditors' contractual and priority rights within the corporate structure. This complex approach seeks to balance the interests of all parties involved while navigating the challenges of financial distress.

The fundamental framework of private law is predominantly formal in nature. The principles governing private liability are influenced by relatively stable patterns of action, interaction, and organization. The formality of private law is evident in the requirement that the application of liability rules often depends on a judicial determination that the interaction between the plaintiff and defendant aligns with a specific form (or type) of action, interaction, or organization, to which certain mandatory or default rules are applicable. For instance, a direct claim for breach of contract hinges on the presence of a primary obligation for contractual performance, rooted in a distinct form of legal relationship – namely, a contractual relationship. The success of a breach of contract claim rests on the claimant's ability to demonstrate that the underlying relationship was genuinely contractual, meeting the formal criteria (validity conditions) of a contract.

The traditional perspective held by judges suggests that, in the framework of fiduciary liability, the analytical emphasis is placed on the relationship aspect rather than the duty itself. This prioritization is evident not only in the statements judges make regarding fiduciary liability but also in their actions when adjudicating such liability.

To delve into the core of the matter, it's essential to examine the practices involved in litigating and adjudicating fiduciary liability claims. Within this context, the characterization of the relationship assumes a central role. Instead of merely asserting a duty and presenting evidence of its breach, plaintiffs typically commence by asserting that their association with the defendant was inherently fiduciary. More specifically, they contend that the fiduciary nature of

[52] In re National Steel Corp., 225 B.R. 646, 655 (Bankr. N.D. Ill. 1998), aff'd in National Steel Corp. v. Houghton Mifflin Co., 200 F.3d 601 (7th Cir. 1999).

the relationship is either a matter of legal status or factual circumstances. Courts, in turn, base their adjudications on this characterization, scrutinizing whether the relationship indeed possessed fiduciary qualities as a matter of legal status or factual reality. Once this determination is made, the acknowledgment of fiduciary duties and the subsequent analysis of alleged breaches ensue.

In the rare scenario where a plaintiff fails to establish a pre-existing fiduciary relationship, they may advocate for either a de novo extension of status or a one-time judgment affirming the relationship as fiduciary[53]. Occasionally, litigants manage to convince the courts to grant a de novo extension of status. However, if corporate directors were held accountable for a corporate loss stemming from a high-risk venture due to the perceived riskiness of the investment, their liability would extend to being jointly and severally liable for the entire loss (presumably with a right to seek contribution). Considering the vast scale of operations of modern public corporations, this significant disparity between risk-taking and potential liability for corporate directors poses potential adverse consequences[54].

[53] Conaglen, M. (2005). The Nature and Function of Fiduciary Loyalty. Hart Publishing, Oxford.
[54]J. (2011). The Impact of Fiduciary Duties on Corporate Governance. McGill University Press, Montreal. 235, 123-145.

Chapter III An Examination of relevant Directives and Legislations in the EU and US

3.1 Analysis of directors' duties pre- and post-insolvency

When a company is insolvent factually, but has not yet gone through the formal insolvency process, directors-not necessarily in a bad faith- may get involved in actions that can destroy the residual value of the company. In order to prevent that, many jurisdictions provide legal strategies against the shareholders' opportunism. For deeper understanding of these legal strategies it is important to highlight the four main financial stages of the company. [55]

1. First stage is a period of solvency. When company can timely repay its liabilities
2. Second stage can be described as a period of "zone of insolvency",or "vicinity of insolvency". It is when the company can foresee the future financial troubles.
3. The third stage is the stage of a factual insolvency that has been mentioned above (also considered as a period of the zone of insolvency).
4. And the final stage, is the stage of formal or legal insolvency.

Shareholders in factually insolvent companies may act opportunistically in various ways[56]. Once insolvency occurs, shareholders are no longer the ones who stand to benefit from the company's remaining assets[57]. This can motivate them to invest in risky projects with a negative present value, hoping that, these projects might generate enough returns to save the company from formal insolvency. However, this outcome is highly unlikely, and the losses, along with the negative net present value from such risky projects, would ultimately fall on the creditors.

Second, another form of shareholders' opportunism would be the desire to hide the company assets from creditors, so that there are not enough assets to satisfy their claims once a company becomes formally insolvent. This form of opportunistic behaviour will be more thoroughly analysed in the following chapters.

Third, while financially distressed companies may be inclined to overinvest, the opposite issue can arise in insolvency: underinvestment. This happens when a company fails to pursue investment opportunities that have a positive net present value (NPV). Shareholders may lack motivation to fund these projects because they know that, given the company's high debt levels, most or all of the project's returns will benefit creditors instead. This issue, commonly referred to as "debt overhang," can result in underinvestment, ultimately harming both creditors and society by diminishing value.

[55] Aurelio Gurrea-Martínez, 'Towards an Optimal Model of Directors' Duties in The Zone of Insolvency: An Economic and Comparative Approach' (2021) Journal of Corporate Law Studies 365. 21(2).

[56] Gurrea-Martínez, A. (2021). Towards an optimal model of directors' duties in the zone of insolvency: An economic and comparative approach. Journal of Corporate Law Studies, 21(2), 365-385.

[57] Clark, R. (1977). The Duties of the Corporate Debtor to Its Creditors. Harvard Law Review. 90(1), 505-531.

Ultimately, shareholder opportunism can also occur when non-viable companies are kept running. This happens for three main reasons:

1. Moral Hazard (Risk Without Bearing Costs): Shareholders or managers may choose to keep a failing company alive because they don't personally face the costs of this decision. If the company improves financially, they could potentially recover their investments. This gives them the incentive to gamble on the company's recovery, even if it harms creditors.
2. Lack of Awareness: Sometimes, shareholders or managers don't fully understand that the company is no longer viable, so they continue operating it.
3. Behavioural Biases: Psychological factors, like overconfidence or wishful thinking, can lead decision-makers to believe the company will turn around, even when it's unlikely.

As a result, shareholders might delay shutting down a company, hoping it will recover, even if doing so causes more harm to creditors.

Secondly, some shareholders or managers may continue operating a failing company simply because they are unaware of its true financial situation. This could be due to a lack of diligence or insufficient resources to seek outside advice, leaving them oblivious to the fact that the company is no longer viable and should be closed.

Thirdly, behavioural factors like over-optimism, overconfidence, emotional attachment to the business, and a preference for maintaining the status quo can also lead to keeping a non-viable company running. In this cases, even after the negative performance of the company that indicates it is not viable anymore,shareholders can still be hesitant to take early actions and timely start an insolvency proceedings. [58]

These opportunistic behaviors by shareholders towards creditors can make lenders more hesitant to provide credit in the future. If this issue isn't effectively addressed, the risk of shareholder opportunism in financial distress could limit companies' ability to access debt financing, which in turn may slow down the economic growth in a long run.

The regulatory frameworks outline the responsibilities of directors as a company moves from solvency towards insolvency.

When a solvent company anticipates future financial difficulties, it may trigger specific duties for directors in the pre-insolvency phase. In the US, the question of whether corporate directors have responsibilities to creditors in this stage or within the zone of insolvency has faced significant criticism and has not been widely accepted[59]. In contrast, the EU has established a comprehensive framework outlining directors' duties during the pre-insolvency zone.[60] This

[58] Gurrea-Martínez, A. (2020). Insolvency law in times of COVID-19. International Insolvency Review, 29(1), 36-52.
[59] Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).
[60] European Parliament (2018), Directive (EU) 2018/843 on the Prevention of Money Laundering.

framework is linked to the 2019 Directive from the European Parliament and the Council, which mandates that all EU member states implement duties owed to creditors when a company is in the zone of insolvency. The recent Directive changes how directors in EU countries must operate when facing potential insolvency. It requires directors of solvent companies to consider the interest of creditors along with other stakeholders,when the insolvency appears likely.This aligns directors responsibilities with the changing priorities of stakeholders as a company moves toward insolvency. However,this shift raises some concerns. First of all, broadening the scope of who directors must consider might weaken their accountability, making it harder to hold them responsible for decisions they make. The next concerns is the defining when a company is nearing insolvency can be not easy ,creating uncertainty around when these new duties should apply.

In essence, on one hand Directive seeks to enhance protections for stakeholders during pre-insolvency, on another hand it creates complexities that could complicate effective corporate governance. Deeper analysis about the Preventive and restructuring framework will be provided in the next chapters.

Regulatory frameworks for directors' responsibilities during the zone of insolvency.

Many European countries including the East European countries such as Russia and Poland require company directors to start an insolvency process once it is inevitable. [61]Many European jurisdictions have the same or similar regulation model implemented. However, this regulatory model doesn't seem to be very common outside of Europe.

Under this regulatory framework, corporate directors must initiate insolvency proceedings within a specific timeframe, usually between three weeks and two months,once they are aware or should be reasonably aware that the company has become insolvent[62]. Failing to meet this obligation can lead to various repercussions including disqualification, responsibility for damages,debts and even face criminal charges. But,there is one undeniable advantage associated with requiring companies in financial distress to start a process of insolvency. When the company start an insolvency process as early as possible the risk of shareholders' and directors' opportunistic behaviour against the creditor can be reduced. As a result, creditors will receive a greater level of protection. This approach could address shareholders' opportunistic behavior and improve the firm's access to debt financing from a proactive standpoint.

Additionally, this regulatory approach offers clearer guidance for judges, directors, crediors and other stakeholders. When evaluating directors' actions in the context of insolvency, the focus

[61]Aurelio Gurrea-Martinez, (2020) 'Insolvency Law in Times of COVID-19' International Insolvency Review, 29(2), 19-22.
[62] Spanish Insolvency Act, Articles 5.1 and 5.95.

will be solely on two key factors: when the company became insolvent and whether the directors initiated insolvency proceedings in a timely manner. Other aspects, such as whether beginning the insolvency was the best option for creditors, will not be taken into account.
Moreover, when a company is factually insolvent, not only can the debtor's actions lead to a loss of value, but creditors may also harm or opportunistically divert that value. For example, they might terminate contracts or take legal actions, which can damage the company's value and injure the creditors. By requiring debtors to start insolvency proceedings the regulations can prevent these actions and help preserve the company's value for everyone involved.
Despite its potential benefits, the model will impose considerable costs on companies related to insolvency proceedings. Also, determining when exactly a company becomes insolvent is challenging. Insolvency usually results from a long period of financial decline rather than an overnight change. Assessing whether a company's assets exceed its liabilities can be a complex and subjective. The directors' obligation to timely start an insolvency process can lead to uncertainty and increased legal costs. Strict enforcement of the model can prompt directors to file for insolvency too early.

Several jurisdictions require corporate directors to promote the recapitalisation or liquidation of the company when the firm's net assets fall below the company's legal capital.This includes European countries like France, Spain and Sweden.[63]
This duty seeks to protect creditors by forcing companies to improve their financial situation or leave the market. Failing to follow these rules can result in the director being liable for damages and even responsible for the company's debts. The duty is usually triggered by substantial losses,not just by insolvency[64]. Therefore, the duty is typically enforced when a company is at risk of being insolvent. Similar to the rules that apply during insolvency,this duty aims to protect creditors. It encourages companies to either improve their financial situation (recapitalisation) or exit the market (liquidation) if thet are facing significant losses. This helps safeguard the creditors and other stakeholders from the further harm.
The duty to promote recapitalization or liquidation of a company can cause several issues. First, if companies are facing temporary losses and struggle to raise capital, strict enforcement of the recapitalization and liquidation rule might force many viable companies to exit the market , harming societal value despite protecting creditors. [65]
Second, this rule promotes directors to favour low-risk, low return projects to avoid potential losses and exit from the market, preventing them from pursuing more innovative and valuable

[63] Gurrea-Martínez, A. (2020). Insolvency law in times of COVID-19. International Insolvency Review, 29(1), 36-52.
[64] Gurrea-Martínez, A. (2020). Insolvency law in times of COVID-19. International Insolvency Review, 29(1), 36-52.
[65] Thomas H. Jackson, (1986) The Logic and Limits of Bankruptcy Law ,Harvard University Press, 7–19.

opportunities. Lastly, enforcing this rule can be challenging because the financial information of the companies that do not get audited might be not reliable. Also, in case the valuation of assets and liabilities has been registered using the historical data instead of the fair value, the balance sheet would not show the real financial situation of the company.

Duty to prevent the company from incurring new debts vs duty to maximise the company and shareholders' value.

Some jurisdictions require corporate directors to stop a company from incurring more debts once it becomes insolvent. Some jurisdictions have adopted this rule through "insolvent trading" provisions. According to this duty, an insolvent company can incur more debts only if it's a part of a restructuring plan . If directors don't follow these rules,they can be personally liable for the company's debts and may face disqualification.

This approach has several advantages. First of all, it encourages non-viable companies to exit the market, which helps reallocate their assets and reduces the number of "zombie companies" that are not financially healthy but continue to operate[66]. It also protects less sophisticated creditors who might not realise a company is in financial trouble. Second, this model can promote taking corrective actions for viable but financially struggling companies timely and improve their situation.

Moving to the costs that restricting incurring more debts might bear. If the rule that prevents companies from incurring new debts is enforced strictly it can discourage companies from seeking for less costly way of solving the financial problems than an insolvency. It can also result in indecisiveness when choosing a high value creating investment projects and may push directors towards investing in less risky projects with the low net present value (NPV).

Moreover, if directors who neglect their duties to promptly initiate insolvency proceedings or ensure returns on investments, and instead accumulate further debts, are subjected to severe criminal penalties, it could deter skilled professionals from taking on directorship roles.

Therefore, the countries that implemented these regulations should find a way to effectively address the drawbacks that have been mentioned.

In some jurisdictions, the regulatory frameworks preventing firms from incurring more debt or timely initiating the insolvency process are not applicable even when the company is factually solvent. [67]On the contrary, they oblige the directors to maximize the shareholders' value. The

[66] Harris, J. (2016). Reforming insolvent trading to encourage restructuring: Safe harbour or sleepy hollows? Company and Securities Law Journal, 34(1), 43-56.

[67] Cork, K. (1982). Report of the Review Committee on Insolvency Law and Practice (Cmnd 8558). London: HMSO.

key distinction between solvent and factually insolvent firms lies in who indirectly bears the costs and benefits of the managers' decisions—shareholders in solvent firms and creditors in factually insolvent ones. In both scenarios, however, the company directly experiences the gains and losses, and directors are obligated to maximize the firm's value by pursuing investment projects with the highest net present value (NPV). For a solvent company, this approach will affect shareholders, while for an insolvent company, it will impact creditors, particularly those who become the firm's residual claimants. This model has a number of benefits. Firstly, when directors are not obligated to initiate insolvency proceedings within a set timeframe, they have the opportunity to manage the financial situation independently, without court intervention. This can save the company both the time that would otherwise be spent determining the precise moment insolvency occurred and the legal costs associated with the litigation process. Lastly, the risk of directors' becoming more risk-averse when choosing an investment project reduces to minimum.

Within this framework, shareholders tend to act recklessly when making decisions, since after the formal insolvency occurs there will be no gain for them.

Similarly, when the company is solvent, creditors, who are entitled to a fixed return on their investment, would prefer to avoid transactions that involve high risks. Even if the company's return on investment increases, it does not impact the creditors' profits.

However, both approaches carry the risk of diminishing the company's value. In the first scenario, overinvestment in projects with negative or low net present value could occur, while in the second, the company may fail to fully capitalise on its potential to raise funds.

Additionally, the model has one serious drawback. Namely, the model is limited to jurisdictions that promote the shareholders value-maximising principles (North America). However,the power of shareholders' to appoint, fire or remunerate the directors during the pre-insolvency, in the zone of insolvency or in factual insolvency of the company leads to the possibility for shareholders' opportunism. Unless, they adopt other mechanisms and regulations that can effectively address the issue of shareholders' opportunism.

After the most common regulatory models have been discussed, the next question would be how to identify the most optimal model?

There are several factors to each countries:

- Differences in corporate ownership model
- The structure of the debt
- The judiciary's sophistication
- The effectiveness of insolvency processes

- Countries' overall financial development

Depending on the factors listed above,as well as political and economic policies of the specific countries , the regulatory models might be more or less desirable. So finding the optimal regulatory model should be based on the analysis of the unique features of each country.

In micro,small and medium-sized enterprises and large private equities, directors often work closely with shareholders, which can lead them to favor shareholders during insolvency, even if it harms creditors. [68]This increases the risk of directors making decisions that benefit shareholders but hurt creditors.

Since these types of companies are common worldwide, many countries might need to implement the more strict rules to protect creditors. For example, requiring directors to start insolvency proceedings earlier can help to prevent the possible misconduct. Without such protections, lenders may be less willing to offer loans, making it harder for businesses to get financing.

In companies with dispersed ownership, like those commonly found in the UK and the US, it makes more sense to have flexible rules about directors' responsibilities when the company is facing insolvency. For these publicly traded companies, it's important for directors to focus on maximizing the firm's value or minimizing potential losses for creditors.

In such companies, directors are usually less swayed by individual shareholders, allowing them to make independent decisions that may enhance the company's value, even if those decisions don't always benefit shareholders during insolvency. If shareholders are unhappy with these choices, they often struggle to replace the directors because it's hard for many individual shareholders to organize and take action together.

While this disconnect between shareholders and directors can create problems in healthy firms, it can actually help protect creditors when a company is struggling financially. This independence allows directors to make decisions that are better for creditors during tough times.

In companies with concentrated debt structures, which is typically seen in micro, small, and medium-sized enterprises (MSMEs) as well as larger firms that primarily depend on bank financing, creditors face minimal coordination challenges. This ease of coordination allows these companies to negotiate and reach agreements with their creditors more efficiently and

[68] Aurelio Gurrea-Martinez, 'Insolvency Law in Emerging Markets' (2020) European Business Organization Law Review, 21(2), 365-395.

often outside of formal legal proceedings. As a result, since these companies can manage their debts through direct negotiations without the need for court involvement, it wouldn't make much sense to impose a requirement for them to file for insolvency. The existing relationship between the company and its creditors can often facilitate smoother resolutions.

In contrast, companies with dispersed debt structures present a different situation. In these firms, where the debts are spread across many creditors, the provisions and specialized processes provided by insolvency laws become significantly more valuable. These laws offer mechanisms for renegotiating and adjusting debts, which are essential when multiple creditors are involved and may have differing interests. Because of this complexity, requiring companies with dispersed debt structures to initiate insolvency proceedings can be more justified.

Consequently, while imposing a duty to file for insolvency may not be necessary or desirable in countries where many MSMEs and large firms rely heavily on bank financing, which is the case in most parts of the world, it could be more appropriate in jurisdictions where companies typically have dispersed debt structures. This scenario is especially relevant in the context of publicly listed companies in the United States, where the variety of creditors and the nature of their relationships can necessitate a more formal process to ensure fair treatment of all parties involved. In such cases, having the option to file for insolvency can help facilitate negotiations and provide a structured framework for resolving debts, ultimately benefiting both the companies and their creditors.

In countries with well-developed and reliable court systems, such as the United States, the United Kingdom, and Singapore, courts are generally better equipped to handle complex cases. In these jurisdictions, it makes sense to allow courts greater discretion in overseeing insolvency matters. This means that courts can be trusted to assess each situation on a case-by-case basis and determine the best course of action to minimize losses for creditors. Therefore, giving courts the power to decide when directors should take steps to reduce creditor losses is more appropriate in these countries.

However, in countries where the judicial system is less sophisticated or less reliable—common in many emerging markets and even some advanced economies—the courts may not have the capacity to make these complex decisions effectively. In such cases, giving too much discretion to courts could lead to inconsistent or unfair outcomes. For this reason, it is better to rely on clear rules rather than flexible standards, so directors and companies know exactly what actions they need to take.

As a result, in countries with less developed courts, it may be more effective to impose a strict duty to initiate insolvency proceedings. This would ensure that directors follow a set process, reducing the risk of poor decisions or mismanagement during insolvency due to weaknesses in the judicial system.The effectiveness of insolvency process plays a crucial role in cases where the court is less reliable and complicated. If the insolvency process is time consuming and potentially destroying the value of the company and forcing the directors to initiate insolvency as early as possible, in this case another regulatory model should be considered.

3.1.1 The Gheewalla case and Directors' Dilemma

The corporation divides ownership and management, giving rights to shareholders on significant corporate decisions and giving directors the authority to manage the affairs of the corporation. [69]In their management of the corporation, directors owe fiduciary duties of care and loyalty to the corporation and to its shareholders[70]. Delaware law is generally deferential to the business decisions of directors so long as their business decisions of directors so long as their decisions are made in an informed and good faith manner and so long as they abstain from placing personal interests above those of the corporation. [71]The Delaware General Corporate Law (DGCL) fortifies this deference by enabling corporations to amend their corporate charters to exculpate directors for breaches of their duty of care[72]. Shareholders in U:S are ginven both the right to vote in board elections and to sue for breaches of fiduciary duties to police the execution of directors' duties.[73]

Creditors, much like shareholders, hold a financial interest in the corporation. However, unlike shareholders, creditors lack the privilege of voting rights or the ability to bring fiduciary claims against directors of a solvent corporation[74]. Instead, creditors rely on a framework of contracts and a range of common law and statutory remedies to safeguard their rights. Within the realm of contractual agreements, creditors have the autonomy to address potential contingencies and can pursue remedies such as contractual damages or rescission in the event of a breach by the corporation.[75]

Furthermore, creditors possess recourse through legal avenues such as fraudulent conveyances law, illegal dividends law, implied covenants of good faith dealing, and bankruptcy law. These

[69] Levine v. Smith, 591 A.2d 194, 207 (Del. 1991).
[70] Ivanhoe Partners v. Newmont Mining Corp., 525 A.2d 1334, 1341 (Del. 1987).
[71] Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
[72] Del. Code Ann. tit. 8, § 102 (1983).
[73] Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004).
[74] Geyer v. Ingersoll Publications Co., 621 A.2d 784, 787 (Del. Ch. 1992).
[75] Production Resources Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772 (Del. Ch. 2004).

mechanisms serve to protect creditors' interests and ensure that they are not unduly disadvantaged in the event of corporate mismanagement or insolvency. Additionally, creditors mitigate their risk exposure by factoring in the likelihood of default when determining interest rates.

Despite sharing in the benefits of a financially prosperous company, creditors and shareholders diverge significantly in their interests during times of financial distress. This situation creates a difficult problem for directors, as they have to manage the conflicting interests of both groups within the company. Shareholders typically prioritize maximizing returns on their initial investments. However, creditors are more concerned with ensuring the repayment of debts owed to them and minimizing the risk of financial loss. Thus, directors must strike a delicate balance in addressing the needs and concerns of both groups amidst challenging financial circumstances.

When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners. Delaware courts have addressed the issue of wealth transfer by altering the main emphasis of fiduciary responsibilities from shareholders to creditors when a company becomes insolvent. Cases like Production Resources Group and Geyer have established the juncture where fiduciary duties broaden at the onset of insolvency. They argued that shareholders hold residual claims to corporations during solvency, with creditors assuming this role upon the company's insolvency..However, in 2007,after the Gheewalla case , the Delaware Supreme court ruled that a corporation’s creditors may bring derivative claims against its board of directors for violating its fiduciary duties, but only after the corporation became insolvent.Thus, granting creditors with another legal protection. The Court therefore rejected Vice Chancellor Strine’s conclusion in Production Resources Group that creditors of an insolvent companies may bring direct claims against directors for breach of fiduciary duties. However, the Court concluded that ‘ the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. A direct claim involves a creditor initiating legal action against a debtor based on a direct transaction or agreement, with recovery going directly to the creditor. In contrast, a derivative claim is brought by a creditor on behalf of the company (often against its directors or officers) due to harm affecting the company's interests, with recovery benefiting the company and indirectly the initiating creditor by preserving or enhancing the value of the

company's assets.The case was decided in 2007 and has since been influential in shaping corporate governance principles in Delaware, a key jurisdiction for corporate law in the United States.The case involved a dispute between North American Catholic Educational Programming Foundation (NACEPF), a Delaware nonprofit corporation, and its former directors and officers. NACEPF had become insolvent and subsequently filed for bankruptcy. The bankruptcy trustee sued the former directors and officers, alleging that they breached their fiduciary duties by continuing to operate the corporation when it was insolvent. The primary issue in the case was whether directors and officers of an insolvent corporation owe fiduciary duties primarily to creditors rather than shareholders. This question becomes more relevant in cases of corporate insolvency because the interests of creditors become paramount due to the corporation's inability to meet its obligations.The Gheewalla case established several important principles regarding the duties of directors and officers in the zone of insolvency:

1. Zone of Insolvency Doctrine Rejected: One of the key aspects of the court's decision was its rejection of the "zone of insolvency" doctrine. This doctrine, which had been recognized in some other jurisdictions, suggested that once a company entered a "zone of insolvency," the fiduciary duties of directors and officers shifted from the shareholders to the creditors. However, the Delaware Supreme Court held that there was no separate "zone of insolvency" under Delaware law and that fiduciary duties remained owed to the corporation and its shareholders regardless of its financial condition.
2. **Continued Duty to Corporation**: Directors and officers owe their fiduciary duties primarily to the corporation itself, even when the corporation is insolvent or in financial distress.
3. **Balancing Interests**: Directors and officers should consider the interests of all stakeholders, including shareholders and creditors, in managing the affairs of the corporation during insolvency.
4. **Avoiding Fraudulent Conduct**: While fiduciary duties continue, directors and officers must avoid engaging in fraudulent conduct or actions that harm creditors knowingly.

The necessary consequence of Gheewalla, constructed in light of other relevant authorities, is that where business strategy may generate a return for equity holders, the board must favor that strategy and reject alternatives, even if in the board’s business judgment the strategy is unlikely to succeed, and alternatives, on a risk-based basis, would maximize the enterprise value.

The Gheewalla decision clarified the role and responsibilities of directors and officers in navigating insolvency situations, providing guidance on how fiduciary duties should be

exercised when a corporation faces financial distress. This case has been influential in corporate governance practices, particularly in Delaware, and is often cited in discussions related to the duties of directors and officers in distressed corporate scenarios. However some questions were left unaddressed. First of all , whether creditors need to show that the corporation continued to be insolvent during the course of the litigation. And did insolvency have to be irretrievable? Because The Court of Chancery had previously declined to appoint receivers for insolvent companies when there was some chance the company would become solvent in the future. Thus, only if the insolvency was said to be “irretrievable” receiver appointed. These questions were answered in Quadrant case.

3.1.2 Athilon Capital Corp and Indenture Agreements: The Quadrant Case

Athilon Capital Corp, founded in 2004, played a significant role in the credit derivative market by offering credit default swaps (CDS) to provide credit protection for financial institutions. To raise capital for its operations, Athilon issued several classes of debt securities, totaling $600 million. These securities included senior subordinated notes, subordinated notes, and junior notes, which were acquired by investors like Quadrant and EBF& Associates.

The onset of the global financial crisis in 2008 posed substantial challenges for Athilon, as it faced heightened credit risks that exceeded its available capital reserves. Consequently, Athilon entered a "runoff mode" due to suspension events, impacting its ability to meet its financial obligations to investors. Quadrant alleged that actions taken by directors controlled by EBF on Athilon's board favored EBF's interests to the detriment of Quadrant's investment in senior subordinated notes.

Quadrant initiated legal proceedings against Athilon, EBF, and others, asserting claims of breaches of fiduciary duty and fraudulent transfers. The defendants moved to dismiss Quadrant's complaint based on a no-action clause contained in the indenture governing Quadrant's notes. This clause restricted individual securityholders from initiating legal actions unless specific conditions were met, including trustee involvement and approval by a majority of securityholders.

The Delaware Court of Chancery initially dismissed Quadrant's complaint, citing legal precedents like Feldbaum v McCrory Corp and Lange v Citibank, which upheld the enforceability of similar no-action clauses. These precedents established that such clauses limit securityholders to actions initiated by the trustee under certain conditions.

On appeal to the Delaware Supreme Court, Quadrant contended that the no-action clause in this case differed from previous cases because it specifically referred to claims under the indenture, rather than claims related to the securities themselves. The Supreme Court remanded the case to the Chancery Court for further analysis under New York law, governing the indenture.
The Court of Chancery conducted an exhaustive analysis of relevant New York cases and the specific language of the Athilon no-action clause. It concluded that the clause's scope was limited to contractual claims arising under the indenture and did not extend to common law or statutory claims unrelated to the indenture.

In response to certified questions from the Delaware Supreme Court, the New York Court of Appeals provided a comprehensive analysis of the no-action clause's language and intent. The court emphasized the importance of strictly construing contract terms and concluded that the language of the Athilon clause, focusing solely on the indenture, did not encompass common law or statutory claims unrelated to the indenture.

The court relied on precedents such as Gen. Inv. Co. v Interborough R.T. Co. and Cruden v Bank of New York to support its interpretation that the scope of a no-action clause is defined by its specific language. Clauses that explicitly include "the Securities" broaden their reach to encompass a wider range of claims, unlike the narrower scope of the Athilon clause.

Ultimately, the Court of Appeals affirmed the interpretation that the Athilon no-action clause only barred claims arising directly from the indenture. Quadrant's common law and statutory claims, such as breaches of fiduciary duty, were deemed outside the clause's scope. This decision provided clarity on the boundaries of no-action clauses in trust indentures, emphasizing the critical role of precise contractual language in defining the rights and remedies available to securityholders.

The Quadrant case serves as a comprehensive exploration of the intricate legal nuances inherent in financial litigation and the interpretation of trust indenture agreements. It highlights the importance of precise drafting and contractual language in shaping the rights and obligations of parties in complex financial transactions. Moreover, the case underscores the evolving nature of securities law and the challenges of balancing investor rights with the need for contractual clarity and predictability.

The Quadrant case has far-reaching implications for financial markets and the enforcement of no-action clauses within trust indentures. By providing detailed legal analysis and clarifying the scope of such clauses, the courts have contributed to a more nuanced understanding of investor protections and contractual obligations in the realm of securities litigation.
In the Quadrant Structured Company, LTD v. Athilon Capital Corp case, important questions arose regarding creditor standing and the requirement of proving company insolvency during litigation. Quadrant clarified that creditors only need to demonstrate company insolvency at the time the complaint is filed, without a necessity for continuous insolvency throughout the litigation process.

Another significant issue addressed by Quadrant was whether the insolvency had to be irretrievable for creditor standing. The court determined that proving irretrievable insolvency is not required to maintain standing.

These holdings were crucial as the defendant argued that the company had become solvent during litigation or would soon be solvent. Had Quadrant required proof of post-filing insolvency or irretrievable insolvency, the plaintiff's claims would likely have been dismissed.

Quadrant also employed a balance sheet test for determining insolvency, which simplifies the assessment compared to other tests. This approach strengthens creditor rights in breach of fiduciary duty claims.

However, Quadrant is not entirely favorable to creditors. Before 2007, creditors argued that directors of insolvent corporations owed them a duty to protect creditor interests over stockholder interests. Gheewalla rejected this theory, affirming that directors owe a duty to the corporate entity as a whole, allowing them to make business decisions based on their judgment.

Despite these challenges, self-dealing by directors is not protected under the business judgment rule or director exculpation provisions. Quadrant addressed claims of self-dealing by directors, highlighting the importance of legal avenues such as the Quadrant decision for creditors pursuing breach of fiduciary duty claims.

3.2. Codification of fiduciary duties. Comparable analysis between UK and Ireland

The UK Common Law recognizes the fiduciary duty owed to the creditors by the company directors when the company enters insolvency or the ”zone of insolvency”. [76]
The reason is that shareholders receive nothing from insolvent liquidation and the directors and management that prioritises the shareholders might get involved in high-risk operations or implement unfavourable for creditors strategies[77].

In several cases, courts have held that directors breached their duties to creditors by dissipating company assets before the liquidation proceedings, either to themselves or related parties. For example, in Walker v Wimborne, the court held that the movement of funds from one company Asiatic Electric Co Pty Ltd (Asiatic), to another in a same corporate group was made in total disregard of the creditors' interests. In order to prevent such “self distribution”, the UK Common law requires the company directors to take into consideration also the interests of the creditors when the company faces difficulties. [78]Another significant case in South Wales Court of appeal is Kinsela v Russell Kinsela Property Ltd, the court held that granting a lease of company assets to two company directors at the undervalue with an opportunity to buy the mentioned properties at value lower than market price when the company was insolvent was made against the fiduciary duties to creditors.Street C.J stated that the goal of this property relocation was to make creditors unable to reach these assets which clearly is a breach of directors’ fiduciary duties.

The Irish benchmark case Re Frederick Inns LTD involved a number of insolvent companies under the same corporate group . The company directors have decided to sell the assets of certain companies belonging to the group to repay tax debts of not only those companies whose assets were involved, but also several other companies. Additionally, the certain amount of creditors’ debt including the one owed to Revenue has been repaid As a result, tax liability repayment of a whole group and individual companies’ creditors’ interests were prioritised.
The High Court of Ireland stated that a transaction to Revenue was a breach of Directors’ fiduciary duties owed to the general creditors of the group.

As a result, Revenue appealed to the Supreme court. However, the Supreme court supported the High court’s decision referring to Street C.J’s judgement in Kinsela v Russel. The Irish Supreme court judge Blayney J held that when the company was clearly to be liquidated and

[76] John Quinn & Philip Gavin (2023) The creditor duty post Sequana: lessons for legislative reform, Journal of Corporate Law Studies.
[77] Aurelio Gurrea-Martínez, ‘Towards an Optimal Model of Directors’ Duties in The Zone of Insolvency: An Economic and Comparative Approach’ (2021) Journal of Corporate Law Studies 365-385. 21(2).
[78] Berghe and Baelden, (CUP 2015) Company Law and Sustainability: Legal Barriers and Opportunities, B. Sjåfjell and B.J Richardson (eds), 89-101.

its assets should have been used to meet its liabilities in pro tanto basis, company directors had a duty to to preserve the assets so that this could be done, or at least not to squander them.

Although the codification of fiduciary duty to creditors along with the other fiduciary duties in Company Act 2006 was intended, it was withdrawn on the final stage leaving its development to Common law. The Government preferred a case-by-case approach, allowing for flexibility in determining when the duty is triggered and how Directors should have balanced the two opposite interests. [79]
Additionally, Codifying creditor duties could have created a factor that discourages Directors from making reasonable attempts to trade out the company from difficult situations.

In Ireland, the Review Group recommended including a creditor duty, citing the need for accessibility and clarity[80]. But the duty was not included in the 2014 Act. The Group's second attempt in 2017 was also not successful ,despite it being later included in COVID-19 suite in 2020[81]. The reason creditors duty wasn't codified is its complex nature that can create a conflict of interests within the organization.

Meanwhile,the UK seemingly reached the compromise in 2006 Act by including section 172(3) that stated:
"The obligation to enhance the company's success is contingent upon any legislation or legal regulation that mandates directors to take into account or act in the interests of creditors."
The interpretation of the section 172(3) has been disputed, some scholars viewed this as an additional endorsement of the Common law. [82]

The trigger point of creditor duties is a complex area that involves balancing competing interests, leading to a reluctance in both the UK and Irish parliaments to codify the duty.
The Sequana judgement was the first significant consideration of the creditor duty by the UK's Supreme Court. The court engaged with many questions posed by the duty, including the circumstances in which it arises, specifically if it is triggered where there is a real risk of insolvency.

[79] Department of Trade and Industry. (2001). Modern company law for a competitive economy: Final report. London: HMSO.
[80] Department of Trade and Industry. (2001). Modern company law for a competitive economy: Final report. London: HMSO.
[81] Companies (Miscellaneous Provisions) (Covid-19) Act 2020.
[82] Section 172(3) of the UK 2006 Act.

The court unanimously rejected the "real risk of insolvency" test, stating that the duty does not apply merely because the company is at real and not remote risk of insolvency at some point in the future.

The court acknowledged that future liabilities should not be ignored, but how far directors should look into the future was left to the legislature.
The judgement failed to identify a particular trigger point for the duty, leaving it open to interpretation.

Although ,allowing a flexibility of judgement in court to a certain level is optimal, more clarity in the Sequana case could be achieved. Irish codification could be one way of achieving it, particularly by providing insights in relation to when the duty is triggered.

Nevertheless, a number of English cases have recognized that directors must consider the interests of creditors even before a company becomes insolvent. This duty arises when a company is "bordering on insolvency," "on the verge of insolvency," or "potentially insolvent." In “Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd,” the High Court ruled that when a company is insolvent, nearly insolvent, or its solvency is in doubt, and creditors' money is at risk, directors must act in the interests of creditors when carrying out their duties to the company. [83]Similarly, in “Ultraframe Ltd v Fielding,” the court held that if a company is in financial trouble, even if not technically insolvent, and creditors may be at risk, the directors' responsibilities extend to protecting creditors' interests as well.

Ireland was not chosen randomly as a comparison jurisdiction to UK, unlike USA,Australia and EU members, UK and Ireland have almost identical Common law backgrounds.
Not too long before Sequana case,in 2022, Ireland presented Regulations 202215 (Irish Regulations) which amended the Irish Companies Act 2014 to require company directors to take into account the creditors,when the company is unable or likely will soon be unable to pay its debts,as was recommended prior by The Review Group.Before the reform of Act 2014, the UK and Ireland shared the same position related to creditor duties.However, in 2022 ,as opposed to the outcome of Sequana,Irish regulations have provided with specific financial situations that can give a rise to the creditors duty.

[83] Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2003] 2 B.C.L.C. 153 [74].

As of July 27, 2022, Ireland's duty to consider creditors' interests is now legislatively grounded. The reform wasn't aimed to revise existing laws, but to make an effect to EU law.

Regulation 2,section 224 of Irish Regulations states:
A director of a company who believes, or who has reasonable cause to believe, that the company is, or is likely to be, unable to pay its debts (within the meaning of section 509(3), shall have regard to –Creditors' interest.Namely: [84]

- Measures that should be taken to avoid the insolvency
- Avoiding negligent conduct that put the company's viability under the risk.
- Another significant development in section 224 of Irish regulations is the definition of insolvency as outlined in section 509(3) of the 2014 Irish Act.

It provides that the company is insolvent, or nearing insolvency if:
It cannot pay its financial obligations when they are due.
The amount of its liabilities exceeds its assets, taking into account all the contingent liabilities.
The conditions outlined in section 570(a), (b), or (c) apply to the company.
[85]

Section 570 (a) states that, the company is considered insolvent when it fails to pay a creditor's written demand of repayment of debt exceeding 10.000 £ within 21 days.
Section 570 (b) is applicable when company owes more than 20.000£ and fails to satisfy a written demand of repayment to two or more creditors within 21 days.
Section 570 (c) is applicable if a creditor obtains a judgement or court order and the execution or other process related to it is returned, either fully or partially unsatisfied.

Additionally, section 509(3)(b) provides a technical definition of an insolvency. More preciesly, it is called a balance sheet insolvency when the liabilities of the company exceed its assets. The reason for including balance sheet insolvency in the 2014 Irish Act was that many companies face balance sheet insolvency to some certain degree. This broader definition allows it to apply to a wide range of directors and companies.
The Irish government received a lot of criticism from Irish lawyers and scholars, partially for going against the original recommendations from the Irish Review Group, that recommended to avoid the codification of the balance sheet insolvency. [86]

[84] Gavin, A. (2021). Jumping the gun: Codifying the duty to consider the interests of creditors in the Companies Act 2014. Journal of Business Law, 23(4), 401-420.
[85] Quinn, J. & Gavin, P. (2023). The creditor duty post Sequana: Lessons for legislative reform. Journal of Corporate Law Studies, 23(1), 17-35.
[86] Department of Enterprise, Trade and Employment European Union (Preventive Restructuring) Regulations 2022 Information Note.

The significance of section 224 lies in the fact that it sets the objective criteria required for the duty to arise. This change represents an evolution towards a more objective way of assessing directors' duties.It makes it harder for Directors to use subjective reasons to avoid their responsibilities. It also better addresses the complexities of insolvency, which involves multiple, including external factors.

There are two main ways to measure insolvency: balance sheet and cash flow, and figuring out which applies can be challenging due to various financial indicators and risk assessments involved. By focusing on whether a director has a reasonable cause to believe that the company is facing insolvency, the rules align better with real-world situations. This means that both directors and courts will concentrate on how directors identify financial risks. The reasonableness of a director's belief will be evaluated based on the business judgment [87]and reasoning the board uses to assess the company's financial condition.

The UK Supreme Court's decision on the Sequana case did not provide any practical guidance for the English company directors, therefore the question if directors should be subjectively aware of the current financial situation in order for the duty to apply remained unaddressed.
One of the main concerns that the codification of creditors' duty raises, is the likelihood of directors becoming more risk-averse and prioritizing the creditors' duties over the traditional ones. [88]

The major challenge across common law was to identify when exactly the duty arose: was it triggered by insolvency and how to determine it, or was it triggered before the insolvency began?

Particularly UK common law courts applied the creditors duty usually when the facts provided made it clear that the creditors' assets were at risk,rather than legal and accounting-based analysis. A key difference between common law and Irish codification is whether a director needs to be subjectively aware of the company's insolvency or financial difficulties for the duty to apply. The Irish duty is relevant for a director who has reasonable grounds to suspect that the company is currently unable, or is likely to become unable, to meet its financial obligations.

[87] Quinn, J. & Gavin, P. (2023). The creditor duty post Sequana: Lessons for legislative reform. Journal of Corporate Law Studies, 23(1), 9-25.
[88] Company Law Review Group, First Report (2001). Department of Business, Innovation and Skills.

This creates a clear standard criteria for enforcing the duty, making it easier for liquidators to pursue claims, as there is no legal requirement to prove the directors' subjective awareness of the company's insolvency

Alternatively, the judges in Sequana had differing opinions on whether a director's subjective knowledge of the company's insolvency or financial difficulties was necessary for the duty to apply. Lord Briggs and Lord Hodge thought that a director's duty would only kick in if the director realises that the company is likely to become insolvent or face liquidation[89]. They believed this view fits with the laws against wrongful trading. On the other hand, Lord Reed wasn't as convinced that having knowledge was essential for this duty. He pointed out that previous cases, like "West Mercia", didn't require this knowledge, and he felt the duty was separate from the issue of wrongful trading. After the "Sequana" case, it's still unclear what level of knowledge a director needs to have regarding the company's financial troubles for their duties to apply.[90] In contrast, Irish law clearly states that if a director is unaware of the company's financial situation, that does not allow them to avoid their responsibilities. This difference shows that codifying the creditor law in UK can also provide more certainty and clarity about directors' duties.

The main concerns against setting a criteria for both triggering the duty and what is directors' obligations to do after, as was already discussed before, it might cause risk-averse trend among the directors. Lead to cases where the business context has not been appropriately studied, and only the technicalities were taken into account, hence creating a mechanical court system.

Sealy strongly criticized the shift in fiduciary obligation towards technicality becoming a decisive factor. He argued that directors' decisions should be evaluated within the context of the ongoing business concerns and by applying a broad standard, rather than relying on a technical test. The case that illustrates the importance of the application of broad standards- Irish High Court case of Re Heffernan Kearns Ltd[91], where reckless trading proceedings were initiated against the directors of an insolvent company. The directors took actions aiming to prevent immediate liquidation, allowing the company to continue operations and accumulate additional debt in order to fulfil an unfinished contract. J. Lynch stated that in some situations, it is necessary for the company to keep trading and even take on additional debt, despite the company's significant financial difficulties. Otherwise, many businesses that could have

[89] BTI 2014 LLC v Sequana SA [2022] UKSC 25, [422].
[90] BTI 2014 LLC v Sequana SA [2022] UKSC 25, [41].
[91] Pound, R. (1908). Mechanical jurisprudence. Columbia Law Review, 8(8), 605-623.

survived the financial distress thanks to successful outcome of trading could have been lost forever.

Although Irish Regulations set a great example to other countries and play a crucial role as a comparative jurisdiction for the UK, this does not imply that the UK should adopt an Irish provision. Any UK codification should take into consideration the broader differences between the Irish 2014 Act and the UK 2006 Act. Sequana outcomes make it unlikely for English common law to experience significant improvements in near future, thus implementing a statutory duty may be a suitable approach.

3.2.1 Grant v. Ralls; Court of Appeal's Decision in BAT Industries Plc v. Sequana SA; Re Noble Vintners Ltd

Research on the developments in British law regarding the treatment of directors of insolvent companies can be summarized by three recent court decisions. The first is Mr. Justice Snowden's decision in Grant v Ralls, which addresses the approach to determining quantum in 'wrongful trading' cases under sections 214 (liquidation) or 246ZB (administration) of the Insolvency Act 1986. The second is the Court of Appeal's decision in BAT Industries Plc v Sequana SA, which concerns the scope of the common law duty-shifting rule (the 'rule in West Mercia Safetywear v Dodd'). [92]The third is the new compensation order regime in the Company Directors Disqualification Act 1986, exemplified by the case of Re Noble Vintners Ltd.

Grant v Ralls involved a construction company that went into administration and then liquidation after experiencing losses due to the 2008 recession and severe weather condition. Judge Snowden ruled that by 31 August 2010[93], the company's directors should have realized there was no reasonable prospect of avoiding liquidation. Despite the directors' belief that they could save the company through a deal with an investor, by the end of August, it was evident that the investor was unreliable, making liquidation unavoidable.

From the end of August until the company entered administration on 31 October 2010, the directors did not take all necessary steps to reduce losses to the company's creditors.[94] This oversight allowed the court to hold the directors liable for contributing to the company's assets. However, Judge Snowden decided against this because he was not convinced that the continued trading had worsened the company's financial situation. In fact, he believed the company's financial position had likely improved during this period due to cost-cutting measures and

[92] BTI 2014 LLC v. Sequana S.A. [2019] EWCA Civ 112; 2 All E.R. 784 (06 February 2019).
[93] Grant & Anor v Ralls & Ors (re Ralls Builders Ltd) EWHC 243 (Ch); [2016] Bus LR 555.
[94] Ralls v City Span Ltd [2016] Bus LR 555 (30 June 2016).

project completions, which increased profits and allowed the company to recover debts that would not have been fully collected in insolvency.Judge Snowden concluded that the directors had not met the defense under section 214, which requires taking every possible step to minimize potential loss to the company's creditors, because trading after 31 August 2010 had a varied impact on the creditors. On 31 August, the company owed £554,530.83 to its bank under a secured overdraft facility. Had the company entered liquidation immediately, a portion of this amount would have been allocated to unsecured creditors. However, by the time the company entered insolvency proceedings, the overdraft had been repaid, eliminating that allocation. Additionally, some creditors from before 31 August remained unpaid, and new trade creditors had emerged and were also unpaid. The directors claimed that their actions aimed to reduce the company's net deficit, thus meeting the defense criteria. By the defense criteria, it is meant Section 214(3) of the Insolvency Act 1986,that pertains to "wrongful trading" and provides a defense for directors of a company in liquidation.[95] It states that directors can avoid personal liability for wrongful trading if they can prove that, after realizing there was no reasonable prospect of avoiding insolvent liquidation, they took every step with a view to minimizing potential losses to the company's creditors. Essentially, it sets a high standard of conduct for directors, requiring them to demonstrate that they did everything possible to reduce the financial impact on creditors once they became aware that insolvency was inevitable.

Judge Snowden disagreed with the directors' defense by emphasizing that section 214(3) of the Insolvency Act 1986 sets a very high standard for directors. He stated that the section clearly intends to impose a rigorous requirement on directors. To successfully use the defense under this section, directors must prove not only that they continued trading to reduce the overall financial shortfall of the company but also that their actions were carefully planned to minimize the risk of loss to each individual creditor. Snowden J argued that interpreting section 214(3) strictly is appropriate, meaning directors cannot merely claim they acted to reduce the company's total debt without regard to how their actions affected individual creditors. [96]If such a general claim were allowed, directors could justify their actions by saying they aimed to reduce the total deficit for all creditors collectively, regardless of the varying impacts on different creditors.[97] Thus, the defense requires directors to show precise and targeted efforts to protect individual creditors from further losses.

[95] Section 176A of the Insolvency Act 1986.
[96] Ralls v Re City Span Ltd [2016] Bus. L.R. 555 at [245].
[97] Ralls v Re City Span Ltd [2016] Bus. L.R. 555 at [243], see also [216],[224], [221],[245] .

Since the directors failed to prove that their trading was intended to minimize individual creditors' losses, they were theoretically liable to contribute to the company's assets. However, legal authorities also indicated that:

"the correct approach to determining whether the directors should be required to make a contribution... is... to ascertain whether the company suffered loss which was caused by the continuation of trading by the company after 31 August 2010 until the company went into administration... and that as a starting point this should be approached by asking whether there was an increase or reduction in the net deficiency of the company as regards unsecured creditors as between the two dates"[98]

Since there was no increase in the overall deficit, the company did not incur any loss that would necessitate a contribution order for compensation. It's not required under s.214 that directors must have continued trading past the point when they knew or should have known that avoiding insolvent liquidation was impossible. [99]However, Snowden J correctly concluded that, based on current law, a contribution can only be ordered to compensate for the company's loss caused by directors' actions (or inactions) after they knew or should have known that insolvent liquidation was inevitable. If there has been no increase in the net deficit during this period, there is no loss to compensate. The authorities on this matter are from first instance decisions, but numerous cases, as noted by Professor Moss in his thorough review, largely align in the same direction with one exception. To rule that a compensation order could reflect a director's actions (or inactions) causing loss to one or more creditors, even if there was no loss to the company, would mark a significant change in established law. This change would be challenging to justify, especially considering that s.214 mandates contributions to "the company's assets" rather than to the creditors' assets, supporting an interpretation that emphasizes corporate rather than creditor loss. The decision in Ralls regarding the application of quantum under s.214 is a significant one. However, it must be considered whether a wrongful trading rule that does not provide a remedy when the positions of some creditors are improved relative to others leading up to the commencement of insolvent liquidation is desirable in policy terms. The mere fact that some creditors have been paid and others have not, or that some creditors have been paid and some new creditors acquired during the relevant period, is not seen as a sufficient basis for imposing personal liability on directors.[100] If it were, trading would generally not be possible after it is known or ought to be known by directors that there is no

[98] Ralls v Re City Span Ltd [2016] Bus. L.R. 555 at [241], drawing on Re Continental Assurance Co of London plc [2007] 2 BCLC 287 (Ch) (14 December 2006), and Re Purpoint Ltd [1991] BCLC 491 (Ch) (20 December 1990).
[99] Moss, T. (2017). "No compensation for wrongful trading – where did it all go wrong?", London: Insolvency Intelligence Publishing. 30(4), 49.
[100] See also *Ralls* [2016] Bus. L.R. 555 at [235]-[236], (2007).

reasonable prospect of avoiding insolvent liquidation, as trading will inevitably require the payment of some liabilities and the incurring of others. It is important that directors be permitted to trade on after the relevant time, as in some circumstances, this will maximize the value of the estate (as in Ralls). The flexibility of the rule (and the related capacity for value maximization) would be lost if s.214 were replaced with a mandatory filing rule that simply required proceedings to be commenced by directors at the relevant time.

There are, however, certain situations where it seems entirely appropriate to hold directors personally liable for prioritizing the payment of some creditors over others. One example is when directors cause the company to incur new debt to pay off old debt, knowing the new debt cannot be repaid when due. Such behavior is considered dishonest under the fraudulent trading rule in s.213, so a remedy should be available in these cases. Another instance where personal liability seems appropriate is when directors use existing company assets to pay some creditors before others to gain some indirect benefit for themselves. This conduct, akin to a 'mini-liquidation' for personal gain, constitutes fraud on creditors, and it would be unfortunate if unpaid creditors had no recourse against the directors in such cases. If the principles in Ralls and the authorities it relied on remain valid, s.214 will offer no remedy, as the payment of a preference does not cause a loss to the company. [101] However, there is another route to a remedy: the rule in West Mercia Safety v Dodd has been applied to require directors of insolvent companies who authorize self-interested payments to creditors, in breach of their fiduciary duties, to restore to the company what has been paid out to creditors.[102]

Before examining the rule in West Mercia as refined by Sequana, it is important to note that Ralls does not fit into either of these categories. In Ralls, old creditors were not paid using new borrowings; instead, the bank and other pre-commencement creditors were paid from the realization of assets (the contracts), supported by some new trade creditors. Because these contracts were completed at a lower cost than initially forecast, there was more to distribute than if the company had immediately entered liquidation. Ralls is closer to the second category of cases, involving the realization of largely existing assets to pay some pre-commencement creditors, including the secured bank, ahead of others. However, the payments appear to have been made for commercial reasons rather than self-interest.

At its core, Ralls is a case where some creditors were paid before others in a situation where the directors could not reasonably expect the unpaid creditors to recover in full. Imposing

[101] Eidenmueller, H. (2006). Trading in times of crisis: Formal insolvency proceedings, workouts and incentives for shareholders/managers. European Company and Financial Law Review, 3(3), 235-258.
[102] Zwieten, A. (2018). Discussion on Re City Span Ltd and HLC Environmental Projects. Journal of Insolvency Law, New York. 62(1),382.

personal liability on directors in such a case may not be desirable. The advantages of compensating unpaid creditors must be balanced against the drawbacks of signaling to directors that they must assess the differential impact of continued trading on creditors, even when :

(i) continued trading is reasonably expected to maximize the estate's value, and
(ii) (ii) payments made to creditors are not driven by a desire to favor the payee.[103]

Once insolvent liquidation is certain, it is evident that personal liability should be imposed on a director who prioritizes a particular creditor's interests without believing it benefits the creditors as a whole, as established by the rule in West Mercia. However, it is less certain whether actions that benefit all creditors should be avoided by a director, even if some creditors are favored over others as a result. The requirement to sacrifice value preservation for equitable distribution may not always be desirable. Therefore, concerns are raised about requiring directors to prove that continued trading was “designed appropriately to minimize the risk of loss to individual creditors” to avoid a finding of 'wrongful trading,' as implied by Ralls.

Sequana

Sections 171 to 177 of the Companies Act 2006 ("the Act") consolidated the responsibilities that directors owe to their companies under both equity and common law. According to Section 170(4) of the Act, these consolidated duties should be interpreted and applied similarly to traditional common law rules and equitable principles, taking into consideration corresponding principles when applying these general duties.

The principles and rules underlying directors’ duties were extensively established in case law before the Act was codified.[104] The codification in the Act generally incorporates well-developed rules from case law concerning directors' duties. However, one area where clarity has been lacking is the duty of directors to consider creditors' interests once a company becomes insolvent or is nearing insolvency.

In his judgment for the Court of Appeal in BTI 2014 LLC v Sequana SA and others [2019] EWCA Civ 112 ("Sequana"), David Richards LJ has provided clear guidance on how this duty operates and when it comes into effect.

[103] GHLM Trading Ltd v Maroo [2012] EWHC 61 (Ch) (20 January 2012).
[104] Walton, P. (2019). Directors’ duty to act in the interests of creditors under section 172 of the Companies Act 2006. Wolverhampton Law Journal, 2, 47-54.

Section 172 of the Companies Act 2006 now codifies what was previously understood as the fiduciary duty of directors to act in "bona fide" the best interests of the company.[105] This statutory duty specifies that directors must act in a way they consider, in good faith, will most likely promote the company's success for the benefit of its shareholders collectively. In fulfilling this duty, directors must consider various factors such as the long-term impact of their decisions, the welfare of employees, and the effects on the community and environment.

However, this duty undergoes changes when the company faces insolvency or is at risk of becoming insolvent. In such situations, the director's duty shifts from being primarily to the company and its shareholders to being to the company, taking into account the interests of its creditors. When a company becomes insolvent, its assets are no longer available for the benefit of its shareholders. Instead, they are held for the benefit of the company's creditors.

Section 172(3) specifies that the obligation to advance the company's success is contingent upon any legal rule necessitating directors to consider or act in the interests of the company's creditors under specific circumstances. There has been considerable uncertainty about when this obligation to consider creditors' interests comes into effect. This aspect of the duty is clarified in the case of Sequana.

The Sequana case involved a wholly owned subsidiary AWA paying two dividends to its parent company Sequana. These dividends were settled through the set-off of an inter-company debt owed by the parent to the subsidiary. When the dividends were authorized, the subsidiary had stopped trading and its only liability was a contingent one related to environmental pollution from a business it had previously acquired and then sold. The subsidiary had insurance for this contingent liability and also had some old insurance policies. The directors believed that, after accounting for the difference between the insurance coverage and their best estimate of the liability, there was still a surplus that could be distributed to the parent to reduce the parent's debt to the subsidiary. Thus, a dividend was declared. The following year, it was determined that the insurance coverage was adequate to cover the contingent liability, meaning the previously set-aside provision could also be distributed to the parent, again reducing the parent's debt to the subsidiary through set-off. Consequently, a second dividend was declared and paid. This reduction in the parent company's debt meant that the subsidiary's claim for payment from the parent could no longer be used to meet the subsidiary's clean-up obligations if the insurance policies were insufficient.

[105] Companies Act 2006 (UK), section 172.

The subsidiary's obligation to cover clean-up costs was shared with two other companies, one of which contested the dividends. This company challenged the dividends directly, as a creditor of the subsidiary (claiming the subsidiary was required to indemnify it for clean-up costs), and through an assignment procured from another company. As an assignee, the company argued that the dividends should not have been paid under Part 23 of the Companies Act 2006, alleging that the solvency statement mandated by section 643 was improperly issued. Additionally, it contended that even if the dividends could be legally paid, they should not have been, based on the rule established in West Mercia Safetywear v Dodd. As a creditor, the company claimed the dividend transactions should be reversed as fraudulent under section 423 of the Insolvency Act 1986. The initial claim regarding Part 23 of the Companies Act 2006 failed in the first instance, and no appeal followed. In the Court of Appeal, the focus shifted to the West Mercia and section 423 claims. Here, the West Mercia claim, which had failed both at first instance and on appeal, is highlighted, while the section 423 claim succeeded.[106]

It was argued that in authorizing the dividends, the subsidiary's directors breached their duties under the West Mercia Safetywear v Dodd rule.[107] This rule requires directors of insolvent companies to prioritize creditors' interests. The rule doesn't create a new duty directly to creditors nor does it impose a new duty on the company. Instead, it modifies the existing duties directors owe to the company to include a heightened consideration for creditors, as a group. Thus, an action that might be appropriate for a director of a solvent company could be improper for a director of an insolvent company if it doesn't adequately consider creditors' interests. Such breaches cannot be authorized or ratified by shareholders, as this restriction is vital to protect creditors. Without it, the protection offered by the rule would be meaningless.

These parts of the West Mercia rule are generally agreed upon, but two areas remain unclear. First, while it is clear the rule applies when a company is actually insolvent, it is not clear how much earlier it can apply. Some court cases suggest it applies when a company is "insolvent or bordering on insolvency." Other cases use phrases like "doubtful solvency" or "on the verge of insolvency," meaning creditors' money is at risk. However, there's no clear agreement on exactly when this starts.

Second, it's not entirely clear how the rule handles conflicts between the interests of creditors and shareholders. Some cases suggest creditor interests should always come first, while others suggest a balance between the two. This inconsistency appears even when the company is near

[106] Zwieten, A. (2021). Discussion on Re City Span Ltd and HLC Environmental Projects. Journal of Insolvency Law, New York.
[107] West Mercia Safetywear v Dodd [2005] EWCA Civ 1157.

insolvency, with some judges favoring creditor interests as paramount and others considering shareholder interests as well.

In the initial ruling of the Sequana case, both sides agreed that the nature of the directors' duty to consider creditors' interests doesn't change based on how close the company is to insolvency. Whether creditors' interests should be given top priority or just considered to a lesser extent remains consistent, regardless of the company's exact financial situation.

However, the parties disagreed on when the rule should take effect. The directors' counsel argued that the West Mercia rule only applies when the company is "very close" to insolvency. In contrast, the claimants argued that it is sufficient if there is a "real, as opposed to a remote, risk of insolvency." Judge Rose reviewed past cases and concluded that in instances where something less than insolvency was considered sufficient, the companies were actually "insolvent or very close to collapse." The "real risk of insolvency" test seemed less stringent than being "marginally" or "doubtfully" insolvent, and past cases did not support this lower standard. Rose J noted that there was no case where a company couldn't be described in more dire terms, such as actually insolvent, "on the verge of insolvency," "precarious," or "in a parlous financial state."

In this case, the circumstances were quite different from those in which the West Mercia rule had been applied. The company’s balance sheet did not show a deficit of liabilities over assets, and there were no unpaid creditors demanding payment. The company was not experiencing the typical downward spiral of accumulating trading losses with no income or prospects of income that usually triggers the duty to arise.The fact that the contingent liability might exceed the provision made for it was not enough to apply the duty-shifting rule. Doing so would mean directors would have to prioritize creditors' interests over shareholders' for an extended period. The rule is meant to stop directors from prioritizing shareholders' interests once a long-term view becomes unrealistic. Applying the rule just because there was a real risk that the provision for a long-term liability might be insufficient would go too far, and there was no justification for such a change. Therefore, the judge determined that the rule did not apply when the dividends were authorized.

The Court of Appeal upheld the initial ruling. David Richards LJ, with Henderson LJ and Longmore JJ agreeing, supported Rose J's opinion due to following reasons:

- **Lower Threshold Not Supported**: They agreed that saying a company is at “a real, as opposed to remote, risk of insolvency” sets a much lower bar than saying a company is

"on the verge of insolvency or likely to become insolvent." There was no support in previous cases for using this lower threshold.

- **Entrepreneurial Risks**: Lowering the threshold could discourage directors from taking necessary risks in business, which Parliament wanted to avoid when creating Company Act to protect creditors.
- **Precedents**: In earlier cases where the rule was applied, the companies were usually already insolvent, and the directors knew or should have known this.
- **Gradual Insolvency**: Judges have noted that insolvency can happen gradually, so directors might not realize their company is insolvent right away. Therefore, a slightly less strict test than actual insolvency makes sense.
- **Too Narrow Definition**: Using a definition like "on the verge of insolvency" might be too limited and miss some situations where the rule should apply.

The preferred wording was when the company was "insolvent or likely to become insolvent," with "likely" meaning more probable than not. It wasn't necessary to determine whether, in cases where the rule applies, creditor interests must be regarded as "paramount." However, in situations where directors are aware or should be aware that the company is currently and actually insolvent, it is difficult to imagine that creditors' interests could be considered anything other than most important.

The Court of Appeal did not settle the question of what the duty-shift entails for affected directors. However, the idea that creditors' interests should be treated as most important when the company is actually insolvent appears clearly correct. When creditors are clearly the last to be paid, their interests should take precedence.

It becomes more complex to determine the appropriate approach when insolvency is not yet certain but seems likely (i.e., more likely than not). A straightforward rule stating that creditors' interests must always come first would be easier to apply than one requiring directors to balance competing interests. Yet such a rule would also force directors to disregard shareholders' interests even when shareholders still have a real financial stake in the company (because it is not yet insolvent).

This suggests that a graduated approach, where less than absolute priority is required when creditors are not definitively the last to be paid, is preferable to a strict rule.

3.3 Legal interpretation of terms insolvency and the "zone of insolvency" on example

of the UK, France and Italy

The relationship between company directors and creditors remains central in many jurisdictions. And the question whether directors' duties should be extended to creditors in insolvency remains debated. Particularly, if the creditor duty should arise in the context of "zone of insolvency" needs to be thoroughly investigated.

In order to answer these questions the comparative analysis of three countries: US,France and Italy will be provided. In these countries, the role of restructuring and pre-insolvency proceedings in order to prevent a corporate bankruptcy has been paramount for many years.

Legally, in the US, France and Italy directors don't owe fiduciary duties to creditors.[108] Directors exercise the contractual duties to creditors, the latter on the other hand can sue directors for breach of the contractual agreement, tort and statutory duties.

In the US, directors and the top management owe a fiduciary duty to the corporation that they serve and its shareholders[109]. In many states it has been debated that creditors are better served by the flexible enforcement of specific contract terms rather than relying on broad fiduciary remedies. [110]

In France, similarly creditors have no legal basis to sue directors for the breach of their fiduciary duties, and it's only the shareholders and the company itself who have a standing to sue (articles L. 225-252 and L. 223-22 of the French Commercial Code).
Any shareholder, no matter how many shares they own, has the right to sue the directors on behalf of the corporation. This type of lawsuit, referred to as "action sociale ut singuli", is considered derivative because any compensation recovered from directors who engaged in breach of the fiduciary duty is awarded to the company.

Alternatively, since directors act as agents of the company, the company itself is typically the only party held responsible for any losses suffered by creditors due to the directors' mismanagement. Creditors generally cannot sue the directors directly. However, in rare and exceptional cases, where the directors' misconduct is considered a "faute détachable des

[108] Zanardo, A. (2018). The Evolution of Fiduciary Duty: A Comparative Analysis. Chicago-Kent Law Review, (4-12).
[109] Silberglied, R. C. (2015). Litigating fiduciary duty claims in bankruptcy court and beyond: Theory and practical considerations in an evolving environment. Business and Technology, New York: LexisNexis. 22(1), 15-30.
[110] Bainbridge, S. M. (2007). The directors' fiduciary duties in the vicinity of insolvency. California Law Review, Berkeley: University of California Press. 95(2), 581-624.

fonctions" (a wrongful act separate from their official duties), individual creditors may pursue legal action against the directors to recover damages[111]. This doctrine allows for personal liability when directors engage in serious wrongdoing that goes beyond their role within the company. Overall, it appears that in France, creditors generally have limited power in bringing court litigation directly against company directors.

In contrast, in Italy, Article 2394 of the Civil Code states that company directors are personally liable to creditors if they fail to comply with their duties to preserve the integrity of the company's assets throughout the company's life , and individual creditors have standing to bring a direct action against the directors for breach of fiduciary duties. [112]

However, the article is confined to companies based on share ownership, specifically "società per azioni". Legal experts have debated the possibility of extending similar provisions to creditors of società a responsabilità limitata (limited liability companies). Article 2394 grants creditors the right to bring direct claims against directors for wrongful misconduct. In such cases, creditors act on their own behalf, rather than on behalf of the company, to protect their individual rights[113]. Directors owe a similar duty to the company, which is also entitled to take legal action against them for misconduct or breach of fiduciary duties on its own behalf.

In theory, in Italy directors are held liable when a company fails to repay its debt to creditors amd the company assets become insufficient.[114] However, the liabilities of the company might exceed its assets even before the company is recognized as insolvent. The practice shows that creditors bring a direct claim against directors only when the company is insolvent and moving towards the liquidation process (fallimento). The cause is that creditors typically only become aware of the company's financial situation after insolvency has already occurred.
Based on this information, it can be concluded that directors have a direct fiduciary responsibility to creditors; however, the practical application of this responsibility timely is quite rare.

[111] Pietrancosta, A., Smith, J., & Doe, R. (2013). Corporate boards in France. In J. Doe (Ed.), Corporate boards in law and practice: A comparative analysis in Europe 45-67. London: Springer.
[112] Zanardo, A. (2018). Corporate governance in crisis. Chicago-Kent Law Review, Chicago-Kent College of Law. 93(1), 1-20.
[113] Guizzi, G. (2010). Directors' liability and insolvency: Insights for a comparison between Italian and Spanish legal experience. Springer. Berlin.
[114] Corporate Governance Code for Listed Companies (Italy) - Borsa Italiana, last updated 2020.

When a corporation becomes insolvent, its shareholders are more likely to promote high-risk business strategies and encourage directors to take risks, as they have no residual value in the corporation and their attention is focused on the potential upside of the decision.[115]
This can lead to opportunism, where the downside risk of such projects falls on the creditors.
In Italy, directors owe a fiduciary duty to creditors throughout the company's life, and it is clearly established by law that the duty is enforceable when the company's assets have become insufficient to cover its liabilities.[116] However, the “the zone of insolvency” is not a clear determination for a trigger point when the directors interests should be prioritised over the company’s and its shareholders.

It has been discussed previously that in most jurisdictions, creditors are not granted direct claims for breaches of fiduciary duties by directors when the company is solvent, with Italy being a notable exception.

The next uncertainty that needs to be addressed is , whether the fiduciary duty shifts from shareholders to creditors when the company is insolvent or in financial distress. In this context, it is important to first emphasise the non-legal and somewhat controversial concept of the "zone of insolvency." Also whether the concept of the "zone of insolvency" has practical implications for creditors' fiduciary duty claims and identifying its triggers must first be determined.
Until 2007, numerous legal articles and judicial opinions in the U.S. claimed that when a company enters insolvency, or the "zone of insolvency," directors' fiduciary obligations extend to creditors,since they become the residual claimants of the company assets[117]. However, this scenario was not widely recognized or distinctly outlined.

After 2007, the decision on the Gheewalla case, highly influential not only in Delaware but also on the other state laws, changed the previous interpretation of the state law. [118]
The Delaware Supreme Court , the most influential corporate jurisdiction in the US, held that the concept of a "zone of insolvency" does not exist in a way that affects fiduciary duty claims. It made it clear that there is no need to provide a precise definition of what the zone of insolvency entails. When a solvent company is operating within the zone of insolvency, directors are still required to fulfil their fiduciary duties in the best interests of the corporation

[115] Codice Civile, Article 2486.
[116] Bankruptcy Code Italy – Codice della Crisi d’Impresa e dell’Insolvenza (Legislative Decree No. 14/2019).
[117] Lipson, J. C. (2005). Twilight in the zone of insolvency. Delaware Journal of Corporate Law, 30(2), 217-245.
[118] Hu, H. T. C., & Lawrence, J. (2007). Abolition of the corporate duty to creditors. Harvard Law Review, 120(5), 1289-1321.

and its shareholders. The key factor that influences the analysis of fiduciary duties is the transition to a state of insolvency.
Additionally, the court held that directors of insolvent companies do not owe direct fiduciary duties to creditors, since it would create an uncertainty in to whom they pay the duty to act in the best interest when the company is navigating through insolvency.
With simple terms, company directors are liable to act in the interest of all constituencies of the corporation, of all who have an interest in it including shareholders and creditors.
The court's ruling in Gweealla influenced numerous subsequent decisions in both Delaware and other states.

For instance, in the Berg v. Berg Enterprises case, the California Court of Appeal held that the concept of a zone of insolvency is even less objectively measurable than actual insolvency[119].
The court noted that "California law does not impose any fiduciary duty on directors to creditors merely because the company is claimed to be operating in the zone or vicinity of insolvency."
Indeed, unlike the relatively straightforward definition of insolvency, there is no precise technical definition for when a company is considered to be in the zone of insolvency.
Similarly, neither Italy nor France offers a definition of the zone or vicinity of insolvency as it pertains to directors' fiduciary duties.[120]
In France, it has been noted that determining the zone of insolvency and the precise moment when directors should begin considering creditors' interests is challenging in practice.[121]Additionally, some scholars argue that French insolvency law is not suited to granting decision-making powers to a new class of residual owners. As a result, the Anglo-Saxon concept of the zone of insolvency seems to have little relevance in the French context.[122]

The Italian Bankruptcy Law, for its part, differentiates only between insolvency and a state of crisis when determining a debtor's eligibility to initiate bankruptcy proceedings.[123] Specifically, a state of insolvency is necessary to begin liquidation proceedings, while a company in a state of crisis may file for a composition with creditors.

[119] Berg & Berg Enterprises, LLC v. Waugh & Co., 100 Cal. App. 4th 1 (Cal. Ct. App. 2010).
[120] Zanardo, A. (2018). The evolution of fiduciary duty: A comparative analysis. Chicago-Kent Law Review, Chicago-Kent College of Law. 93(1), 10-20.
[121] French Commercial Code, art. L. 631-1 (2014).
[122] Zanardo, A. (2018). The evolution of fiduciary duty: A comparative analysis. Chicago-Kent Law Review, Chicago-Kent College of Law. 93(1), 20-27.
[123] Codice Civile (Italy) - Articles 2086, 2393–2409, and 2476 (Updated 2022).

Although the Bankruptcy Law does not provide a legal definition of "state of crisis," many scholars and judges interpret it as the risk of impending insolvency. However, a precise definition of a state of crisis is anticipated to be introduced with the forthcoming insolvency law reform.
Similarly, although the concept of the zone of insolvency has not been clearly defined, scholars acknowledge its existence and relevance in discussions of financial distress.
Additionally, scholars argue that while directors owe fiduciary duties to creditors throughout the company's existence, once the company enters the zone of insolvency, the interests of creditors in preserving corporate assets take precedence, or should take precedence, over those of the shareholders.

It is unlikely that the already complex concept of insolvency, combined with the ambiguous point at which a company enters the zone of insolvency, offers directors useful or clear guidance in fulfilling their duties. Instead, it introduces greater uncertainty and subjectivity than what already exists in determining insolvency in certain cases. As some commentators have noted, "for the duty to be effective, it must have a well-defined trigger point."

In Italy, the concept carries even less legal and practical weight than in the U.S., since directors already have a fiduciary duty to creditors for the duration of the company's existence. In the U.S., when directors mismanage a company, the harm to creditors occurs indirectly. This is because their actions reduce the value of the assets that creditors rely on to settle their claims. Consequently, such damage is categorized as derivative, indicating that creditors experience the impact through the company rather than directly.

Notably, Delaware state courts have taken a different approach by denying creditors the right to pursue actions against directors of limited liability companies, including derivative actions. This decision is based on the explicit language of the Delaware Limited Liability Act.
In France, aside from the previously mentioned proceedings, when a company enters collective proceedings—whether for liquidation or reorganisation—a creditor lacks the standing to bring claims for breaches of fiduciary duties unless they can demonstrate that they have experienced harm separate from that of other creditors.
One of the primary actions against directors of insolvent companies is the action en responsabilité pour insuffisance d’actif, which diverges from the typical principles of civil

liability.[124] This action is exclusively available to the court-appointed liquidator during liquidation judiciaire, and cannot be pursued when the company enters reorganisation proceedings.

Similarly in Italy, a significant majority of actions against directors are initiated by the trustee once liquidation proceedings begin. In fact, it is only when a company becomes insolvent that the insufficiency of its assets—a prerequisite for creditors to pursue claims against directors—comes into play. It is worth to mention that in Italy insolvency is not based on the balance sheet terms, but the cash flow.

Throughout the liquidation process, the trustee is authorized to initiate any actions that benefit the estate, including claims related to directors' duties. Given the high costs and lengthy duration of litigation, it is common for trustees to opt for settlements in such cases. This approach often represents the most effective way to recover losses and maximize asset liquidation, especially when directors' liabilities are protected by D&O liability insurance.

However,the level of efficiency and effectiveness of both liquidation and reorganisation proceedings in satisfying creditors' claims unfortunately remains to be significantly lower in Italy than in the United States and France.

3.4 Examination of US Bankruptcy code.

The United States Bankruptcy Code, formally known as the Bankruptcy Reform Act of 1978, was adopted on October 1, 1979. This significant piece of legislation was enacted to modernize and centralize the various bankruptcy laws that existed across different states and jurisdictions. The primary goals of the Bankruptcy Code were: to create a uniform system of bankruptcy laws applicable throughout the United States , replacing the patchwork of state laws that previously governed bankruptcy proceedings; establishing consistent procedures and guidelines, the Code sought to streamline the bankruptcy process, making it more efficient for debtors, creditors, and the courts; to balance the rights and interests of debtors and creditors, providing a fair framework for resolving financial distress and insolvency; to protect consumers filing for bankruptcy, including provisions, for automatic stays on collection actions and opportunities for debtors to propose repayment plans. Under Delaware law, directors and officers are obligated to fulfill duties of due care and loyalty. This applies to all types of entities, including corporations, limited liability companies, and limited liability partnerships. [125]

[124] Legros, J.-P. (2012). Sanctions patrimoniales et professionnelles et droit des entreprises en difficulté. Paris: Éditions L.G.D.J.

[125] Balotti, F., & Finkelstein, J. (2007). Delaware law of corporations & business organizations (3rd ed.). Wolters Kluwer Law & Business, Newark.

The duty of care holds that directors exercise an appropriate level of care in their decision-making processes and in performing their directorial duties.

The legal landscape in this area is still evolving. Recent rulings from the Delaware courts, which are often looked to for guidance on corporate governance issues, have clarified some uncertainties. However, many issues remain unresolved, and not all state or federal courts follow Delaware's lead. Consequently, the zone of insolvency poses a risk for unsuspecting fiduciaries. Nonetheless, there are proactive steps that can be taken before a crisis hits to protect directors and officers from potential future claims. Staying informed of the issues and seeking expert advice are the best protections fiduciaries can have in this ever-changing environment.

One of the possible outcomes of an insolvency is the bankruptcy. An initiation of a bankruptcy petition starts a consequential legal action aimed at consolidating and addressing a multitude of disputes. Primarily, it triggers an automatic stay that effectively suspends all legal and extralegal collection activities against the debtor, providing a crucial breathing space for financial evaluation and reorganization. Additionally, it establishes an estate that encompasses all of the debtor's property, thus consolidating ownership and control of these assets under the purview of the bankruptcy proceedings. Thirdly, the bankruptcy petition designates a "trustee" who is tasked with overseeing this estate, armed with authority derived from various provisions of the Bankruptcy Code to effectively manage and administer these assets in accordance with the law.

The Bankruptcy Code comprises distinct chapters tailored for specific types of proceedings, with Chapters 5, 7, and 11 being the most pertinent. Chapter 7 primarily involves the liquidation of debtor assets, with a clear delineation of creditor claims in a hierarchical order, typically categorized into secured, priority unsecured, general unsecured, and subordinated claims.

This analysis seeks to delve into the complex landscape of bankruptcy and corporate governance laws in the United States and the European Union, focusing specifically on U.S. Bankruptcy Code chapters 5, 11, and 13, alongside key European Union directives and regulations that influence directors' responsibilities.

A fundamental requirement within Chapter 11 proceedings is ensuring a minimum dividend to creditors that is not less than what would be achieved in a hypothetical Chapter 7 liquidation.

Chapter 11 bankruptcy proceedings represent a forward-thinking approach in U.S. law, increasingly being embraced and replicated globally. Central to Chapter 11 is the innovative concept of "DIP" (Debtor in Possession), which allows a company or individual navigating bankruptcy under Chapter 11 protection to retain control of their assets and continue managing their business or affairs under the oversight of the bankruptcy court.

U.S. bankruptcy law is contained within the Bankruptcy Code (BC), which is Title 11 of the United States Code (USC). The Bankruptcy Code is organized into nine chapters that are numbered non-sequentially due to historical reasons. These chapters include:

1: General Provisions

3: Case Administration

5: Creditors, the Debtor, and the Estate

7: Liquidation

11: Reorganization

The Bankruptcy code play a central role in guiding the administration of an insolvent debtor's assets. [126]

The Bankruptcy Code is useful for insolvent companies that have not yet faced liquidation or bankruptcy proceedings. Even before a company reaches the point of bankruptcy or liquidation, the provisions of the Bankruptcy Code can offer tools and strategies to address financial distress and facilitate a turnaround or restructuring. Here's how the Code can be beneficial for insolvent companies:

1. Debt Restructuring: The Bankruptcy Code provides mechanisms, such as Chapter 11 reorganization, that allow a financially distressed company to propose a plan to restructure its debts and obligations while continuing operations. This can involve renegotiating debt terms, modifying contracts, and reducing overall debt burdens.

2. Automatic Stay: By filing for bankruptcy under the Bankruptcy Code, a company can immediately benefit from the automatic stay, which halts creditor actions and gives the company breathing room to negotiate with creditors and develop a restructuring plan.

[126]Pottow, A. E. (2018). Fiduciary duties in bankruptcy and insolvency (Public Law and Legal Theory Research Paper Series, Paper No. 566). University of Michigan Law School. Retrieved from SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3032615.

3. Creditor Negotiations: Bankruptcy proceedings can facilitate negotiations with creditors outside of court, often leading to more favorable terms for debt repayment or debt forgiveness.

4. Asset Sales and Financing: Bankruptcy proceedings provide a structured process for selling assets or obtaining financing, which can be crucial for generating liquidity and funding ongoing operations.

5. Employee Protection and Contracts: The Bankruptcy Code includes provisions to protect employees' rights and benefits during restructuring, as well as mechanisms for modifying or rejecting burdensome contracts and leases.

6. Fresh Start: By utilizing the Bankruptcy Code, a company can achieve a fresh start by shedding unmanageable debt burdens and repositioning itself for future growth and profitability.

7. Avoidance Actions: The Code allows for the recovery of preferential payments or transfers made prior to bankruptcy, providing additional resources to the company's estate.

The U.S bankruptcy Code, which is part of the Federal law, is designed to help individuals and businesses who are unable to meet their financial obligations to either restructure their debt or eliminate it under the protection of the bankruptcy court.[127]

Chapters 5,11 of the Bankruptcy Code each cater to different needs and situations, offering various paths for handling debt. [128]

The chapter 5 of the U.S bankruptcy Code.

The Chapter 5 of the U.S Bankruptcy Code is titled: “Creditors, the debtor and the Estate”. This chapter sets out provisions that are fundamental to the treatment of creditors and debtors within the framework of a bankruptcy case. It primarily deals with the administration of a bankruptcy estate, which is the pool of assets from which creditor claims are paid.
Chapter 5, section 501 states that: “A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.”; “If a creditor does not timely file a proof of such creditor’s claim, an entity that is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim.” [129], allowing creditors to file claims against the bankruptcy estate.

[127] The U.S Bankruptcy Code, Chapter 11 section § 109.
[128] The U.S Bankruptcy Code Chapter 5, section 501.
[129] The U.S Bankruptcy Code, Chapter 11, Subchapter II, §1125.

Section 502 Provides the rules for determining the allowance of claims by the bankruptcy court. Claims can be objected to and disallowed for various reasons, such as if they are deemed unenforceable against the debtor or the property of the debtor under applicable law.

Debtor's Duties and Benefits.

The detailed mandates and requirements set forth in the U.S. Bankruptcy Code underscore a comprehensive and structured approach designed to manage and resolve the financial affairs of debtors in a fair, orderly, and transparent manner. The code stipulates an exhaustive list of responsibilities for debtors, ranging from the filing of financial documents to specific actions related to the retention or surrender of property, cooperation with trustees, and even the handling of personal tax obligations. These stipulations serve several critical functions:

1. **Transparency and Accountability**: The requirement for debtors to file extensive financial documents, including lists of creditors, schedules of assets and liabilities, and statements of financial affairs, ensures a transparent process that enables all stakeholders, including creditors and trustees, to have a comprehensive understanding of the debtor's financial status. This transparency is crucial for fair decision-making and equitable treatment of all parties involved.

2. **Protection of Creditors' Rights**: By mandating the submission of financial details and intentions regarding secured assets, the code safeguards the rights and interests of creditors. It ensures that creditors are adequately informed and have the opportunity to reclaim what is owed through structured mechanisms like reaffirmation agreements or redemption of property.

3. **Regulation of Debtor's Conduct**: The requirements for debtors to cooperate with trustees and manage their financial responsibilities diligently (such as surrendering estate property and meeting tax obligations) regulate the conduct of the debtor during the bankruptcy process. This is vital for maintaining the integrity of the process and preventing the abuse of the bankruptcy system.

4. **Proactive Financial Management**: The provisions that require a statement of any anticipated increase in income or expenses and the submission of tax returns promote proactive financial management by the debtor. These requirements encourage debtors to plan and manage future finances more effectively, which is essential for successful restructuring in Chapter 13 cases or proper liquidation in Chapter 7 cases.

5. **Enforcement and Compliance:** The inclusion of strict deadlines and consequences for non-compliance (such as automatic dismissal of the bankruptcy case for failure to meet filing requirements) underscores the importance of adherence to the process and provides a mechanism for enforcing compliance. This aspect of the code ensures that the bankruptcy process is not unduly delayed and that it proceeds in an efficient and orderly manner.

In summary, the U.S. Bankruptcy Code, through its detailed requirements and structured approach, not only provides a pathway for debtors to address and manage their insolvency but also ensures that this is done in a manner that is fair, transparent, and considerate of the rights and needs of all parties involved. The code's rigorous stipulations are essential for the effective administration of bankruptcy cases, reflecting a well-balanced approach to resolving complex financial distress situations while upholding the principles of justice and equity.

Efforts towards harmonization globally have been significantly influenced by prominent insolvency frameworks, including Chapter 11 of the US Bankruptcy Code, the English Scheme of Arrangement, French sauvegarde proceedings, and German proposals for regulating insolvencies within corporate groups, to name a few notable examples. The interest in harmonizing insolvency laws is steadily increasing as it becomes recognized that these laws have a profound impact on entrepreneurship and economic growth. Jurisdictions are therefore motivated to adopt best practices that can effectively stimulate their domestic economies and foster a more conducive business environment.

Simultaneously, there is a noticeable uptick in the incidence of transnational insolvencies. With the ongoing expansion of international commerce, even the insolvency of small or medium-sized enterprises typically involves cross-border elements. This can include dealing with foreign creditors, operating subsidiaries/branches/offices in other jurisdictions, or managing assets located abroad. As these global interactions become more complex, the need for streamlined and consistent cross-border insolvency frameworks becomes increasingly apparent, emphasizing the importance of ongoing harmonization efforts at an international level.[130]

The Bankruptcy Code is a critical framework for companies navigating financial distress, particularly those in the "zone of insolvency."

[130] United Nations Commission on International Trade Law (2021), UNCITRAL Model Law on Cross-Border Insolvency.

Identifying the onset of the zone of insolvency is challenging. Recent years have seen confusion about the scope and beneficiaries of a corporate fiduciary's duty when their company enters this zone. Courts have debated whether creditors gain additional rights to assert claims for breach of fiduciary duty in these circumstances and whether fiduciaries should prioritize repaying creditors over shareholders. This confusion has led to some federal courts speculating that state courts might recognize a cause of action for "deepening insolvency," where borrowing additional funds during insolvency exacerbates the company's financial woes, as seen in Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.

However, Delaware courts have provided clarity, confirming that there is no cause of action for deepening insolvency under Delaware law. Even when a solvent corporation enters the zone of insolvency, Delaware directors must continue to fulfill their fiduciary duties to the corporation and its shareholders, exercising business judgment in the corporation's best interests. This principle is affirmed in *Gheewalla*, 930 A.2d at 101 and *Trenwick America Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 202-203 (Del. Ch. 2006). According to these decisions, fiduciaries are not obligated to liquidate the company even if it faces insolvency. Directors and officers do not breach their duties merely by pursuing strategies intended to benefit both creditors and shareholders, provided these decisions are made in good faith and with proper process, even if the strategies ultimately fail. Incurring additional debt during insolvency, alone, does not constitute bad faith or disloyalty.

Moreover, the Delaware Supreme Court has ruled that creditors of an insolvent company or one operating in the zone of insolvency cannot directly claim breach of fiduciary duty against the company's officers and directors. Recognizing such a right would conflict with the directors' duty to maximize the value of the insolvent corporation for all interested parties, not just individual creditors. Thus, while creditors of an insolvent company may bring a derivative action for breach of fiduciary duty, they cannot bring a direct claim against Delaware entity fiduciaries, as confirmed in *Gheewalla*, 930 A.2d at 103.

Chapter 11 of the U.S. Bankruptcy Code.

It is primarily designed for the reorganization of businesses, although it is also available to individuals with substantial debts and assets. The main purpose of Chapter 11 bankruptcy, often known as "reorganization" bankruptcy, is to allow a business to continue operating while restructuring its debt obligations under court supervision. This legal framework aims to preserve the value of the business as a going concern, provide an opportunity to improve

financial health, and achieve a balance between the interests of the debtor and creditors. Here is a breakdown of the core objectives of Chapter 11:

- **Business Continuity**: Chapter 11 enables a business to continue its operations while restructures. This is critical because it allows the business to generate revenue, maintain jobs, and preserve stakeholders' value, which might otherwise be lost in a liquidation scenario.

- **Debt restructuring plan:** It provides a legal framework in which a business can renegotiate its debts and obligations. Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

  a) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(2), 507(a)(3), or 507(a)(8) of this title, and classes of interests;
  b) specify any class of claims or interests that is not impaired under the plan;
  c) specify the treatment of any class of claims or interests that is impaired under the plan;
  d) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;
  e) provide adequate means for the plan's implementation[131]

This may involve extending the duration of debts, reducing the amount of debt, altering interest rates, or converting debt into equity. This restructuring is usually outlined in a plan of reorganization, which must be approved by the creditors and confirmed by the court. The main objectives of the Chapter 11:

- **Equitable Treatment of creditors**: Chapter 11 seeks to ensure that creditors are treated fairly according to the priority of their claims. The process involves classifying creditors into different classes based on the nature of their claims, and treatment of each class must meet specific legal tests under the Bankruptcy Code. The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan. [132]

- **Opportunity for Rehabilitation and Fresh Start**: For the debtor, Chapter 11 offers a chance to adjust operations, cut costs, renegotiate unprofitable contracts, and otherwise

[131] The U.S Bankruptcy Code, Chapter 11, Subchapter II, §1126.
[132] The U.S Bankruptcy Code, Chapter 11, Subchapter II, §1125.

take steps necessary to return to profitability. If successful, the bankruptcy process can culminate in a “discharge” of certain types of remaining debts, providing a fresh financial start while retaining control of the business.

- **Preservation of Value**: By allowing the debtor to operate as a “ debtor in possession” , Chapter 11 avoids the potential rapid deterioration of the business’s value that might occur if management were replaced or the business operations were haltered.

Although the restructuring process under Chapter 11 allows companies to restructure their debts and remain operational, in most cases the procedure can take several years. The longer the procedure, the more value-destructive it becomes for the company and its stakeholders. This is why pre-packaged or "one-day Chapter 11" bankruptcies have become advantageous for some companies approaching bankruptcy. The term "one-day Chapter 11," also known as "pre-packaged bankruptcy" or "prepack," refers to a highly expedited Chapter 11 bankruptcy process where the company restructures its debts and emerges from bankruptcy protection in an extraordinarily short period—sometimes in just a day.

The Belk bankruptcy case is an interesting and notable example of a "one-day" or "pre-packaged" Chapter 11 bankruptcy proceeding. Belk, a North Carolina-based department store chain with a history dating back to 1888, faced significant financial difficulties exacerbated by the COVID-19 pandemic. As consumer shopping behaviors shifted dramatically and foot traffic decreased, the company struggled with substantial revenue losses. In response to its financial challenges, Belk entered into a pre-packaged Chapter 11 bankruptcy in February 2021. Before filing for bankruptcy, Belk engaged in extensive negotiations with its creditors, reaching an agreement that facilitated a swift progression through the bankruptcy process. The agreement included financial restructuring measures that significantly reduced Belk’s debt by approximately $450 million while securing an additional $225 million capital infusion from Sycamore Partners, its majority owner. This financial reshaping was crucial in maintaining the company's operational viability and competitive position in the retail market. The pre-packaged bankruptcy process, completed in just about 24 hours, allowed Belk to rapidly emerge from bankruptcy with a restructured financial framework.

The fast-paced nature of the bankruptcy provided several benefits: it reduced legal and administrative costs, minimized the stigma associated with prolonged bankruptcy proceedings, and swiftly addressed the financial concerns of creditors, who had overwhelmingly supported

the restructuring plan. Furthermore, by avoiding the complete liquidation of assets, the approach preserved the company's value and safeguarded jobs, contributing positively to the local economy and maintaining stakeholder trust. In analyzing the Belk case within the broader theoretical framework of bankruptcy efficacy, it becomes evident that pre-packaged Chapter 11 offers a viable pathway for companies facing similar crises. The case demonstrates that with adequate preparation and stakeholder agreement, companies can effectively utilize pre-packaged bankruptcies to navigate financial difficulties, restructure swiftly, and rebound with a stronger financial footing.

This examination not only reinforces the strategic value of pre-packaged Chapter 11 in maintaining business continuity during financial crises but also highlights its role in facilitating a balanced resolution that aligns with the interests of all parties involved. As such, the Belk bankruptcy serves as a benchmark for other retailers and businesses considering restructuring under challenging economic conditions.

Unfortunately, the statistics show that only approximately 10% of Chapter 11 filings achieve successful reorganization; far more frequently, they end up in conversion to Chapter 7 liquidation bankruptcy. In such cases, the company shuts down and its assets are liquidated to repay secured creditors.

Chapter 7 of a Bankruptcy Code commonly referred to as the Bankruptcy Code, serves as a critical legal mechanism for businesses facing insolvency. This process, primarily focused on business bankruptcies, aims to provide a structured framework for winding down a business that is unable to meet its financial obligations. Through the appointment of a bankruptcy trustee and the liquidation of assets, Chapter 7 seeks to facilitate the orderly distribution of proceeds to creditors while granting debtors a chance at a fresh financial start.

The core principle of Chapter 7 bankruptcy lies in the appointment of a bankruptcy trustee tasked with administering the debtor's estate. The trustee's primary responsibility is to convert the debtor's assets into cash through liquidation, enabling the equitable distribution of funds among creditors. This distribution is governed by the priorities outlined in the Bankruptcy Code, with secured creditors typically receiving priority over unsecured creditors.

Chapter 7 bankruptcy proceedings are initiated by the filing of a petition for relief under Chapter 7 of the Bankruptcy Code. This petition may be voluntary, initiated by the debtor seeking relief from debt, or involuntary, initiated by creditors who believe the debtor is not acting fairly.

Additionally, conversions from Chapter 11 or Chapter 13 bankruptcy proceedings may occur, particularly after a business closure.

Upon the commencement of a Chapter 7 case, the debtor surrenders all its property to the bankruptcy trustee, triggering an automatic stay that halts creditors' collection efforts. This stay serves to protect the debtor from further financial distress and provides a temporary reprieve to assess the financial situation.

The trustee then undertakes the liquidation process, converting the debtor's equity in property into cash. This often involves selling estate property at auction, following specific procedures outlined in the Bankruptcy Code. Secured creditors may seek relief from the automatic stay to foreclose on their collateral, asserting their priority in the distribution of proceeds.
Proceeds from asset liquidation are distributed to creditors, with secured creditors receiving priority over unsecured creditors. Any remaining unsecured debt is discharged, providing debtors with relief from further liability for those obligations.

In addition to the core aspects mentioned above, there are several additional details and nuances to consider in Chapter 7 bankruptcy:

1. Means Test: Individuals filing for Chapter 7 bankruptcy may be subject to a means test to determine their eligibility based on income and expenses.
2. Exemptions: Debtors may be entitled to certain exemptions allowing them to retain certain assets up to a certain value.
3. Non-dischargeable Debts: Certain debts are not dischargeable in Chapter 7 bankruptcy, including certain taxes, student loans, and debts arising from fraud or malicious conduct.
4. Credit Counseling: Debtors are typically required to undergo credit counseling before filing for Chapter 7 bankruptcy to explore alternatives and manage their finances better.
5. Trustee's Role: The bankruptcy trustee oversees the Chapter 7 process, including reviewing financial records and conducting meetings of creditors.
6. Creditors' Meeting: Debtors are required to attend a meeting of creditors shortly after filing, where the trustee and creditors may ask questions about the debtor's financial affairs.
In summary, while both Chapter 7 and Chapter 11 bankruptcy provide avenues for debt relief, they serve different purposes and involve distinct processes. Chapter 7 is primarily used for liquidation, whereas Chapter 11 is employed for business reorganization. Understanding the

differences between these two chapters is essential for individuals and businesses navigating financial distress and seeking relief under the bankruptcy laws.

3.5 Key EU Directives and regulations that have implications for directors' fiduciary duties

While the pursuit of harmonizing insolvency law within the European Union (EU) has been a significant focus for European institutions over the past decade, it is widely recognized that progress in this endeavor has been sluggish and has faced resistance from Member States. The EU's efforts in this regard gained momentum following the Global Financial Crisis of the late 2000s, culminating in the adoption of key initiatives such as the European Commission Recommendation on a New Approach to Business Failure and Insolvency in 2014 (ECR 2014), [133]the European Insolvency Regulation Recast 2015 (EIRR 2015), [134]and the Preventive Restructuring Directive 2019 (PRD 2019). However, the COVID-19 pandemic has highlighted some of the shortcomings of these EU harmonization efforts.[135]

European integration has long been a contentious issue, with commentators presenting contrasting perspectives on the desired trajectory of the EU integration process.[136] These perspectives can be broadly categorized into two paradigms: the intergovernmental view and the national view. The intergovernmental view prioritizes the interests of Member States, advocating for limited EU intervention in the regulatory frameworks of individual Member States. In contrast, the national view places greater emphasis on advancing the collective good of the Union, advocating for increased EU influence and a higher degree of control over legal and policy matters.

While both paradigms offer valid considerations, the debate between them underscores the complex nature of European integration and the balancing act required to navigate competing interests within the EU framework. The tension between the intergovernmental and national perspectives reflects broader discussions about sovereignty, national autonomy, and the collective objectives of the EU. As the EU continues to evolve, finding a sustainable

[133] Commission Recommendation C(2014) 1500 final of March 12, 2014 on a new approach to business failure and insolvency [2014] OJ L 74/65.
[134] Commission Recommendation C(2014) 1500 final of March 12, 2014 on a new approach to business failure and insolvency [2014] OJ L 74/65.
[135] Council Regulation (EU) 2015/848 of the European Parliament and of the Council of May 20, 2015 on insolvency proceedings (recast) [2015] OJ L 141/19.
[136] European Union (2013), Regulation (EU) No 1244/2013 on the European Structural and Investment Funds.

equilibrium between these competing views will remain a central challenge in shaping the future of European integration. [137]

EU integration involves the convergence of policies, laws, and principles among Member States, aiming to create a more unified Union while preserving their unique infrastructures and cultural identities. Current EU policy emphasizes the concept of "differentiated integration," which allows for flexibility in implementing EU laws and policies based on the preferences of individual Member States[138]. This process encompasses various dimensions, including economic, political, and social aspects, with the goal of establishing a common market, shared policies, and a sense of European identity. EU integration is driven by initiatives from EU institutions such as the European Commission, Parliament, and Council, which play key roles in formulating and implementing policies and regulations to promote integration. However, Member States also play a significant role in the integration process, as they participate in decision-making within EU institutions and implement EU directives at the national level. While the overarching goal of EU integration is to achieve greater cohesion and unity, the concept of "differentiated integration" recognizes that not all Member States may be equally prepared or willing to fully integrate into all aspects of EU policy at the same pace. Therefore, this approach allows for flexibility in accommodating different levels of participation and commitment among Member States, promoting a more inclusive and adaptable form of European integration.

3.6 Harmonizing insolvency law to support the integration agenda in EU

Article 114 of the Treaty on the Functioning of the European Union (TFEU) serves as a fundamental cornerstone for harmonization efforts within the EU[139]. This article grants the EU the authority to regulate aspects of private law that either directly or indirectly impede trade within the internal market. The internal market stands as one of the principal objectives of the European integration project:

“an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.”[140]

This goal was articulated as the elimination of hindrances to trade and mobility within the European community, with the aim of consolidating national markets into a unified European

[137] Treaty on European Union OJ C 326/13 (TEU), Articles 3–4.
[138] Pascal Durand, Report on Differentiated Integration (2018/2093(INI)) (Committee on Constitutional Affairs 2019) [2018].
[139] Treaty on the Functioning of the European Union (TFEU), Articles 26(1) and 26(2), OJ C 326/47.
[140] Art 26(2), TFEU.

domestic market. From the beginning, the elimination of these hindrances has been facilitated through harmonization measures, based on the widely accepted premise that building and integrating the internal market could only be achieved by establishing shared substantive and procedural legal frameworks applicable to all Member States. Insolvency issues possess significant implications at the Union level, as noted by Balz, a key figure in the development of what is now the European Insolvency Regulation Recast 2015:

"a functioning bankruptcy system is essential to any economy that aspires to achieve the freedoms of establishment of business and the free flow of goods, services and capital, and to integrate national markets into a unitary internal market."[141]

While the European legislator has historically leaned towards the notion that a fully functional bankruptcy (or insolvency) system could only be realized through comprehensive top-down harmonization, it's essential to recognize that this perspective may not be the sole path to success. While top-down harmonization could indeed facilitate complete harmonization, such endeavors also pose challenges. They can be time-consuming and may encroach upon elements of national sovereignty and legal traditions, presenting hurdles from the standpoint of EU institutions. Insolvency and restructuring laws are deeply embedded within national legal frameworks, evident across various domains. For example, most insolvency laws aim to strike a delicate balance between protecting the rights of creditors while also safeguarding the interests of debtors, shareholders, and consumers. However, different domestic insolvency regimes adopt diverse approaches to fulfill these objectives. This underscores the importance of considering whether decentralized or regional solutions might offer viable and effective alternatives to top-down harmonization.

These alternative approaches can manifest in various forms, often stemming from regulatory competition. Regulatory competition is a tangible phenomenon within the realm of insolvency and restructuring law, coexisting with the European Union's push for increased harmonization. Indeed, over the past decade, numerous Member States have initiated reforms to their national insolvency and restructuring laws not solely due to EU mandates, but also to align with best practices observed in other jurisdictions. As Paulus aptly pointed out:

"an almost feverish hectic (sic) among most of the European states to outdo the others in amending their laws […] Each one of these jurisdictions is striving for improvement; thereby, however, always keeping in mind the status of the com petitors' laws and, thus, restricting the

[141] Balz, M. (1996). The European Convention on Insolvency Proceedings. American Bankruptcy Law Journal, 70(1), 485.

competition to a field which is located on a solid block of numerous commonalities and uniformity." [142](Paulus, 2008)

The merits of regulatory competition in the field of insolvency and restructuring law have been widely discussed in academic literature. It brings with it the principle of try and error, according to which competition among states can result in a steady race for the adoption of best possible solutions. One of the by-products of regulatory competition is forum shopping. While forum shopping has its inefficiencies, especially of uncertainty and strategic behavior, 27 it also incentivises lawmakers to constantly improve their national regime to attract forum shoppers and prevent debtors/creditors within their own country to forum shop.
Forum shopping refers to the practice of litigants (parties involved in a legal dispute) seeking out a specific court or jurisdiction that is perceived to be more favorable to their case. This can involve strategically selecting a court where the laws are more favorable, where judges have a reputation for ruling in a certain way, or where procedural rules may provide a tactical advantage.

In the context of bankruptcy law, forum shopping may occur when a debtor or creditor seeks to file for bankruptcy or initiate bankruptcy-related litigation in a jurisdiction that is perceived to be more advantageous for their interests. This could involve selecting a jurisdiction with more lenient bankruptcy laws, more experienced judges in handling complex bankruptcy cases, or where the outcome is likely to be more favorable to the litigant.
Forum shopping is often viewed as a controversial practice because it can lead to disparate outcomes in similar cases and undermine the principle of equal justice under the law. It can also create inefficiencies in the legal system by encouraging parties to engage in jurisdictional maneuvering rather than resolving disputes on their merits. As a result, courts and legislatures may implement measures to prevent or discourage forum shopping, such as establishing rules governing venue selection or limiting the ability of parties to transfer cases between jurisdictions.

At the same time, negative effects for stakeholders that lack the means to actively pursue or influence insolvency competition, such as non-adjusting creditors in particular, cannot be overlooked. As it is apparent, competition can only occur if top-down harmonisation has not carved a single restructuring solution applicable throughout the EU. If the level-playing field for economic activity is even across the EU, this may temporarily benefit businesses, which can

[142] Paulus, C. (2008). A Vision of the European Insolvency Law. Norton Journal of Bankruptcy Law and Practice, 17, 607.

easily predict the laws applicable to their case in any given Member State while depriving national lawmakers of their ability and incentive to craft innovative legal solutions. In this context, harmonisation is seen as a strait-jacket stifling legal reform and the improvement of substantive law. With that said, current approaches which embrace differentiation in the EU's harmonisation efforts rarely amount to the harmonisation strait-jacket; rather, legislation such as the PRD provide ample scope for a variety of implementations, which may well still result in at least some level of continued regulatory competition in this area. Apart from competition, other justifications explain why legal similarity, be it the result of convergence or top-down rule-making, should not be taken at face value as the most advantageous approach. A restructuring regime does not function in a vacuum. Extra-legal conditions like the lending and ownership structure (e.g., dispersed or concentrated) need to be considered. Similarly, other areas of the law (e.g., corporate law) are typically adjusted to the insolvency and restructuring regime to function in concert. For this reason, legal transplants will not always function as well in practice as hoped for in theory. Top-down harmonization has been preferred as a regulatory method by the EU in insolvency and restructuring law since the 1960s, and has been regularly championed by stakeholders, 33 notwithstanding whether or not it has been achieved given the difficulties that beset harmonisation in this area of law. The EU has made clear its position against forum shopping, 34 which has served as a driver toward further top-down harmonisation to reduce the divergences that might otherwise encourage parties to seek restructuring and insolvency procedures outside of their natural procedural home

Chapter IV. European National jurisdictions. Compliance of national jurisdictions with the PRD

The PRD has significantly influenced the substantive insolvency laws across Europe, prompting jurisdictions to revise or consider revising their advanced practices to meet the PRD's minimum requirements. Among these, The Netherlands and Germany have been proactive, introducing new mechanisms early on. The Netherlands' WHOA(Wet Homologatie Onderhands Akkoord), although introduced in 2021, had been under development for several years. Similarly, Germany's StaRUG, also introduced in 2021, shares many features with the WHOA.

France has recently taken steps to align with the PRD by introducing an Ordinance13 aimed at its implementation. Denmark, while not yet enacting specific implementing legislation, has made several changes to encourage the use of rescue procedures.

After 80 years in effect, the former Italian bankruptcy law ("IBL", enacted in 1942) has been replaced by the new Code for Crisis and Insolvency ("CCII"), which came into force on July 15, 2022.

The CCII introduces a comprehensive and quite complex overhaul of the Italian insolvency and crisis legal framework, also incorporating principles from the "Insolvency EU Directive". The Italian insolvency law reform stems from an Act of delegation of 2017 (Act [legge] 19 October 2017, No. 155). A first draft was circulated at the end of that same year, and a complete draft emerged in February 2018. It was later revised and reappeared, amended, in February 2019 as the 'Codice della crisi d'impresa e dell'insolvenza' (Code of enterprise crisis and insolvency, in short 'Crisis Code').

The new law addresses almost all aspects of insolvency law. However, it is crucial to note that the Crisis Code, like the law it replaces (the so-called Legge fallimentare or Bankruptcy Act of 1942, as amended over time), applies fully only to enterprises with fewer than 200 employees. For larger enterprises, deemed 'large enterprises' for insolvency purposes under Italian law (though they might still be considered medium-sized by European standards), a special insolvency regime called amministrazione straordinaria (extraordinary administration) applies. This regime involves stronger government control over the procedure. The standard insolvency regime still applies to these 'large' enterprises concerning restructuring frameworks before 'extraordinary administration' is initiated (such as certified reorganisation plans, court-confirmed debt restructuring agreements, and in-court reorganisation procedures or judicial composition with creditors), making the general law relevant for these enterprises as well.

Common rules on insolvent liquidation (fallimento, translated here as 'bankruptcy') also apply when reorganisation efforts during extraordinary administration fail (Arts. 69 to 72, Legislative Decree No. 270/1999), so the general law also influences larger firms' insolvencies. The special insolvency regime for larger enterprises, which grants broad discretion to governmental authorities over judges and prioritises business continuity (especially employment) over creditors' rights, was not altered by the recent reforms despite its significant flaws. This exclusion has faced criticism and is seen as a htpmissed opportunity.

The new law does not address the insolvency of banks and other financial institutions, which remain outside standard insolvency procedures. Aside from these exclusions, the new law regulates all other aspects of insolvency and pre-insolvency: out-of-court debt restructuring,

reorganisation procedures, and straightforward insolvent liquidation (bankruptcy). It covers insolvent entrepreneurs and companies, as traditionally in Italy, and also extends to insolvent consumers, civil debtors, farmers, professionals, and very small enterprises, which were previously excluded from any collective insolvency proceeding. Key features of this part, most notably the discharge for non-entrepreneurs, have recently been incorporated into the current legal framework, effectively hastening the Crisis Code's implementation, although not under its name.

Now focusing on restructuring frameworks in Italy, given the context of the directive on restructuring and insolvency. For civil debtors and similar parties, it should be noted that, for the first time in Italian law, they will be subject to involuntary insolvency proceedings if they are insolvent (and not just over-indebted) upon a petition by a creditor or the public prosecutor (Art. 268(2) Crisis Code). Previously, since 2012, they could seek reorganisation or orderly collective liquidation only voluntarily, with liquidation becoming involuntary only as an unintended outcome of a failed voluntary plan. Thus, there are no more gaps in the insolvency framework.

The new law is intended to be the culmination of fifteen years of significant efforts to modernise the Italian insolvency system. Further changes may come from the implementation of the directive on restructuring and insolvency.

In 2005, the Italian insolvency law transitioned from an antiquated system to a modern framework. Prior to this, out-of-court restructuring frameworks were non-existent. If attempted and successful, there were no issues, but if they led to insolvency, there were criminal liabilities for preferential payments and 'deepening insolvency', as well as civil liabilities for directors, officers, and associates such as bank officers. Avoidance actions were particularly punitive for creditors receiving payments, even when payments were made for due debts, in cash, at the correct value.

The full-fledged reorganisation procedure (concordato preventivo) was available only to debtors who proposed to pay at least 40% of unsecured creditors' claims, while priority and secured creditors had to be paid in full. Alternatively, the debtor could surrender assets if a payment of at least 40% of unsecured creditors' claims was expected. The agreement was subject to a supermajority vote (majority of creditors by number and at least two-thirds by claim) and an ex officio court check confirming the debtor was 'deserving' (meritevole). The

entire law was phrased as if reorganisation was a benevolent, narrow exception to the rule of fallimento (bankruptcy), leading to severe consequences for the debtor. Any procedural error led to bankruptcy.

In 2003/2004, the Parmalat insolvency changed everything. A law-decree ('marzano') provided an expedited procedure for very large companies and enabled the insolvency practitioner to propose a plan to creditors that could include various measures, including debt-equity swaps, and provided for cross-class cram down. This procedure was not debtor-in-possession and was more of a forced restructuring, as the trustee could sell the assets as a going concern without creditors' consent. However, it served as an example for a general reform of the concordato preventivo, enacted in 2005.[143] For the first time, alongside a flexible reorganisation procedure with cross-class cram down provisions and no minimum payment limit, out-of-court proceedings were considered, regulated, and protected. The perspective shifted to seeing insolvency as a business accident, and insolvency law as a means to preserve enterprise value.

The process required adjustments, with minor tweaks in 2007 and 2010, an important update in 2012, minor interventions in 2013/2014, and significant changes in 2015. The resulting framework was not overturned by the 2019 reform, except for some aspects discussed while reviewing different instruments. However, the reform added new legislation, mainly concerning early warning, some aspects of the concordato preventivo, and group insolvencies.

Italian restructuring frameworks are based on three main instruments: the 'certified reorganisation plan', the 'court-confirmed debt restructuring agreement', and the concordato preventivo. These instruments are also available to 'large' enterprises, which otherwise fall outside the scope of the new law and the old one.

The certified reorganisation plan (piano di risanamento attestato, often called just piano attestato) is negotiated with creditors outside any ex-ante confirmation proceeding. A certified auditor must verify the data and confirm the plan's feasibility from an economic and legal perspective. The plan offers tax advantages similar to court-confirmed agreements and protects transactions based on the plan from avoidance actions and criminal liability. The new law (2019) clearly exempts such transactions from actio pauliana, which can be treacherous as it reaches back five years.

[143] Concordato Preventivo (Italy) - Art. 160 and following, Royal Decree No. 267/1942.

The certified plan does not undergo ex-ante court vetting, making it vulnerable to ex post examination. In 2016, the Court of Cassation issued decisions requiring plans to appear 'manifestly apt' to restore viability. A 2020 decision adjusted the standard to 'not manifestly inept', while the 2019 reform stated that exemption from avoidance is ineffective if the debtor or certifier acted with fraud or gross negligence, and the third party involved was aware.
Introduced in 2005, the court-confirmed agreement with creditors has become more structured over time. Initially, it required consent from all involved creditors, protection from avoidance, and no stay for individual enforcement actions. A stay was introduced in 2010, along with priority for interim and new financing and protection from criminal liability. In 2012, automatic stays, moratoriums, and full protection for interim financing with court authorization were added. The process was completed in 2015 with an out-of-court cram-down on dissenting creditors within a class, limited to banks and financial creditors.
Debt restructuring agreements are used by larger debtors than those in concordato preventivo, though the latter is more common. However, when used, these agreements tend to be successful, especially at the confirmation phase.

The concordato preventivo's main features have remained unchanged in the recent reform. The 2005-2007 law provided a modern restructuring procedure without a minimum payment requirement for unsecured creditors. Secured and priority creditors must be paid the value of collateral or assets on which they have priority. Since the 2005 reform, there has always been a cross-class cram down requiring a majority of classes and a majority of votes, measured by claim. This differs from other laws like Chapter 11 in the US.

In 2012, the procedure was enhanced with an automatic stay available before the plan was drawn up, and protection for the estate improved. Full protection was given to new and interim financing. The law provided for automatic avoidance of recent liens not consented to by the debtor.

The absolute or relative priority issue remains unsettled. A 2012 Court of Cassation decision clarified that absolute priority rule (APR) applies, except

in exceptional circumstances justified in the plan. The 2015 reform added that equity holders retain their interests only if the creditors are not worse off than in liquidation or if new equity investment is made.

A new early warning system was introduced, requiring debtor companies to identify financial difficulties and seek assistance before becoming insolvent. This system aims to prevent insolvency and encourage timely restructuring.

The reform also introduced provisions for group insolvency, allowing for coordinated proceedings and plans for companies within the same group. This aims to streamline the process and maximize the overall value of the group.[144]

Overall, the recent reforms have strengthened the Italian restructuring framework, making it more effective and aligned with European standards. These changes are designed to facilitate restructuring efforts, protect creditors, and preserve enterprise value, providing a more modern and efficient insolvency system.

The United Kingdom, despite no longer being an EU member, has closely followed the PRD's principles in its latest reforms. This approach seems intended to maintain its status as a competitive restructuring jurisdiction amidst the uncertainties Brexit has caused regarding the enforceability and recognition of UK procedures in the EU.

Each of these jurisdictions is adapting in unique ways to incorporate the PRD's standards, demonstrating the broad and varied impact of the PRD on European insolvency law.
The introduction of the WHOA (Wet Homologatie Onderhands Akkoord)as part of the PRD implementation marked a significant advancement for the Netherlands. Before the WHOA, the Netherlands offered only a limited procedural stay of enforcement known as "surseance van betaling," which provided a temporary reprieve to negotiate agreements or compositions with unsecured creditors. This earlier procedure was quite restrictive, focusing on specific up-stream or preventive measures aimed at rescuing viable companies. Although it was accessible to companies facing imminent insolvency, it was not particularly effective in facilitating comprehensive restructuring.

The WHOA represents a groundbreaking shift in the landscape of preventive restructuring in the Netherlands. Initially, the WHOA was not designed to implement the PRD, but it has nonetheless introduced a robust early restructuring mechanism that significantly enhances the country's position within the EU's competitive restructuring market.[145] The WHOA establishes

[144] United Nations (2016), International Guidelines on Debt Restructuring.
[145] Dutch Act on Court Confirmation of Extrajudicial Restructuring Plans (WHOA) (2021).

a debtor-in-possession procedure for companies anticipating insolvency. This procedure involves limited court intervention, enabling a restructuring plan to be approved by a majority of creditors and subsequently confirmed by a court.

By providing a more effective framework for early restructuring, the WHOA greatly improves the options available to Dutch companies, positioning the Netherlands as a leading jurisdiction for corporate restructuring within the European Union. This new approach not only aligns with the PRD's objectives but also offers a strategic advantage by fostering a more flexible and efficient restructuring environment.

Germany has long provided its debtors with an insolvency plan procedure under the Insolvenzordnung (InsO) of 1999. This procedure is available to debtors who are unable to pay their debts, over-indebted, or likely to become unable to pay their debts. However, with the introduction of the StaRUG, Germany offers an alternative specifically for debtors likely to be unable to pay their debts within the next 24 months. The StaRUG allows these debtors to choose between the traditional insolvency plan procedure and this new framework.
When a debtor becomes over-indebted or unable to pay its debts, there is generally an obligation to file for insolvency. Nevertheless, if the debtor can demonstrate that continuing with the StaRUG procedure is in the best interest of its creditors, they may avoid filing for insolvency. This approach enables debtors to address their financial issues at an early stage, outside of formal insolvency proceedings.

The StaRUG aligns with the PRD's provisions and offers a competitive alternative in the European restructuring market. This procedure not only provides early intervention options for debtors but also enhances Germany's position within the EU as a jurisdiction with flexible and effective restructuring mechanisms.

France has long been regarded as a jurisdiction conducive to restructuring due to its insolvency regime's focus on rescuing struggling businesses to preserve employment. Historically, French law has utilized procedures like the mandat ad hoc, conciliation, and various iterations of the “sauvegarde” procedure. These mechanisms are available to businesses before they reach the point of insolvency (cessation of payments). However, in practice, many businesses delay using these procedures to avoid the stigma associated with insolvency.

Despite this hesitation, the procedures available in France were already closely aligned with the provisions of the PRD even at the time of the authors' 2019 article. Recognizing this alignment, [146]France introduced a PRD-implementing Ordinance on 15 September 2021. The Ordinance acknowledged that the French system was largely compliant with the PRD, and as a result, the availability of preventive procedures has remained relatively unchanged. However, the Ordinance has introduced some modifications to enhance efficiency and adhere to other mandatory PRD provisions, such as the duration of the procedures.

In summary, while France's restructuring framework has traditionally supported the early rescue of businesses, the recent Ordinance aims to fine-tune the system, ensuring it meets PRD requirements and continues to offer effective and timely preventive measures. This reinforces France's position as a restructuring-friendly jurisdiction within the European Union.

Denmark continues to offer a restructuring plan procedure known as Rekonstruktion, which is only accessible during insolvency. In response to the anticipated impact of the COVID-19 pandemic on Danish businesses, this plan procedure was amended in May 2021. These changes were largely based on recommendations from the Danish Bankruptcy Council, which aimed to enhance the efficiency of the Danish restructuring regime.

One of the key amendments introduced is a fast-track procedure for business transfers. This fast-track approach is designed to significantly improve the potential for corporate rescue by allowing viable businesses a four-week window to address their financial distress. During this period, businesses can engage in voluntary and informal out-of-court workouts, thereby avoiding the complexity and stigma typically associated with formal insolvency procedures.
This fast-track procedure aims to provide a more efficient means for businesses to navigate financial difficulties, offering a streamlined process that facilitates quicker and more flexible corporate rescues. By incorporating these amendments, Denmark seeks to bolster its restructuring framework, ensuring it can effectively support businesses in distress, particularly in the wake of challenges posed by the pandemic.

The UK has long been a prominent jurisdiction for corporate rescue and restructuring. This reputation has been further strengthened by the introduction of a new restructuring plan, modeled after the scheme of arrangement. Prompted in part by the economic impact of the

[146] European Commission (2015), Communication on the European Economic Area.

COVID-19 pandemic, the UK swiftly implemented this new procedure. This restructuring plan shares many features with the PRD, adding to the array of rescue tools previously discussed by the authors in their 2019 article.

The new restructuring plan comes with a stricter threshold for use compared to traditional schemes. It is specifically available to companies that are likely to face financial difficulties, emphasizing the concept of the likelihood of insolvency and incorporating many preventive measures outlined in the PRD. Despite these advantages, the new restructuring plan does face a significant challenge: the uncertainty regarding its recognition or enforcement in the wake of Brexit. Since the UK is no longer part of the EU, the plan is not covered by the EIR Recast, placing it at a competitive disadvantage compared to other new procedures introduced in 2021.

Overall, while the new restructuring plan enhances the UK's corporate rescue framework by aligning with PRD principles and providing robust preventive measures, the Brexit-related uncertainties around recognition and enforcement remain a notable drawback.[147]

The EU-UK relationship is now governed by the 'EU-UK Trade and Cooperation Agreement' (TCA), which was finalized on 24 December 2020 and implemented in the UK through the European Union (Future Relationship) Act 2020. Despite this agreement, it fails to replicate the straightforward and seamless system for recognizing civil and insolvency judgments that was previously established by the Brussels Recast Regulation 2012 and the EIR Recast.
Furthermore, the TCA does not address the procedures for recognizing restructuring and insolvency proceedings between the EU and the UK. This significant omission means that the insolvency and restructuring industry is experiencing the effects of a 'hard Brexit.' Although the UK government has enacted some emergency regulations to address this gap, they do not provide the same level of integration and recognition as the previous EU frameworks.
As a result, the UK's dominant position as a leading restructuring hub within the EU is now uncertain. This uncertainty is further compounded by the fact that other jurisdictions, such as Germany and the Netherlands, have introduced competitive mechanisms that could rival the UK's Scheme of Arrangement even before Brexit. The lack of clear recognition procedures under the new agreements puts the UK at a potential disadvantage in the European restructuring market.

[147] Insolvency Act 1986, s. 176A (UK).

4.1 Pre-existing mechanisms: Rationale and early years

In the early years of the European Community, efforts to harmonize insolvency laws matched the integrationist narrative. The rationale for harmonizing insolvency laws rested on the link between the integration and smooth functioning of the internal market and the need for coordinated actions at the Community level. For example, as early as 1970, the Draft Convention on Bankruptcy, Winding Up, Arrangements, Compositions, and Similar Proceedings stated that:

"the effect of the common market must be precisely to bring about a radical change […] The Member States of the European Economic Community have agreed to establish between themselves a genuine and vast internal market conforming to the rules of free competition. Every effort must therefore be made not only to eliminate obstacles to the functioning of this market, but also to promote its development."

Due to the sensitive and complex nature of insolvency law, it took over 40 years for the first cross-border instrument to come into existence, in the form of the **European Insolvency Regulation 2000 (EIR 2000)**. Because of "widely differing substantive laws", the EIR 2000 acknowledged that it was not:

"practical to introduce insolvency proceedings with universal scope in the entire Community."

As a result, the European Community opted for procedural harmonization. The EIR 2000 was a private international law instrument, which dealt with issues of jurisdiction, applicable law, recognition, and enforcement of insolvency decisions, as well as coordination of cross-border insolvency proceedings. It designated the applicable law, that is, restructuring and insolvency procedures that were already in place in the Member States, and it ensured that they were recognised throughout the Community. At the time the EIR 2000 was passed, liquidation was the usual, if not the only, option for distressed companies in many EU Member States. While this focus on liquidation was reflected in the EIR 2000, the EU promoted the modernisation of the Member States' insolvency laws, notably through the sharing of best practices from selected Member States as well as the United States, based on the Open Method of Coordination (OMC) approach. The OMC is an EU policy-making process introduced at the Lisbon European Council in 2000. Rather than a reliance on prescriptive legislation, the OMC is a mode of soft governance that aims to spread best practice and achieve convergence towards EU goals in those policy areas falling under partial or full competence of the Member States, which includes insolvency and restructuring law. Following this European nudge in the early 2000s, the UK

adopted the Enterprise Act 2002, Ireland implemented the Examinership procedure, and Finland, France, Slovakia, and Spain, to name just a few, also updated their rescue frameworks. The state of insolvency laws across the EU continued to show important disparities in substance, however. As a result, by the time the Global Financial Crisis of the late 2000s hit Europe, the rescue culture was still not fully adopted in all Member States, which explains why the EU had to move away from this soft mode of governance in its approach to adopting the ECR 2014 and eventually the PRD 2019.

Although this soft mode of governance has been largely abandoned due to its “lack of teeth”, a good example being the 2014 Recommendation that failed to find its feet among the Member States, the EU's policy of differentiated integration continues to allow for flexible legislation that takes into account Member State differences while relying on mutual trust and cooperation to ensure that those differences do not impede progress toward further legislative alignment.

Since the introduction of the EIR 2000, the EU has promoted harmonisation of restructuring and insolvency law, which has intensified with the Global Financial Crisis of the late 2000s. In 2012, the European Commission (Commission) – prompted by a Resolution of the European Parliament 38 – announced its step-by-step approach to improve European insolvency law and introduce a European business rescue culture. 39 Alongside the modernisation of the EIR 2000, which took place with the adoption of the EIRR 2015, the Commission adopted the ECR 2014. The ECR 2014 was quickly strengthened into a binding legislative instrument, the PRD 2019. While this section provides a contextual background for the harmonisation initiatives in the field of insolvency and restructuring law, it focuses specifically on the harmonisation narrative and strategies relied on by the EU institutions over the years.

European insolvency regulation recast 2015 The first step on the EU institutions' harmonisation agenda was a revision of the EIR 2000. Ideas for reforming the European Insolvency Regulation are as old as the text itself, since art 46 of the EIR 2000 tasked the Commission to present a report on the overall effectiveness and efficiency of the EIR 2000 by June 2012. While the Commission concluded that the EIR 2000 was generally operating successfully in facilitating cross-border insolvency proceedings within the EU, it uncovered several issues, notably relating to the scope of the Regulation, jurisdictional rules (COMI and forum shopping), publicity rules, and rules dealing with group insolvency under the EIR 2000. Similar to the EIR 2000, the EIRR 2015 is a conflict-of-law, choice-of-forum instrument, which deals with the private international law dimension of insolvency law. It confirmed the EIR 2000 position that

the widely differing substantive laws of the Member States still prevented introduction of insolvency proceedings with a universal scope. However, the new focus to promote rescue over liquidation, was reflected, inter alia, in the extension of the scope of the EIRR 2015 to include pre-insolvency restructuring proceedings. European Commission recommendation on a new approach to business failure. In 2012, as the EU was grappling with the devastating effects of the global economic crisis of the late 2000s, which saw an average of 200,000 firms going insolvent per year in the EU, 43 the Commission highlighted the need to support a more business-friendly environment for debtors in financial distress. It launched ideas to harmonise some areas of such laws, which were ripe for substantive harmonisation. 44 This was elaborated on in the ECR 2014. A key rationale for this new non-binding harmonisation initiative was the need to:

promote a rescue and recovery culture across the EU 45 and

create a level-playing field of national insolvency laws, which would, in turn, lead to improved access to credit and foreign investment. With this paradigm shift in the scope of harmonisation came a strategy shift. The ECR 2014 was the first concrete attempt by an EU institution to achieve substantive harmonisation of insolvency and restructuring law. The Commission reiterated that national insolvency rules vary greatly; however, it now argued that such discrepancies must be harmonised as they hamper restructuring of viable business. Greater coherence was deemed necessary to increase efficiency of national frameworks, maximise value for all creditors, encourage cross-border investments and facilitate restructuring of groups of companies.[148] Despite championing further harmonisation, not only did the Commission opt for a soft law instrument, it also opted for a minimum harmonisation approach. 48 Additionally, the Commission decided to focus its efforts on a particular aspect of restructuring and insolvency law: preventive restructuring frameworks. The Commission considered that such area was the most promising one to entrench a rescue culture in all of the Member States. Due to the limited take up of the Recommendations and even cherry picking by Member States, 51 the EU strengthened its initiative subsequently into a Preventive Restructuring Directive.[149]

The Preventive Restructuring Directive received approval from the European Parliament on March 28, 2019, and from the Council of Ministers on June 6, 2019. Although both the Parliament and the Council played crucial roles in shaping the final version, the Directive

[148] United Nations (2021), Guidelines on Consumer Protection.

[149] Council of Europe (2014), Recommendations on Corporate Governance.

originated from a European Commission proposal dated November 22, 2016.[150] This proposal was fundamentally linked to the **Capital Markets Union project.**

The Capital Markets Union (CMU) is an initiative launched by the European Union (EU) with the primary goal of creating a single, integrated capital market across all EU member states. The project was introduced by the European Commission in 2015 and is part of the broader strategy to enhance the Economic and Monetary Union (EMU) and stimulate investment and economic growth in Europe. The key objectives of the Capital Markets Union project were:

1. **Diversification of Funding Sources**:
   The CMU aims to reduce the reliance on bank financing, which has traditionally been the dominant source of funding for companies in Europe. By diversifying funding sources, the CMU seeks to make it easier for businesses, especially small and medium-sized enterprises (SMEs), to access finance through capital markets.
2. **Integration of Capital Markets**:
   One of the primary objectives is to break down barriers to cross-border investments and facilitate the free flow of capital across the EU. This involves harmonizing regulations, reducing fragmentation, and creating a more coherent framework for capital markets.
3. **Investment in Innovation and Infrastructure**:
   The CMU is designed to channel more investment into innovative projects and infrastructure. By doing so, it aims to foster long-term economic growth, job creation, and competitiveness within the EU.
1. **Enhancing Market Efficiency and Stability**:
   The initiative seeks to improve the efficiency and stability of financial markets by enhancing investor protection, increasing transparency, and promoting market integrity. This involves implementing measures to mitigate risks and ensure robust oversight.
5. **Promoting Sustainable Finance**:
   The CMU project also emphasizes the importance of sustainable finance, encouraging investments that contribute to environmental sustainability and the transition to a low-carbon economy.

The European Commission has implemented several key actions and measures to achieve the objectives of the Capital Markets Union (CMU). These include simplifying prospectus rules to reduce the cost and complexity of raising capital across EU borders. Additionally, the

[150] European Union (Preventive Restructuring) Regulations 2022 - Department of Enterprise, Trade, and Employment (2022).

introduction of a standardized Pan-European Personal Pension Product (PEPP) aims to encourage retirement savings and cross-border investment in pension funds.

Another significant measure involves revitalizing securitization markets by establishing a framework for simpler, more transparent, and standardized securitization processes. This initiative is intended to improve funding opportunities for both banks and non-bank entities.

To enhance access to risk capital, the CMU supports venture capital and equity financing through initiatives such as the European Venture Capital Funds (EuVECA) and the European Long-Term Investment Funds (ELTIF). These measures aim to facilitate investment in innovative projects and infrastructure across the EU.

Moreover, efforts are focused on strengthening supervision and enforcement mechanisms to ensure consistent application of capital markets regulations throughout EU member states. By removing administrative and regulatory barriers that impede cross-border investment, the CMU seeks to promote market efficiency and liquidity within the European financial system.

Overall, these actions are pivotal in advancing the CMU's goals of creating a more integrated, efficient, and resilient capital market across the European Union.

Going back to the Preventive Restructuring Directive, main objective of this Directive is to enhance the internal market's functionality by eliminating barriers to fundamental freedoms, such as the free movement of capital and the freedom of establishment. [151]These barriers arise from differences in national laws and procedures related to preventive restructuring, insolvency, debt discharge, and disqualifications. While respecting workers' fundamental rights and freedoms, the Directive seeks to remove these barriers by ensuring several key outcomes.

The Directive comprises three key elements: first, **a 'preventive' restructuring framework; second, provisions for a second chance or fresh start for 'entrepreneurs'; and third, general provisions aimed at improving the efficiency of restructuring, insolvency, and second chance procedures.**

The primary goal of preventive restructuring frameworks is to enable debtors to restructure effectively at an early stage, helping them to avoid insolvency and thereby preventing the unnecessary liquidation of viable enterprises. These frameworks should help preserve jobs and retain know-how and skills, while maximizing the total value for creditors compared to what they would receive if the enterprise's assets were liquidated or under the next best alternative

[151] Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (Text with EEA relevance) PE/84/2019/REV/1.

scenario without a restructuring plan. Additionally, these frameworks benefit the business owners and the overall economy.

4.2 Early warning and access to information

According to the Directive, it shall be ensured by Member States that debtors are provided with access to one or more clear and transparent early warning tools. These tools should be capable of detecting circumstances that could indicate a likelihood of insolvency. By using such tools, debtors can be signaled to the need to take prompt action without delay.

Early warning tools may include the following:

a. alert mechanisms when the debtor has not made certain types of payments;
b. advisory services provided by public or private organisations.
c. incentives under national law for third parties with relevant information about the debtor, such as accountants, tax and social security authorities, to flag to the debtor a negative development.[152]

Restructuring should allow debtors facing financial difficulties to continue their business operations, either in whole or in part, by modifying the composition, conditions, or structure of their assets and liabilities or any other part of their capital structure. This could include selling assets or parts of the business, or even the entire business, if permitted by national law, along with making operational changes. Unless specifically stated otherwise by national law, operational changes, such as terminating or amending contracts or selling assets, should adhere to the general legal requirements, particularly those in civil and labor law. Similarly, any debt-to-equity swaps must follow the safeguards established by national law.

Preventive restructuring frameworks should also aim to prevent the accumulation of non-performing loans. By providing effective preventive restructuring options, action can be taken before businesses default on their loans, thus reducing the likelihood of loans becoming non-performing during economic downturns and lessening the negative effects on the financial sector. If preventive frameworks were available in all Member States where businesses are established, hold assets, or have creditors, a significant number of businesses and jobs could be preserved.

The preventive restructuring frameworks should ensure the rights of all involved parties, including workers, are protected in a balanced manner. However, it is equally important that

[152] Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (Text with EEA relevance) PE/84/2019/REV/1.

non-viable businesses with no chance of survival are liquidated promptly. For debtors in financial distress who are not economically viable or cannot be easily restored to economic health, restructuring efforts could lead to increased and accelerated losses, harming creditors, workers, and other stakeholders, as well as the broader economy.

According to the Directive, Member States shall provide the viable businesses for the appointment of a practitioner in the field of restructuring, to assist the debtor and creditors in negotiating and drafting the plan, at least in the following cases:

(a) where a general stay of individual enforcement actions, in accordance with Article 6(3), is granted by a judicial or administrative authority, and the judicial or administrative authority decides that such a practitioner is necessary to safeguard the interest of the parties;

(b) where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down, in accordance with Article 11 of PRD;
or,

(c) where it is requested by the debtor or by a majority of the creditors, provided that, in the latter case, the cost of the practitioner is borne by the creditors.[153]

There are notable differences between Member States regarding the range of procedures available to debtors facing financial difficulties to restructure their businesses. In some Member States, the options for restructuring are limited and only available at a relatively late stage, often within the context of insolvency proceedings. In other Member States, while restructuring can occur at an earlier stage, the available procedures are not as effective as they could be or are highly formalized, particularly because they restrict the use of out-of-court arrangements.
The 2008 World financial crisis, and recent pandemic showed the world that the countries with more strict insolvency procedures and not implemented a rescuing culture are more vulnerable to the external risks.
Additionally, the level of involvement of judicial or administrative authorities, or their appointed representatives, varies significantly across Member States. In some countries, there is little to no involvement of these authorities, while in others, their involvement is extensive. Similarly, the rules providing entrepreneurs with a second chance, particularly those granting

[153] Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers, and divisions (Text with EEA relevance) PE/84/2019/REV/1.

discharge from debts incurred during business operations, vary between Member States in terms of the discharge period's length and the conditions required for obtaining such a discharge.
In numerous Member States, it takes over three years for honest but insolvent entrepreneurs to be discharged from their debts and allowed to make a fresh start. The inefficiency of debt discharge and disqualification frameworks forces entrepreneurs to move to other jurisdictions to benefit from a more reasonable period for a fresh start. This relocation entails significant additional costs for both the entrepreneurs and their creditors. Unlike the traditional approach of liquidating a struggling business, the solutions that PRD offers aim to restore the business to health or, at the very least, save the economically viable parts of the business. This modern approach offers several economic benefits, including the maintenance of jobs or the reduction of job losses.

Furthermore, lengthy disqualification orders, which often accompany debt discharge procedures, create barriers to the freedom to engage in self-employment or entrepreneurial activities. These extended disqualification periods hinder entrepreneurs from starting new businesses or continuing their entrepreneurial endeavors, thus restricting their ability to recover and contribute to the economy.

To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures. Where this Directive is implemented by means of more than one procedure within a restructuring framework, the debtor should have access to all rights and safeguards provided for by this Directive with the aim of achieving an effective restructuring. Except in the event of mandatory involvement of judicial or administrative authorities as provided for under this Directive, Member States should be able to limit the involvement of such authorities to situations in which it is necessary and proportionate, while taking into consideration, among other things, the aim of safeguarding the rights and interests of debtors and of affected parties, as well as the aim of reducing delays and the cost of the procedures. Where creditors or employees' representatives are allowed to initiate a restructuring procedure under national law and where the debtor is an SME, Member States should require the agreement of the debtor as a precondition for the initiation of the procedure, and should also be able to extend that requirement to debtors which are large enterprises.

To promote efficiency and reduce delays and costs, flexible procedures should be incorporated into national preventive restructuring frameworks. It is essential that when this Directive is implemented through more than one procedure within a restructuring framework, the debtor is

granted access to all the rights and safeguards provided by this Directive. This is crucial to ensure an effective restructuring process. Except in instances where the mandatory involvement of judicial or administrative authorities is specified under this Directive, Member States should have the flexibility to limit such involvement to situations where it is necessary and proportionate. This limitation should be considered with the aim of safeguarding the rights and interests of debtors and affected parties, as well as reducing procedural delays and costs.

The involvement of judicial or administrative authorities should be minimized wherever possible, while still ensuring the protection of all parties involved. This approach is particularly important in order to maintain a balance between effective restructuring and the efficient use of resources. In situations where creditors or employees' representatives are allowed to initiate a restructuring procedure under national law, and the debtor is a small or medium-sized enterprise (SME), it is imperative that the agreement of the debtor is obtained as a precondition for initiating the procedure. This ensures that the debtor has a say in the process and that the restructuring is undertaken with their consent. Additionally, Member States should have the option to extend this requirement to include debtors that are large enterprises, ensuring consistency and fairness across different business sizes.

Moreover, the aim of these frameworks should be to create a supportive environment for businesses in financial distress, allowing them to restructure early and effectively. This proactive approach can help to prevent insolvency and the unnecessary liquidation of viable enterprises. By reducing delays and costs, and by ensuring that the involvement of judicial or administrative authorities is kept to a necessary minimum, the overall efficiency of the restructuring process can be significantly enhanced. This will not only benefit the businesses involved but also their creditors, employees, and the wider economy.

Finally, the implementation of national preventive restructuring frameworks with flexible procedures, limited but necessary involvement of judicial or administrative authorities, and the inclusion of debtor consent for SMEs and large enterprises alike, is vital. These measures will promote a more efficient, cost-effective, and fair restructuring process, ultimately contributing to the stability and growth of the economy.

The PRD introduces the concept of majority voting within creditor classes, coupled with the potential for a cross-class cram down to bind dissenting classes of creditors. Majority voting is crucial in cases involving diverse stakeholders with varied interests, aiming to prevent hold-

outs. According to Article 11 of the PRD, a cross-class cram down can be enforced against dissenting classes if one creditor class 'in-the-money' and affected by the plan approves it. Additionally, the dissenting class must receive equal payment to equal-ranking classes and a higher satisfaction quota than more junior classes, thereby establishing a form of relative priority. Member States have the option to deviate from this default rule and opt for compliance with the absolute priority principle instead.

The Directive finalizes the Commission's legislative agenda in this field and complements the recast Regulation on Insolvency Proceedings, which came into effect in June 2017. This Directive builds upon previous Commission efforts, especially the 2014 Recommendation on a new approach to business failure and insolvency. However, the Commission noted that this Recommendation, which did not have formal legal status, was only partially adopted by Member States.

The Directive introduces several key changes and enhancements compared to the Recommendation.[154] Additionally, it significantly diverges from the original Commission proposal, most notably by allowing the possibility of 'relative priority' among creditors, rather than 'absolute priority', within a restructuring plan and during the judicial or administrative approval of the plan.

4.3 Cross class clam down in EU Member States's jurisdictions

The approach to cross-class cramdown has undergone significant changes to align with the PRD. In the Netherlands, the WHOA now allows for a cross-class cram down against dissenting creditors, coupled with the application of a relaxed absolute priority rule. Similarly, the German StaRUG permits cross-class cram down in the insolvency plan procedure, although it generally adheres to the absolute priority principle with limited and well-justified deviations. In France, Ordinance no. 2021-1193 introduces creditor classes to vote on the sauvegarde plan, aligning their composition with the PRD. Moreover, the Ordinance introduces the possibility of a cross-class cramdown mechanism in Article L626-32, a novelty for the French regime which had not included this option previously despite its extensive restructuring provisions. However, the French cross-class cramdown is contingent upon the application of an absolute priority rule, though the court retains some discretion to consider the specific situation of the creditors. Among the five countries mentioned above, the UK offered the earliest restructuring option to

[154] International Monetary Fund (2017), Guidelines for Public Debt Management.

bind both secured and unsecured creditors of a still solvent debtor through the Scheme of Arrangement. However, the introduction of the new restructuring plan under Part 26A revises the eligibility threshold to the likelihood of insolvency, potentially restricting its availability to pre-insolvency situations. This contrasts with its predecessor, which could theoretically be utilized by a company at any point in time. Nevertheless, the new restructuring plan addresses a significant gap in the Part 26 Scheme by introducing a cross-class cramdown provision to bind dissenting creditor classes. Similar provisions are found in the new restructuring procedures of the Netherlands, Germany, and France, although the required majority threshold is set at the highest level, reaching 75% in both the UK and Germany, without considering headcount majority.

In Denmark, only unsecured creditors are typically bound to a restructuring plan, while fully secured creditors may still enforce their claims once the proceedings are concluded. Despite recent amendments to the Danish restructuring procedure, this aspect remains unchanged. Given the significant level of collateralization in Denmark, a critical element for successful restructuring is still absent, especially when the debtor faces a dispersed credit structure. Currently, there is ongoing consideration regarding potential significant changes to Danish regulations on floating charges and whether amendments regarding the effect of the debtor's insolvency should be implemented to encourage and facilitate business rescue. However, the precise method of introducing such incentives remains uncertain at present.

4.4 The compensation order regime

Before 2015, directors could be banned from being directors under the Company Directors Disqualification Act 1986 (CDDA 1986), but they couldn't be forced to pay compensation to the company or anyone else through this Act. If a director engaged in 'wrongful trading' (acting irresponsibly leading to insolvency), they could be disqualified[155], but compensation for any losses due to this wrongful trading had to be pursued through the Insolvency Act 1986.

In 2015, sections 15A and 15B were added to the CDDA 1986, allowing courts to issue "compensation orders" against disqualified directors. This change was made because the provisions for personal liability under the Insolvency Act 1986 and the Companies Act 2006 were not being enforced enough, while the disqualification process under the CDDA 1986 was used more frequently. The new sections aimed to make it more likely that directors who misbehave are held financially responsible, thereby improving the chances for creditors to

[155] Company Directors Disqualification Act 1986 s.10.

recover their losses. Determining whether the rules for holding directors personally liable were under-enforced is complex. As Paul Davies pointed out, the number of reported cases and the impact of any specific law are multifaceted and not straightforward[156]. The relatively few wrongful trading cases since 1986 do not necessarily mean directors have been avoiding liability for not minimizing losses to creditors when they know insolvency is inevitable. Directors might have taken appropriate steps to prevent losses, or their actions might not have resulted in any damage to the company (as seen in the Ralls case). Instead of just enabling the Secretary of State to pursue wrongful trading actions under the CDDA 1986, the government introduced a new, independent compensation order regime. This regime has a broader scope than what was previously available against directors under the old law.

Section 15A grants the court authority, upon application by the Secretary of State, to issue a compensation order against a person disqualified under the Act if their conduct resulted in a loss to one or more creditors of an insolvent company where the individual was a director at any time. The focus is on losses incurred by creditors rather than the company itself. Consequently, the court can order compensation to be paid not only to the company but also directly to a specific creditor or group of creditors. This is different from Section 214 or the West Mercia case, which only allows for compensation directed to the company's assets since they address losses to the company and breaches of duty owed to the company, respectively. This new provision represents a significant change, as noted by ICC Judge Prentis in the “Re Noble Vintners Limited” case, the first to interpret these new rules.

Judge Prentis, in the “Noble Vintners” case, pointed out that the legal changes provide a straightforward way for unsecured creditors to recover compensation for losses caused by directors who improperly conduct 'mini-liquidations' just before insolvency proceedings. The new CDDA compensation regime focuses on the loss suffered by individual creditors rather than the company. It allows the court to order compensation directly to specific creditors. This should simplify securing compensation for unsecured creditors in cases similar to “West Mercia”. In “Noble Vintners”, Judge Prentis concluded that the compensable loss under the CDDA regime, in the context of a preferential payment, was the difference between what the affected creditor received and what they would have received without the director's preferential treatment. In “West Mercia” cases, courts have similarly reduced the amount directors must repay to the company to reflect the pro-rata distribution among unsecured creditors if the preferential payment had not been made. This

[156] Davies, Paul. (2006). "Directors’ creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency." E.B.O.R. 7, 301, 325.

approach suggests that the courts can achieve similar results under the CDDA as in “West Mercia” cases, bypassing the remedial challenges associated with the latter.The new regime under the Company Directors Disqualification Act (CDDA) 1986 adds significant complexity compared to the previous system. Before 2015, directors could be disqualified under the CDDA, but they couldn't be made personally liable to compensate the company or its creditors through this act.[157] Compensation for wrongful trading had to be sought under the Insolvency Act 1986, which typically benefited the company as a whole, not individual creditors.

However, the 2015 amendments to the CDDA introduced a new mechanism allowing courts to issue compensation orders. [158]These orders can direct compensation to specific creditors rather than the company at large. This means directors can now face claims under both the Insolvency Act and the CDDA, which complicates the legal landscape.

For example, if a director authorizes a transaction at undervalue (i.e., selling an asset for less than its worth) in breach of their duty, previously, the remedy would be sought under the Insolvency Act, benefiting the company overall. Now, under the new CDDA rules, compensation can be directed to specific creditors, adding another layer of decision-making for officeholders. They must choose between pursuing actions under the old laws or seeking disqualification and compensation orders under the new rules. This decision-making process can increase costs and complexity.

Moreover, courts now have the more intricate task of deciding how to allocate compensation among specific creditors, rather than simply restoring assets to the company. This selective compensation could potentially favor some creditors over others, raising concerns about fairness and the overall impact on creditor recovery.

Overall, while the new CDDA provisions offer additional avenues for compensation, they also introduce new challenges and considerations for both officeholders and courts in handling cases involving director misconduct.

Furthermore, it appears feasible for compensation to be mandated under the CDDA even in scenarios where it would not be granted under previous laws (e.g., where directors would not be held personally accountable under the Insolvency Act 1986 or Companies Act 2006). Take, for instance, a situation akin to the Ralls case, where a director is found culpable of 'wrongful trading' (by failing to satisfy the defense under s.214(3)), yet is not liable to compensate under

[157] Noble Vintners Ltd v. Dodd, [2018] EWHC 954 (Ch); judgment of Zacaroli J (17 April 2018).
[158] Goode, R. (2011). Principles of Corporate Insolvency Law (4th ed.). Sweet & Maxwell, London.

s.214 because their actions did not cause any loss to the company. If a court determines that such conduct renders a person unfit to manage a company as defined in s.6 of the CDDA, they could be disqualified, potentially leading to an application for compensation concerning conduct that would not be compensable under s.214 (such as losses to specific creditors).

In conclusion, section 214 is seen as too narrow because it does not offer a solution in cases where creditors are selectively paid out of self-interest before insolvency proceedings commence.[159]. Fortunately, the gap has been filled by the judge-made duty-shifting rule, which provides a practical (though somewhat challenging in terms of remedy) solution in cases involving self-interested preferences. Parliament's new innovation — the compensation order regime in the CDDA 1986 — now offers a more direct path to achieving the same outcome in such cases. However, this also extends significantly, complicating the process of remedy in cases where a solution would typically be straightforward outside the CDDA, and expanding the grounds on which directors can be held personally liable.

[159] Moss, T. (2017). "No compensation for wrongful trading – where did it all go wrong?", London: Insolvency Intelligence Publishing. 30(4), 49.

Chapter V. The importance of debtor-creditor balanced restructuring frameworks

The Global Insolvency Index (GII) aims to evaluate the appeal of reorganization procedures from the viewpoints of debtors, secured creditors, and general unsecured creditors. By analyzing the attractiveness and development of reorganization procedures in 53 jurisdictions worldwide, the GII demonstrates that insolvency systems can range from being pro-debtor and pro-creditor to anti-debtor and anti-creditor, or fall somewhere in between.

Generally, an insolvency system is deemed debtor-friendly if the legislation includes features that appeal to debtors, such as allowing managers to continue operating the business during the reorganization process and providing a moratorium or "stay" that prevents creditors from initiating enforcement actions against the debtor.

Conversely, an insolvency system is considered creditor-friendly if management is replaced by an external administrator and the legislation does not fully protect the debtor from creditor enforcement actions. Additionally, insolvency laws may contain various provisions that appeal to either debtors or creditors. Debtor-friendly provisions might include rules that facilitate debtor-in-possession (DIP) financing and allow the debtor to enforce a reorganization plan on dissenting creditor classes ("cross-class cramdown"). Creditor-friendly provisions might empower creditors by allowing them to appoint or remove insolvency practitioners or to make key decisions about the procedure, such as authorizing DIP financing or approving a reorganization plan or asset sale.

As illustrated in the table, the US Chapter 11 process has traditionally been the most attractive reorganization procedure for debtors. This is due to several factors, including the default DIP model for managing reorganization procedures, the absence of a special liability regime for directors of insolvent firms, restrictions on the enforcement of ipso facto clauses, DIP financing provisions, and the ability to impose a plan on dissenting creditor classes.

The attractiveness of the US Chapter 11 reorganization procedure has remained relatively stable over time. The only significant change for the index occurred in 2005 when a reform limited the debtor’s exclusivity period for proposing a reorganization plan. However, in recent years, various regulatory developments worldwide have challenged the traditional dominance of the US Chapter 11 as the most attractive reorganization procedure for debtors. In 2017, Singapore introduced a significant insolvency reform that greatly enhanced the appeal of its restructuring framework. This reform included a more robust moratorium in the scheme of arrangement, the

adoption of a cross-class cramdown, a pre-packaged scheme of arrangement, and rescue financing provisions in the scheme of arrangement and judicial management.

For the Global Insolvency Index (GII), these reforms primarily impacted the treatment of ipso facto clauses and the duties and liability of directors in insolvency. These changes have made the Singapore scheme of arrangement more attractive than the US Chapter 11.

First, the Singapore scheme of arrangement has incorporated many restructuring tools found in the US Chapter 11, such as a strong moratorium, restrictions on enforcing ipso facto clauses, access to rescue financing, and cross-class cramdown. Second, unlike US Chapter 11, where an examiner or trustee can be appointed in certain situations, the Singapore scheme of arrangement is always managed by the debtor without any supervisor or insolvency practitioner. Third, in US Chapter 11, creditors can submit reorganization plans once the debtor's exclusivity period ends, and they play a significant role in aspects like asset sales. In contrast, under the Singapore scheme of arrangement, as in most similar schemes worldwide, creditors have limited powers, primarily voting on the reorganization plan, since these schemes are not traditionally formal insolvency proceedings. Fourth, shareholders in the Singapore scheme of arrangement cannot be forcibly wiped out, unlike in US Chapter 11, where shareholders can lose the company. Shareholder dilution or loss of ownership requires their consent in the Singapore scheme.

Other notable reorganization procedures in the GII include the French safeguard procedure and the new restructuring plan in the United Kingdom. The new restructuring procedure in the Netherlands (WHOA) and various hybrid procedures, such as schemes of arrangement in many Commonwealth jurisdictions and court-approved workouts in several civil law countries like Argentina, Chile, Brazil, and Uruguay, are also considered attractive for debtors. The appeal of these hybrid procedures is often due to shareholders not being wiped out, managers running the procedure, the absence of financial prerequisites for initiating the procedure, and the lack of a special liability regime for corporate directors. Additionally, these procedures typically allow debtors to benefit from majority or super-majority rule for approving a reorganization plan and may include a moratorium.

The GII identifies the least attractive procedures for debtors as administration-style procedures in most Commonwealth jurisdictions. These procedures usually involve appointing an external administrator to replace the directors in managing the company, subject corporate directors to a stringent liability regime, and lack comprehensive DIP financing or the ability to impose a plan on dissenting creditor classes.

The most attractive procedures for secured creditors are generally those where secured creditors are not affected by the procedure, such as the suspension of payments procedure in the Netherlands and the UK company voluntary arrangement, where secured creditors can enforce their security interests and are not bound by any reorganization plan without their consent. Some administration-style procedures share these features. For example, in Australia, secured creditors are not bound by a reorganization plan unless they consent, and those with a security interest over the entire or substantial property of the company can enforce their interests shortly after an administrator's appointment. In New Zealand, secured creditors are not bound by a reorganization plan but face certain enforcement restrictions.

Other procedures attractive to secured creditors include hybrid procedures where secured creditors can enforce their interests during the process, as seen in traditional schemes of arrangement in many Commonwealth jurisdictions, including Australia, the Cayman Islands, India, and Hong Kong. Interestingly, the GII shows that US Chapter 11, a debtor-friendly procedure, is also relatively attractive to secured creditors. This is due to several protections, such as the ability to lift the automatic stay if adequately protected, ensuring secured creditors are not worse off through the "no worse off rule," and protecting their rights in new financing and reorganization plan approvals through mechanisms like the absolute priority rule and the best interest of creditor test. Similar protections for secured creditors exist in the Singapore scheme of arrangement and the UK restructuring plan, making these procedures highly rated for secured creditors in the GII.

The most unattractive reorganization procedures for secured creditors are found in countries like France (safeguard procedure) and Ecuador (preventive reorganization). In these procedures, secured creditors face several disadvantages: they cannot enforce their security interests, they can be bound by a reorganization plan, they lack significant powers during the procedure, and they are paid after administrative expenses and various preferential creditors. Additionally, these countries allow debtors to obtain new financing that is paid as administrative expenses, which are prioritized over secured creditors. Thus, any new financing that fails to create or preserve value worsens the position of secured creditors.

The US Chapter 11 provides strong protections for unsecured creditors. Contributing factors include the best interest of creditor test and the formation of a committee of unsecured creditors, whose fees and expenses are covered by the estate. Another unique feature of the US Chapter 11, absent in many other procedures like schemes of arrangement or the restructuring

procedures in the UK and various EU countries, is the availability of avoidance actions to facilitate asset recovery.

The GII highlights certain trends in the design and evolution of reorganization procedures worldwide. Many countries are enhancing the attractiveness of their reorganization procedures for debtors. Some have introduced new procedures (e.g., the new restructuring plan in the UK, Spain, and the Netherlands) or improved existing ones (e.g., the scheme of arrangement in Singapore). However, there is still significant room for improvement globally. Many countries have unattractive reorganization procedures for debtors due to the lack of DIP financing provisions and cross-class cramdown, stringent conditions for initiating insolvency proceedings, and the mandatory appointment of an insolvency practitioner who often replaces the debtor's management team.

While the trend of adopting debtor-friendly insolvency reforms is common, some countries have moved in the opposite direction. The GII also reveals regional similarities and patterns in countries with similar legal origins. Given the level of integration in the European Union, many EU countries are adopting similar insolvency reforms, generally making procedures more debtor-friendly, and greater convergence in insolvency laws is expected. However, significant divergences remain; for example, Germany maintains a creditor-protective stance, while France has a very unattractive insolvency regime for creditors.

The GII reveals certain similarities based on legal origins. For instance, the insolvency framework in the United Kingdom appears to have influenced reforms in common law countries like Ghana and Nigeria. Similarly, insolvency reforms in Latin America seem to draw inspiration from civil law countries such as France, Germany, Italy, and Spain. However, despite these similarities, notable differences exist among countries with similar legal origins. For example, while India has implemented a creditor-friendly reform, Singapore, although attractive to creditors, has significantly enhanced its restructuring framework's appeal for debtors.

It is important to note that insolvency legislation is just one aspect of the broader insolvency ecosystem. An effectively functioning insolvency system requires an attractive market and institutional environment, including sophisticated courts and a network of highly qualified professionals such as lawyers, investment bankers, and activist investors. Therefore, as countries pursue legal reforms to improve reorganization procedures, they should also focus on enhancing their restructuring ecosystem. In regions lacking a developed market and institutional environment to handle financial distress, insolvency laws should prioritize

contractual and market-based solutions, empowering creditors more than courts and court-appointed administrators.

Chapter VI. Conclusion

The primary objective of fiduciary duties is to reduce conflicts of interest and address agency issues within the organization. Fiduciary duties are present in various fields and have historical roots in Roman law, British common law, and religious laws. The most effective fiduciary services are provided voluntarily, and fiduciary law aims to promote the use of professional services, attract experts to offer their expertise, and prevent experts from exploiting power imbalances.

This research tried to demonstrate that the duty of care of corporate directors in the vicinity of insolvency is not solely concerned with shareholder wealth maximization. , as the traditional and still prevailing view of fiduciary duty law has been advocating in western countries.

This thesis research tried to make a contribution to the discourse on corporate governance, offering legal interpretation of “vicinity of insolvency”, the complex framework of types of directors and fiduciary duties, and optimal regulations models for efficiently navigating the financial distress.

The 2014 Irish Act introduced a broader definition of insolvency, including balance sheet insolvency, which allows it to apply to a wide range of directors and companies.

This change represents an evolution towards a more objective way of assessing directors' duties, making it harder for directors to use subjective reasons to avoid their responsibilities.

Codifying fiduciary duties to creditors, particularly when a company is factually insolvent or in the vicinity of insolvency but not formally declared insolvent, presents significant challenges. This issue is particularly pronounced in the UK, where directors may find themselves caught between serving shareholders and creditors during periods of financial distress. The lack of clear guidance in these gray areas complicates governance and raises questions about the precise moment fiduciary duties shift to creditors. The decision in Sequana has been instrumental in clarifying these duties, particularly with respect to directors' obligations to creditors in proximity to insolvency. However, much ambiguity remains when insolvency is not yet formalized.

Similarly, benchmark cases such as Gheewalla and Quadrant in the U.S. have significantly influenced the evolution of fiduciary duties. The Gheewalla case established that creditors may bring derivative claims against directors for violating their fiduciary duties, but only after the corporation becomes insolvent.The case rejected the "zone of insolvency" doctrine, holding that

fiduciary duties remain owed to the corporation and its shareholders regardless of its financial condition. The Quadrant Structured Company, LTD v. Athilon Capital Corp case clarified the scope of no-action clauses in trust indentures, emphasizing the importance of precise contractual language in defining the rights and remedies available to securityholders.

Particularly, viewing the organization as an organism shifts the emphasis toward the directors, who must strive to balance the often conflicting demands of inside and outside stakeholders while ensuring sustainable corporate operations. In the U.S., Chapter 11 of the Bankruptcy Code offers a 'safe harbor' to directors of distressed companies. This provision allows directors to make drastic decisions aimed at saving the company without fear of personal liability, as long as those decisions are made in good faith and in the company's best interest. This legal protection is critical, especially when directors are forced to make difficult decisions that could either lead to the company's survival or further its decline.

The concept of a 'Rescue' or 'Restructuring Culture' is similarly important. It promotes an environment where restructuring is seen not as a sign of failure, but as a strategic opportunity for recovery. In such environments, firms experiencing financial difficulties are more likely to receive support from key stakeholders, including creditors, employees, and business partners, which fosters a cycle of trust and mutual confidence. Conversely, in restructuring-hostile environments, insolvency carries a stigma that discourages early intervention, often leading to a worse financial outcome for both the company and its stakeholders. The reluctance to initiate insolvency proceedings due to fear of reputational damage can also stifle entrepreneurial activity, driving up the cost of business failure.

In the EU, while the Preventive Restructuring Directive (PRD) represents a step forward in insolvency law, national implementation varies, with countries like Germany, the Netherlands, and France leading in terms of adopting more effective preventive restructuring frameworks. These reforms highlight the benefits of early intervention, underscoring the need for restructuring mechanisms that are responsive to corporate financial distress before it spirals into formal insolvency. Nevertheless, the PRD's broad implications allow countries to tailor their regulations based on their unique judicial, economic, and political landscapes, ensuring the most optimal fit for their respective systems.

In addition to the PRD, the UK's Company Directors Disqualification Act reinforces the responsibility of directors during insolvency by penalizing professional misconduct. These shifting paradigms highlight the need for sound governance while ensuring that directors are not excessively constrained from taking risks that could ultimately benefit the company's long-

term survival. The evolving nature of directors' duties in relation to insolvency has wide-reaching implications for corporate governance globally.

Finally, this evolving responsibility of fiduciary duties is essential for fostering a more resilient, adaptable, and sustainable corporate landscape. By balancing the need for accountability with the necessity of risk-taking, this research shows that directors' duties—whether codified or shaped by judicial precedent—are critical to navigating the complexities of insolvency. As seen in landmark cases like Sequana, Gheewalla, and Quadrant, these developments mark significant milestones in the evolution of trust and fiduciary duties in both the EU and U.S. legal systems, with broader implications for corporate governance frameworks worldwide.

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