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Introduction

The themes of this paper are harmonisation of insolvency and rescue law in the EU, codification of common law rules and equitable principles, and enforcement with a particular focus on directors' duties. The paper is written in the context of the proposed EU Directive on Harmonisation of Certain Aspects of Insolvency Law 2022//0408 (COD).[1] Part 1 of this paper outlines the genesis of the directive, including significant policy drivers under the Capital Markets Union Action Plan, and its key topics. Part II then focuses on the current state of play regarding directors' duties under Irish law, and the growing influence of EU policy in this area. Part III considers the issue of enforcement of directors' duties highlighting the difference between public and private enforcement and finally, Part IV considers some additional important areas under the proposed directive and concludes with some observations.

Part I

The Directive is currently undergoing a consultation phase with representatives of the member states, and is also being considered by the Council and the Parliament at this time. The Preamble to the proposal mentions that the text of the proposal has been put together following a public consultation, the consideration of other policy matters and the input of the Commission Group of Experts on Insolvency and Rescue law. The Group met almost monthly during 2021 to discuss the issues which are now addressed in the proposed directive.[2] The main policy driver of this directive is the Capital Markets Union Action plan and the need to alleviate or mitigate issues for lenders and investors in businesses across the European Union caused by a varying legislative landscape within member states. There is a perceived need to mitigate

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[1] Brussels, 7.12.2022 COM (2022) 702 final

[2] The author, Irene Lynch Fannon is a member of this Group of Experts. Details of this Group, its membership and the meetings held in 2021 are available HERE

uncertain risks as regards enforcement, rights of access to assets across member states and the complex legislative landscape regarding removal of assets from insolvency processes:-

> "Diverging rules among member states have contributed to increasing legal uncertainty and unpredictability about insolvency proceedings' outcome, so raising barriers especially for cross-border investments in the internal market."[3]

This uncertainty in insolvency outcomes and processes is specifically linked to the importance of efficiently functioning capital markets in the European Union with increased and better access to corporate financing for businesses.[4]

The directive follows on from the Preventive Restructuring Directive 2019/1023 (PRD) passed in 2019 and implemented in Ireland by the European Union (Preventive Restructuring) Regulations 2022. The PRD was not particularly surprising to us in Ireland as we have been accustomed to preventive restructuring since the passing of the Examinership legislation under the Companies (Amendment) Act in 1990 and its continued inclusion (with certain refinements) in current legislation under Part 10 of the Companies Act 2014 (as amended). Around the time of the enactment of the PRD there was a lot of discussion around the 'rescue culture' presented as an alternative to formal liquidation and other insolvency proceedings. In European debates the 'rescue culture' and legislation derived from it is viewed as a predominantly common law phenomenon where particular attention was paid to English Schemes of Arrangement and the rescue or turnaround of some significant European corporates through the English courts in the early 2000s.[5] However, this view of rescue being a particularly common law practice, and in some ways not entirely above-board, is not completely accurate as these processes existed in French law particularly, and to some extent in Italian law before the Directive being passed.[6] Nevertheless, what is surprising is that very soon after the PRD was passed the impetus for this new directive increased and it would seem that in some ways, this new directive is driven by a need to present a harmonised and more orderly European version of traditional insolvency proceedings, which may be the preferred option in terms of policy. One could argue therefore, that there is an unresolved tension between the principles and rules normally involved in a

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[3] Preamble, Para. (3)

[4] Preamble, Para (4). It is important to note that while the directive is presented from DG Justice and Home Affairs, DG FISMA is also mentioned as having a an associated role.

[5] For a general discussion of the growth of this practice see Jennifer Payne : Schemes of Arrangement: Theory, Structure and Operation (CUP, Second Edition, 2021).

[6] See generally Irene Lynch Fannon, Jennifer LL Gant and Aoife Finnerty: Judicial Co-operation for Corporate Recovery in an Integrated Europe (Elgar, 2022).

rescue process, now embodied in the Preventive Restructuring Directive, and the traditional rules emanating from an insolvency process embodied in the proposed Directive.

The directive contains eight operative parts, leaving aside the introduction containing definitions and some introductory statements. These eight parts address the following matters:-

- Transactional Avoidance- Title II
- Asset Tracing- Title III
- Pre-pack proceedings - Title IV
- Directors' duties- Title V
- A proposal for a Simplified Liquidation Procedure-VI
- Creditors' Committees- VII
- Transparency Measures- VIII

Of these parts the main focus of this paper is Title V on Directors' duties but some observations will be made on transactional avoidance measures and the proposal for a pre-pack proceeding in Title IV.

Part II

Turning for the moment to directors duties. The starting point for consideration is the Companies Act as it was passed in 2014. As we know s.227 of that act set out some initial provisions regarding directors' duties which include the statement in s.227(1) that the codified duties in s.228 are *'duties owed to the company (and the company alone)*'. This is an unusual text in that the provisions of the statute are emphasised as if this was a crucial point that must be clearly understood. In my opinion this provision underlines a somewhat conservative approach to the enforcement of directors' duties that is quite restrictive in terms of stakeholders' interests, including shareholders and in a secondary way other stakeholders such as employees and creditors, to whom we will return. Section 227(4) then goes on to indicate that the codified duties which will appear in s.288 will *'take effect in place of common law rules and equitable principles*…' and then s.227 (5) goes on to state that *'regard shall be had to the corresponding common law rules and equitable principles in interpreting those duties and applying those provisions*'.

Interestingly when the Companies Act 2014 was passed it included a provision in s.224 which stated that in exercising their duties directors may take into consideration the interests of employees. Oddly the Act did not include a codification of a duty to consider the interests of creditors (a similarly important set of stakeholders). Such a duty might arise at a point of insolvency or likely insolvency and had been enunciated precisely two decades before the legislation by the Supreme Court in *Re Frederick Inns Ltd.*[7] The fact that this duty was not codified is interesting considering that the enunciation of the principle was very much in keeping with developments in other common law countries at the time and in fact a number of authorities of significant import were mentioned in the judgements from the High Court and Supreme Court in that case.[8] Not only that but the decision in *Re Frederick Inns Ltd* had been mentioned by the High Court in 2006 in its important decision on restriction concerning the relevant criteria to be applied when considering whether or not to restrict a director. Clarke J in *Re Swanpool: McLaghlen v. Lennon*[9] stated that the relevant criteria would include the following:

"(1) Compliance with Companies Acts.

(2) Compliance with other duties.

(3) Duties which may arise under *Re Frederick Inns Ltd*,…"

However, the duty remained uncodified despite the fact that the Company Law Review Group in its Report on the Protection of Employees and Unsecured Creditors in 2017 recommended that this should happen. This duty came under review for a second time by the CLRG in 2020–2021 and again it was recommended this would be codified. It is now codified following the transposition of the European Preventive Restructuring Directive (EU) 2019/1023 in s.224A of the Companies Act 2014 which made it necessary, although the impetus for codifying the duty had increased before that.

- **The common law duty to creditors.**

In terms of understanding the nature of the duty, the common law rules underlying the duty to creditors are important. In addition to considering the decision in *Re Frederick Inns Ltd* there have been two important decisions from the English courts in relation to the common law duty of directors to consider the interests of creditors in the 'zone' of insolvency, sometimes called the 'twilight zone'. These are the decision of the UK Supreme Court in *BTI v Sequana* [10] and

[7] Re Frederick Inns [1994] IRLM 387.

[8] Kinsley v. Russell Kinsela Pty Ltd (1986) 10 ACLR 395; Walker v. Wimbourne (1976) CLR 1 (cited in the High Court judgement in Re Frederick Inns Ltd [1991] ILRM 582) and Nicholson v. Permakraft (NZ) Ltd (in liq) [1985] 1 NZLR 242 (again cited in the High Court udgement Re Frederick Inns Ltd [1991] ILRM 582).

[9] [2006] 2 ILRM 217.

[10] BT I 2014 LLC (Appellant) v Sequana SA and others (Respondents) [2022] UKSC 25

the more recent decision of the English High Court in *Hunt v Singh*.[11] In *Frederick Inns* the court acknowledged the identification at common law that the directors' duties to consider the interests of the company would include considering the interests of creditors when the company was in the vicinity of insolvency. This decision and the two English cases arguably identify three separate questions :

a. What triggers the duty? Is this the fact of insolvency, the likelihood of insolvency or the probability of insolvency?
b. Once the possibility of the duty to consider creditors arises, what attracts liability for a particular director, actual knowledge of the insolvency or its likelihood or does the standard include an objective element, what the director ought to have known regarding the position of the company?
c. And finally, if there is a breach what is the extent of liability?

In *Sequana* the Supreme Court took the view that the trigger for liability was a strong probability of insolvency, something more than a mere likelihood. The court in *Sequana* did not reach a conclusion on this point but had other observations on the nature of the duty mostly around the probability as distinct from likelihood of insolvency. In other cases however, the likelihood of insolvency seemed to be sufficient. In relation to the second question it would seem that there is an objective element to the attraction of liability, in other words, where a director ought to have known that insolvency was likely and did not act in the interests of creditors, this would be sufficient to ground an allegation of a breach of duty. In other words a creditor did not have to prove that the director knew of the insolvency before a breach of duty could be alleged. But, then, and this is the final question, what does a director have to do to show that he or she took the interests of creditors into account and even more importantly how can it be shown that a failure to take the interests of creditors into account, if there had been such a failure, has led to loss? The facts in *Frederick Inns* are instructive here, where there was a failure on the part of the directors to focus on the interests of the creditors of each separate corporate entity within a group, rather than focussing on satisfying the requirements of a particular creditor (in this case the Revenue) of the group as a whole. However, it is true to say this is a particularly clearly presented set of facts, in other cases, there is less clarity. In both *Sequana* and *Hunt v Singh*, the facts were very specific and so the test which included probability in *Sequana* may not be universally helpful. In *Hunt v Singh* the facts were again specific as the Company's solvency was hinged on it successfully challenging a claim against the company of outstanding taxes made by HMRC. The court held that the duty was triggered if the directors "knew or ought to know that there was least a real prospect of the challenge failing". This was the test which was remitted to the lower court.

[11] Hunt v Singh [2023] EWHC 1784

There are many questions we could ask but one that has been discussed at recent meetings is whether a decision to take a risk to achieve a better, more profitable business, amounting to a 'bet the company' type of decision amounts to a breach of duty or how does it fit in with this duty? This is very much the kind of action which arose in Hunt (although not quite as business facing as an entrepreneurial risk). A second question has arisen in relation to groups…does the director have a duty to consider the creditors of the group or must the director focus on the creditors of the particular company? The answer seems to be that the particular company is paramount. This is the principle established in *Frederick Inns* and this is supported by the decision in the Hong Kong[12] commercial court in *Tradepower (Holdings) Ltd. V Tradepower (Hong Kong) Ltd.* 2009 12 HKCFAR. No doubt further questions will arise, but since then we have had a codification of these duties which will provide clarity.

- **Codification**

In terms of codification of Irish law, the insertion of s.224A was about to happen with impetus of recommendations from the CLRG, but the need to implement the Preventive Restructuring Directive 2019/ 1023 was the final element.

The implementation of Article 19 of the PRD[13] on directors' duties has led to the insertion of s.224A in the Companies Act 2014 which repeats the terminology of the Article.

The section (as inserted by the European Union (Preventative Restructuring) Regulations 2022, SI No 380 of 2022) created, for the first time, a statutory duty on the part of the director who believes, or has reasonable cause to believe that the company is, or is likely to be, unable to pay its debts to have regard to

(a) the interests of creditors;

(b) the need to take steps to avoid insolvency; and

(c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the company's business.

[12] Tradepower (Holdings) Ltd. V Tradepower (Hong Kong) Ltd. 2009 12 HKCFAR. Similar to the decision of the Supreme Court in *Re Frederick Inns Ltd.* [1994] ILRM 387

[13] For a commentary on the Preventive Restructuring Directive generally and Art. 19 please see Christoph Paulus and Reinhard Dammann *et al.* European Preventive Restructuring: Article by Article Commentary (Beck, Hart, Domus 2021) pp.238-248 by Georgio Corno.

Essentially, what the director must do are outlined under three headings so that they will not be in breach of their duties. A further amendment to the Companies Act 2014 was introduced to the codified list of directors' duties. Accordingly, section 228 also includes an amendment from the European Union (Preventative Restructuring) Regulations 2022, SI No 380 of 2022) Regulation 5(c) adding the following to s.228(1)(i) [after para (h)];

"(i) in addition to the duties under section 224A (directors to have regard to certain matters where company is, or is likely to be, unable to pay its debts),… [directors had a duty to]…have regard to the interests of its creditors where the directors become aware of the company's insolvency." This is a lesser level of obligation as the duty only arises when the director is aware of the insolvency.

Before we look at what is proposed under the new directive it is therefore important to understand that the codification in s.224A is the current law in Ireland and we await interpretation from the courts.

- **EU Policy.**

As mentioned the current proposed directive seems to be driven from a different perspective than the 'rescue' driven policy of the PRD. As regards Directors' duties the following is provided for in Title V of the proposed Directive under Articles 36 and 37

Article 36

"Member States shall ensure that, where a legal entity becomes insolvent, its directors are obliged to submit a request for the opening of insolvency proceedings with the court no later than 3 months after the directors became aware or can reasonably be expected to have been aware that the legal entity is insolvent."

Article 37

"1. Member States shall ensure that the insolvent legal entity's directors are liable for damages incurred by creditors as a result of their failure to comply with the obligation laid down in Article 36.

2. Paragraph 1 shall be without prejudice to national rules on civil liability for the breach of the duty of directors to submit a request for the opening of insolvency proceedings as set out in Article 36 that are stricter towards directors."

This approach is problematic for a number of reasons. In terms of the interface with Irish law the article imposes an obligation on a director to file a request with a court, ignoring that the most important insolvency process in Ireland is the creditor voluntary liquidation which does not involve any process of filing with a court. This needs to be addressed.

Secondly, the obligation to commence insolvency proceedings within 3 months of knowledge or, objectively judged knowledge of insolvency based on a reasonable standard, does not resonate with current judicial interpretations of how directors should act. In restriction cases for example there is quite a bit of tolerance for a director who may decide to trade on through a temporary period of insolvency where there is hope of recovery that is reasonable. A company may dip in and out of insolvency and it may not be appropriate to impose a specific obligation on directors to file for liquidation within 3 months of a point of insolvency. The courts in Ireland in the multitude of decisions on disqualification or restriction of directors have expressed the need for some flexibility on this particular type of inflection point in a business's history. Many very viable businesses are balance sheet insolvent. Requiring directors to file for a formal insolvency process may reduce the prospects of preserving a viable business.

Finally, and perhaps most importantly, this strictly set out obligation does not resonate with the rescue driven policies evident in the PRD 2019/1023 and with the implementing statue. It is not clear how a director might comply with this obligation to file within three months of a point of insolvency and comply with the second and third part of the obligations imposed by s.224A, namely to take steps to avoid insolvency and not to do anything deliberate or grossly negligent that threatens the viability of the business.

Part III

- **Enforcement of directors' duties: Private enforcement through individual causes of action or public enforcement by agencies such as the CEA.**

Enforcement of directors' duties can be public or private. In Ireland there is considerable emphasis on public enforcement of directors' duties, namely the role of the CEA and other enforcement agencies is emphasised. Private enforcement of directors duties relies on the statement that the director owes his or her duties to the company as described above and in s.227. The company is the proper plaintiff to enforce directors' duties in a private law sphere, ie in litigation brought against a director under the codified duties in s.228. When a company is not insolvent this would require a decision on the part of the board of directors' to sue one of their own. Absent a change of control or some sort of dramatic exit of a director this is unlikely.[14] When a company becomes insolvent the right of action enures to the liquidator and

[14] A considerable barrier to private actions against directors when a company is not insolvent is presented by the lack of willingness to reform shareholder actions which has dominated the Irish corporate law landscape for some

this is where it is possible for the liquidator to take action against a director. The codification of the duty to creditors is particularly relevant and important. The duty is now clearly outlined making it easier for liquidators. However there are still outstanding problems. The extent and nature of the director's duty is not entirely clear and is relatively untested and judging from what has happened recently in English legislation open to quite a bit of interpretation by the courts. It would be quite a risky step for a liquidator to pursue a director under s.224A, specifically where the extent of liability is not clear and where questions of causation might arise - did the director's breach cause any loss and if so what loss? Would the loss the creditor is suffering have occurred in any event? Would it have occurred in any event as a result of the insolvency?

The risk of using remaining funds to bring such an action which might not succeed is a significant deterrent. The CLRG in its report in 2021[15] has made some suggestions to address this problem including a recommendation around third party funding to support enforcement in this way.

Without these supports, we must rely on public enforcement, actions through the CEA relying primarily on restriction and disqualification proceedings. There are of course a growing array of other enforcement agencies that can address the effect on other constituencies by particular corporate or directorial actions, but in terms of core company law the reality of suing a director for breach of duties described in company law is a complex matter, rendering such actions uncommon. For the moment the work of the CEA is therefore vital

Part IV

Other parts of the directive are also important and also represent, in my view, a turn away from rescue as a process towards an increased emphasis on traditional insolvency proceedings. The short discussion on directors' duties represents the desire to pivot away from rescue towards an orderly dismantling of an indebted business. Two parts of the directive will be considered briefly which reflect a similar emphasis and which are important.

- **Title II- Transactional Avoidance**

The first is Title II on Transactional Avoidance. Here there are three different provisions in Articles 6, 7 and 8 respectively. The first is a preference provision which is different from our

time. In short derivative actions or some other form of shareholder action must be considered in the near future.

This is an important step in relation to investor protection and robust corporate governance.

[15] CLRG Report on the Consequences of Certain Corporate Liquidations and Restructuring Practices. Part 8 at pp. 37 ff

own fraudulent preference in s.604 because there is no mention of intent. The second, Article 7 concerns actions with inadequate or no consideration. Of greater interest is Article 8 which has a significant 'look back' period of 4 years from the date of the commencement of the insolvency proceeding designed to challenge actions or transactions where it can be shown that there is an intention on the part of the debtor to cause detriment to the general body of creditors. One condition attaching to this is that the creditor receiving the benefit knew or ought to have known of the debtors' intent. This latter provision is an 'anti-deprivation' principle which focusses on the damage to the general body of creditors, rather than any other consideration. In my view this is similar to s.608 of the Companies Act 2014 which encompasses a similar principle. Although quite under-utilised in the last decade,[16] there have been a handful of decisions on this provision including the decision in *Re Tucon Process Installations Ltd.* [17] which, in carving out an exception relating to payments made in the ordinary course of business, has opened the door to further interpretation of the exact meaning of the provision.

In the meantime the emphasis in Article 8 is on the intention of the debtor but again the focus is on the **effect** on the general body of creditors.[18] The key point though is that these transactional avoidance provisions reflect the primary policy driver behind this proposed directive, a harmonisation of insolvency law as regards insolvency proceedings, the recovery of assets and the protection of investors and creditors.

- **Title IV on Pre-pack proceedings.**

The pre-pack proceeding described in Title IV of the directive has nothing very much in common with the sorts of pre-pack arrangement or sales which we have seen over the years during receiverships, particularly in England and Wales during a certain period in the 1990s. In addition, pre-packs have been concluded also under Administrations. The Graham Review of Pre-Pack Administration published by the UK Insolvency Service in 2014 was critical of these arrangements.[19]

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[16] As observed by Laffoy J in *Devey Enterprises Ltd v. Devey and Devey* [2011] IEHC 340 where she observed that 'strangely, despite the fact that twenty years have elapsed since section 139 (the previously enacted provision from the 1990 Companies Act) was enacted, it has been the subject of very little judicial consideration'.

In *Re Chatelaine Thudichum* [2008] IEHC 58 the transactions were successfully challenged on the grounds that these transactions had the effect of perpetrating fraud on the creditors. Interestingly, in the same decision, the same transaction was unsuccessfully challenged as an unfair preference.

[17] Re Tucon Process Installations Ltd.[2016] IECA 211

[18] Reinhord Bord and Michael Veder: Transactional Avoidance Law (Intersentia, 2021)

[19] The Graham Review can be found HERE

However, the pre-pack proceeding proposed by the EU has two phases, the first a preparation phase which allows for an application to court for the appointment of an indicated IP in a future insolvency. During this preparation phase a sale is negotiated under the supervision of the indicated IP acting as 'monitor'. The preparation phase is followed quickly by the second phase, a liquidation phase, where the sale is concluded following the commencement of a formal insolvency process. It seems that the design of the process is best understood in the context of decisions of the CJEU in the SmallSteps[20] case and the following Heiploeg[21]cases. Here the proposed transfer of the business of SmallSteps was to take place with the redundancy of a third of the workforce of approximately 3,000. The issue referred to the CJEU by the Dutch court on the application of the relevant trade unions, was whether the non-application of the Transfer of Undertakings Directive 2001/23 was appropriate on the basis of the sale being conducted through a 'rescue' amounting to an insolvency process. The CJEU held that the form or objective of the process was important, this being the sale of a viable business without any formal insolvency. On this basis there was no exemption from the application of the Directive which applied to protect the interests of all of the employees, which transferred to the acquirer of the business.

By including a formal liquidation process at a point between the arrangement of the sale and the actual sale it is intended to avoid the effect of the CJEU decision. A formal insolvency proceeding will be commenced and the Transfer of Undertaking Directive will therefore not apply. Again this is arguably bringing the purpose of a rescue or turnaround, namely the transfer of a viable business from one investor to another within the liquidation or formal insolvency sphere. However, by allowing for the insolvency exemption to apply, it effectively works against one of the ideas underlying our Examinership process, namely that the rescue of a viable business preserves jobs. These tensions will have to be resolved and further explored.

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[20] Federatie Nederlandse Vakvereniging and Others v Smallsteps BV Case C-126/16.

See further this note from Oxford Law Blog: The ECJ in 'Estro/Smallstep': The End of Pre-packs as we Know Them? 20 July 2017 https://blogs.law.ox.ac.uk/business-law-blog/blog/2017/07/ecj-estrosmallstep-end-pre-packs-we-know-them

[21] European Court of Justice 28 April 2022, C-237/20, ECLI:EU:C:2022:321 (Heiploeg).

Conclusion

The evolution of EU insolvency law into a part of law, traditionally excluded from a hamonisation process, into one upon which the policies of harmonisation are focussed is a very interesting development but not one without complications for us as a member state. There are two issues particularly which may be problematic, the first the overall emphasis on orderly dismantling of debtor businesses rather than an inclination towards rescue will have interesting effects, which in some ways can be contradictory of what is already in place, even where this is derived from previous EU legislation. The issues around directors' duties are a case in point. The second is the basic issue which has been pointed out by many, harmonisation of a complex area of law, which is impacted by a range of other areas, many of which are quite steeped in the legal culture of particular states may not be a simple process. Each member state will experience its own *'pinch points'*. The question is the extent to which member state concerns will be addressed in resolving these inconsistencies.

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