To File, or Not to File: That Is the Question. Directors' Duties in the Company Crisis

A Critical Comparison of the UK and the Austrian Framework in the Light of the Upcoming EU Restructuring Directive

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Summary

This article deals with directors' duties in the company crisis (representing the period of vicinity of insolvency as well as material insolvency) and compares the UK and Austria as countries with mostly divergent approaches and different legal mentality. In the course of the analysis, the article shows that – especially in the light of the upcoming EU restructuring directive – the question should not be 'what is the better approach' but rather 'how can existing approaches be made fit to reach desired results' (mainly preserving value and at the same time protecting legitimate interests of creditors and other stakeholders). The hybrid approach proposed at the end of this article should help in pursuing such efforts.

1 Introduction

The main rationale behind most provisions addressing directors' duties is to promote companies' long-term success. Such provisions must in particular find answers on how to deal with financial difficulties because as soon as companies slide into financial difficulties and/or insolvency, not only the companies and their shareholders are at risk, but rather stakeholders, and amongst them especially creditors. Special provisions are also necessary to incentivize timely action and promote the rescue of viable businesses:

Wood summarizes the responsibility of national policymakers in this area perfectly:

> As is so often the case, the real test of the credentials of a jurisdiction is on insolvency which is when legal doctrine really matters and when the law has to make a choice.[1]

There is agreement that directors must somehow change their managerial acting when a company slides into a financial crisis. Different jurisdictions have established different strategies to deal with this issue, especially regarding the questions of <u>when</u> companies are in a crisis and <u>what</u> the specific duties of directors should be. This analysis will show that policymakers in Austria and the UK have made their choices in very different ways. Austria applies an arguably strict 'duty to file'-approach while the UK's 'wrongful trading' approach may give directors more flexibility. In both countries, there is arguably room for improvement.

This article will first give some theoretical background, then discuss and compare the different approaches in the UK and Austria and highlight differences through case studies. Then, it will analyse international and European harmonization efforts and finally give recommendations for a hybrid approach. So far, discussions were mainly limited to the question 'which approach is better?', especially the latter might highlight the subject from a new perspective.

2 Scope and methods

2.1 Why Does This Subject Matter? It Is All About Preserving Value!

Nowadays, it is broadly accepted that the main purpose of effective insolvency laws is not to punish debtors but rather to preserve value in the broadest sense. Value means value for struggling businesses and their employees, value for the economy and especially value for creditors. Despite lots of different national approaches, law reforms and international harmonization efforts, it is a fact that still 'too many insolvencies result in creditors getting less than they should because of poor laws'.[2]

It is also accepted that directors play a key role. It is the task of national laws to influence managerial acting by providing positive as well as negative incentives. Cooper calls the ability to reorganize the business the 'carrot' and potential liability the 'stick' which were both required 'to make the donkey move'.[3]

Keay, one of the leading commentators in this field, perfectly summarizes the importance of clear rules:

> As a matter of legal certainty and fairness, lines have to be drawn so that directors can be confident that when they act they are taking into account the appropriate interests and that their action is safe from attack. If directors are unable to ascertain [...] what they can do and when they are potentially liable, then, from an academic viewpoint, the law is unjust, and, from a practical perspective, directors will nearly always take the safest option in order to prevent any possible lawsuits. In doing this, directors are likely to act defensively and make decisions not on the basis of what is best for the company, but of what will avoid liability.[4]

United Nations Commission on International Trade Law (UNCITRAL) underlines its importance as follows:

> Inefficient, unclear, antiquated and inconsistent guidelines on the obligations of those responsible for making decisions with respect to management of an enterprise as it approaches insolvency have the potential to undermine the benefits that an effective and efficient insolvency law is intended to produce and exacerbate the financial difficulty they are intended to address.[5]

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[1] *See* Philip R. Woods, 'Overview' in INSOL International, *Directors in the Twilight Zone* ix (5th ed. INSOL, London 2017).

[2] *See* Neil Cooper, (Past President of INSOL) 'Foreword and Acknowledgement' in *ibid*., at ii.

[3] *Ibid*.

[4] A. Keay, *The Director's Duty to Take into Account the Interests of Company Creditors: When is It Triggered?*, 25(2) Melb. U. L. Rev. 315, 316 (2001).

[5] *See* United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law Part four: Directors' obligations in the period approaching insolvency* (2013) www.uncitral.org/pdf/

Given that different jurisdictions address this topic differently and that, on an international level, harmonization efforts have not come to an end, controversy and actuality of this subject are apparent. Recent harmonization efforts at the European Union (EU) level (*see* 4.2, *infra*) are followed with great interest.

2.2 Company Crisis: What Are We Talking About?

In the course of business, companies experience different stages of financial and economic stability. There are clearly solvent companies. Then, there are clearly insolvent companies. Finally, there are companies which are somewhere in between. UNCITRAL has described the latter period as the 'twilight zone', the 'zone of insolvency' or the 'vicinity of insolvency'.[6] Cases in common law jurisdictions use expressions such as 'doubtful solvency', 'risk of insolvency' or 'financial instability'.[7]

Undisputedly, it is a period in which a company is still solvent but which somehow requires changes in how directors act. For the sake of consistency, this article defines it as 'vicinity of insolvency' summarizing the above-mentioned terms used for the pre-stage of material insolvency. Vicinity of insolvency and material insolvency together constitute the company crisis.

It will be shown that the two discussed jurisdictions use very different ways of identifying the company crisis and that uncertainty and inconsistency in this regard can be problematic.

2.3 Special Duties for Directors as a Result of Limited Liability

The opportunity to establish companies with limited liability does affect directors' duties significantly. Limited liability means a separation of ownership and control. It also means that even if a company is in a crisis, shareholders basically do not have to fear loss besides the capital already invested. In such circumstances, shareholders may try to influence directors to implement a riskier business strategy without facing further liability and thereby hoping that the company recovers again. This may often not correspond with the interests of other stakeholders, especially creditors, which is why special duties for directors are needed.[8]

Thus, this article will focus on duties of directors of limited liability companies (Ltd and Plc regarding the UK and GmbH and AG regarding Austria). It will only deal with duties arising from statutory provisions, common law tradition and case law.[9] Individual duties owed for other reasons (especially fiduciary duties arising from consulting or employment contracts, articles of association or shareholders' agreements) will not be examined.

In order to narrow down the article, priority will be on primary duties arising from company and insolvency law. Specific duties e.g. regarding the calling of general meetings, reporting obligations or other specific provisions regarding *insolvency prophylaxis* as well as sanctions such as anti-avoidance rules, criminal sanctions or disqualification rules will not be further analysed.

2.4 Who Is a Director?

Dealing with limited liability companies, only directors of Ltd and Plc as well as 'Geschäftsführer' of Austrian GmbHs and 'Vorstände' of Austrian AGs will be addressed. For the sake of consistency, they will be defined as 'directors'. Both countries ensure that rules regarding directors' duties also apply for persons who de facto act like directors by actually controlling the company's operations (so called 'shadow' or 'actual directors').[10] A deeper analysis of this matter will not be undertaken. Still, it should be noted that uncertainty regarding directors' duties can also negatively affect decisions of major shareholders and creditors as potential shadow directors, which are often crucial for a successful turnaround.

3 National approaches: A matter of different mentalities

3.1 Some Introductory Remarks

Whilst in the UK primary concern is to keep viable companies trading as long as there is a chance to overcome a crisis, Austria at a certain point pulls the emergency brake and obliges directors to file for insolvency proceedings. These different mentalities can also be described as the 'wrongful trading' and the 'duty to file' approach.[11] This may lead to the legal reality that whilst in Austria, even directors of – supposedly – viable companies might be at a certain point obliged to file for insolvency, in the UK 'ceasing to trade and liquidating too soon can be stigmatised as the coward's way out'.[12]

Both approaches will be analysed on the basis of four parameters (the 'when', the 'what', the 'carrot' and the 'stick').

3.2 Definition of the Company Crisis (the 'When')

3.2.1 The UK

3.2.1.1 Vicinity of Insolvency

This is the early stage of the company crisis. As already mentioned (*see* 2.2, *supra*), UK case law as well as international papers use different expressions for this period. There is agreement that the meaning behind all of these terms is arguably the same: It is a period close to material insolvency where directors should in particular consider creditors'

english/texts/insolven/Leg-Guide-Insol-Part4-ebook-E.pdf, accessed 13 Aug. 2017, 8.

[6] *Ibid.*, at 14.

[7] A. Keay, *The Shifting of Directors' Duties in the Vicinity of Insolvency,* 24 Int'l Insolv Rev. 140, 152 et seq. (2015).

[8] *See* 3.3.1.2, *infra* and Keay, *supra* n. 4, at 317.

[9] If not stated otherwise, this article has considered statutory changes, academic literature and jurisprudence until 13 Aug. 2017 (included).

[10] *See* s. 251 CA 2006, s. 214 (7) IA 1986 and Austrian case law (Austrian Supreme Court (OGH) RS0123113).

[11] *See* 'Study on Directors' Duties and Liability' prepared for the European Commission DG Markt by C. Gerner-Beuerle, P. Paech & E. P. Schuster (LSE, 2013) http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle%2C%20C_Study%20on%20directors%E2%80%99%20duties%20and%20liability%28lsero%29.pdf (accessed 13 Aug. 2017, 208 et seq.).

[12] *Re Continental Assurance of London Plc* [2001] B.P.I.R. 733 at 281.

interests (*see* 3.3.1.2, *infra*). The specific term used mainly depends on the facts.[13]

The concept 'vicinity of insolvency' has been established in a decade-long series of case law in which UK courts have been stating that interests of creditors require different managerial acting when a company approaches insolvency (mostly called a shift of directors' duties in the vicinity of insolvency, *see* 3.3.1.2, *infra*). The first recorded English case was *Liquidator of West Mercia Safetwear Ltd v. Dodd*.[14] Since the UK Company Law Reform, this principle has also been codified in the UK Companies Act 2006 (CA 2006). Although section 172 (3) CA 2006 just briefly states that it requires 'directors, in certain circumstances, to consider or act in the interests of creditors of the company', there is agreement that this provision means a codification of the principle mentioned before.[15] Section 172 (3) CA 2006 shall be triggered earlier than the wrongful trading provision (*see* 3.2.1.3, *infra*).[16]

Still, the principle has been extensively criticized because of the lack of certainty regarding the 'when'. This uncertainty is especially problematic for directors who must know how and when to act in a certain way but also for officeholders (liquidators and administrators) who might want to sue directors for non-compliance. Thus, commentators have been trying to identify triggering events and to establish guidelines. Keay has been on the forefront by suggesting that the shift should be triggered 'where the circumstances of a company are such that its directors know, or can reasonably expect, that the action upon which they are going to embark could lead to the insolvency of the company'.[17]

Dickinson v. NAL Realisations (Staffordshire) Ltd,[18] a very recent case, e.g. held that even if at the time of entering into a transaction during the company's solvency there was a recognized risk of adverse events that might result in a large liability leading to insolvency, that did not trigger section 172 (3) CA 2006. This case might give arguments to disagree with the approach suggested by Keay.

Bottom line, there is no certainty (yet). Interestingly, UK policymakers do not seem to be concerned about that but have rather deliberately decided to use the words 'certain circumstances' which can be interpreted in various ways.[19] The Explanatory Notes of the Companies Act 2006 explicitly suggest to 'leave the law to develop in this area'.[20]

3.2.1.2 Material Insolvency

The definition of material insolvency can be found in section 123 of the UK Insolvency Act 1986 (IA 1986) under the heading 'Definition of inability to pay debts'. Section 123 (1) lit (e) codifies a 'cash flow test' (illiquidity) and section 123 (2) a 'balance sheet test' (over-indebtedness).[21] The landmark decision regarding the interpretation of these tests is *Eurosail*.[22]

- Cash flow test: Cash flow insolvency or illiquidity is also referred to as 'commercial insolvency' and can be established by evidence showing continuing failure by a company to pay its debts as they fall due.[23] The cash flow test is not only concerned with the debts that are immediately due and payable but also debts which will fall due in the reasonably near future.[24]
- Balance sheet test: More difficult to establish is balance sheet insolvency. Since *Eurosail*, it has been clarified that a company is not automatically over-indebted 'just' because its liabilities exceed its assets. Part of the test is a forecast in such sense that the court must be – in brief – convinced that the company has insufficient assets to be able to meet all its present, future and contingent liabilities.[25]

3.2.1.3 Wrongful Trading Zone

As already mentioned, UK law does not provide a duty to file for insolvency mainly arguing that it would often take away the opportunity to rescue viable businesses.[26] There is rather a specific regime of creditor protection in section 214 IA 1986 which was codified with the IA 1986. This was a consequence of the Cork Report,[27] which had suggested that there should be a civil remedy for creditors who suffered loss as a consequence of the mismanagement of a company in addition to the already existing fraudulent trading provision.[28]

The Cork Report recommended a provision where a director would engage in wrongful trading if his company incurred liabilities whilst being insolvent with no reasonable prospect of satisfying the debts in full.[29] Policymakers did not entirely follow this recommendation but rather codified that a director trades wrongfully when he 'knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation'[30] or 'insolvent administration'.[31] From

[13] *See HLC Environmental Projects Limited (in liquidation)* [2013] EWHC 2876 (Ch) at 89, where the judge states: 'For my part, I do not detect any difference […] behind these varying verbal formulations. […] Exactly when the risk to creditors' interests becomes real […] will ultimately have to be judged on a case by case basis. Different verbal formulations may fit more comfortably with different factual circumstances.'

[14] [1988] 4 BCC 30. *See* the development of case law in Keay, *supra* n. 7, at 144 et seq.

[15] Keay, *supra* n. 7, at 148.

[16] *See* Explanatory Notes of the Companies Act 2006, www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen_20060046_en.pdf (accessed 13 Aug. 2017) at 331–32 where the Government states that additionally to the wrongful trading provision, s. 172 (3) CA 2006 shall introduce 'an obligation to have regard to the interests of creditors as the company nears insolvency'. *See also* A. Keay, *Directors' Duties and Creditors' Interests* 130 L.Q.R. 443, 445 et seq. (2014).

[17] Keay, *supra* n. 4, at 334.

[18] [2017] EWHC 28 (Ch), at 118.

[19] W. Doralt, *Managerpflichten in der englischen Limited* 48 (1st ed. Linde, Vienna, 2011), who mentions that there had been huge opposition during the legislative process of the CA 2006 because legal practice had been worried about a loss of flexibility.

[20] www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen_20060046_en.pdf (accessed 13 Aug. 2017, at 332).

[21] S. 123 (1) lit (a)-(d) IA 1986 provide other formalistic presumptions for the inability to pay debts which are not relevant for this article.

[22] *BNY Corporate Trustee Services Ltd v. Eurosail UK 2007 – 3BL plc* [2013] UKSC 28, [2013] 1 WLR 1408.

[23] R. Olivares-Caminal et al., *Debt Restructuring* 21 et seq. (2d ed. OUP, Oxford 2016).

[24] *Supra* n. 22, at 37.

[25] *Ibid.*, at 48 and Olivares-Caminal et al., *supra* n. 23, at 27 et seq.

[26] A. Keay, *Directors' duties and creditors' interests,* 130 L.Q.R. 443, 445 et seq. (2014).

[27] Report of the Review Committee, *Insolvency Law and Practice* (Cmnd. 8558, 1982) with Sir Kenneth Cork as Chairman.

[28] *Ibid.*, paras 1776–777.

[29] *Ibid.*, para. 1781.

[30] S. 214 (2) lit b IA 1986.

[31] The UK Small Business, Enterprise and Employment Act 2015 has amended the IA 1986 by a new s. 246ZB. Since then, also administrators can raise wrongful trading claims. For the sake of the further analysis

this moment on, a director must take 'every step with a view to minimising the potential loss to the company's creditors'.[32] The reason for the different and especially broader wording was mainly that policymakers did not want to impose a too severe responsibility on directors.[33]

Section 214 (6) IA 1986 makes clear that for the purpose of this section, a company going into insolvent liquidation or administration means 'a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the insolvency proceeding'. Contrary to the Cork Report, which recommended referring to a cash flow test (no reasonable prospect of meeting new liabilities), the provision explicitly refers to a balance sheet test. The argument for adopting this balance sheet test is simple: If assets are sufficient to pay all debts, liabilities and expenses then there is no need for directors' liability because creditors do not suffer any loss.[34]

Still, section 214 has been highly criticized especially because it creates uncertainty regarding the 'when'. Commentators argue that it may be 'near impossible' to define the relevant moment.[35] Courts tend to set the trigger of the wrongful trading zone even later than material insolvency.[36] This uncertainty has been criticized[37] and seen as one possible reason why officeholders have been reluctant in suing directors so far.[38] Thus, some commentators suggest that the provision should be reformed and – as already recommended by the Cork Report – refer to an easier assessable cash flow rather than a balance sheet test.[39]

3.2.2 Austria

In Austria, the company crisis can be mainly distinguished in the period of reorganization need and material insolvency. Other than UK law, Austrian law provides for a quite precise definition. According to paragraph 2 (2) of the Austrian 'Eigenkapitalersatzgesetz' (EKEG),[40] a company is in a crisis when:
- being illiquid (paragraph 66 IO),[41]
- over-indebted (paragraph 67 IO),[42] or
- facing reorganization need (paragraphs 23 and 24 URG).[43]

3.2.2.1 Reorganization Need

The Austrian 'Unternehmensreorganisationsgesetz' (URG) was introduced in 1997 to encourage timely and well-considered reorganization measures for companies which are not (yet) insolvent but face reorganization need.[44] For the purpose of this chapter, mainly the definition of reorganization need is relevant.

Such need is assumed when, from a forward-looking perspective, a lasting deterioration of the equity ratio can be identified.[45] To measure this, the URG provides two accounting parameters. Reorganization need is assumed[46] when:
- the company's equity capital is below 8%[47] and
- the (expected) term for debt repayment exceeds fifteen years.[48]

According to the Austrian legislator, these accounting parameters were easy to calculate, easy to understand and identifiable *ex post* without any appreciable effort.[49] In practice, the parameters are partly criticized[50] but still applied, especially in accounting whilst preparing annual accounts and in insolvency proceedings when officeholders investigate possible claims against directors.

3.2.2.2 Material Insolvency

According to the Austrian Insolvency Act (IO),[51] there are two definitions for material insolvency:[52]
- Illiquidity[53]: Austrian case law defines the term illiquidity as the inability to pay all debts when they fall due (the ability to pay 95% of the debt may indicate liquidity).[54] As long as the debtor is able to pay all his due debts within a period of three months, he is not illiquid but rather in temporary payment difficulties.[55]
- Over-indebtedness[56]: A company is over-indebted when its asset status in a liquidation scenario (calculated over-indebtedness) and its future forecast on its continued existence are both negative.[57] Calculated over-indebtedness is usually rather easy to assess by comparing the company's assets and liabilities in a liquidation scenario. Usually more difficult is the assessment of the forecast on the company's continued existence which must be based on realistic and promising restructuring measures.[58]

As soon as a company is illiquid or over-indebted, the duty to file is triggered (*see* 3.3.2.3, *infra*).

s. 214 IA 1986 will be used as the line of argument for both insolvent liquidation and administration.

[32] S. 214 (3) IA 1986 and in detail point 3.3.1.(iii), *infra.*

[33] A. Keay, *Wrongful Trading: Problems and Proposals,* 65 N.I.L.Q. at 63, 64 et seq. (2014).

[34] R. Goode, *Principles of Corporate Insolvency Law* 14–42 (4th ed. Sweet & Maxwell, UK 2011).

[35] *Ibid.*, at 14–41.

[36] *See* e.g. *Ralls Builders Ltd (In Liquidation), Re* [2016] EWHC 243 (Ch) at 190 and [216] and the case study 5.1., *infra.*

[37] R. Werdnik, *Wrongful trading provision – is it efficient?,* 25(6) Insolv. Int. 81, 85 (2012).

[38] *Ibid.*, at 86.

[39] *Supra* n. 33, at 73 et seq.

[40] Rationale of the EKEG is to – under certain circumstances – declare loans granted by shareholders to their company as equity-replacing during a crisis.

[41] *See* 3.2.2.2, *infra.*

[42] *See* 3.2.2.2, *infra.*

[43] *See* 3.2.2.1, *infra.*

[44] Legislative materials Regierungsvorlage (Austria) 734/XX, 10 June 1997, 75.

[45] Para. 1 (3) URG.

[46] Para. 22 (2) N1 URG.

[47] Detailed definition in para. 23 URG.

[48] Detailed definition in para. 24 URG.

[49] *Supra* n. 44, at 86.

[50] K. Binder in *Handbuch Geschäftsführerhaftung mit Vorstandshaftung* 242 (T. Ratka & R. Rauter eds, 2nd ed. Facultas, Vienna 2011).

[51] 'Insolvenzordnung'.

[52] *See* details in G. Wabl, *Preventive Restructuring Mechanisms in Austria: More Flexibility Needed? A Practical Analysis of Existing Tools and Possible International Impacts,* 14 Int. C. R. 245, 245 et seq. (2017).

[53] Para. 66 IO.

[54] Austrian Supreme Court (OGH) RS0126559.

[55] Austrian Supreme Court (OGH) RS126561.

[56] Para. 67 IO.

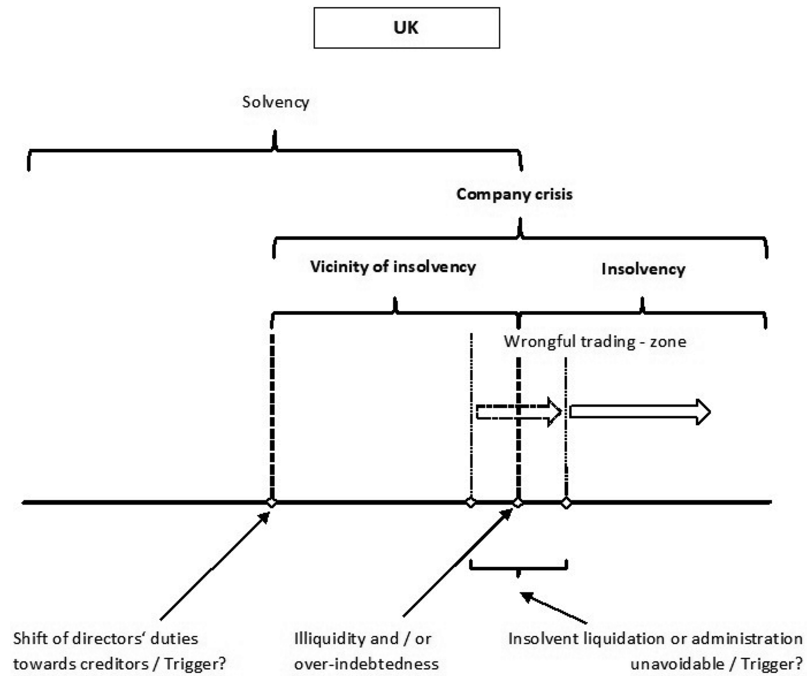
[57] Austrian Supreme Court (OGH) RS0064962.

[58] Details in C. Jaufer, *Das Unternehmen in der Krise. Verantwortung und Haftung der Gesellschaftsorgane* 97 et seq. (3d ed. Verlag Österreich, Vienna 2014).

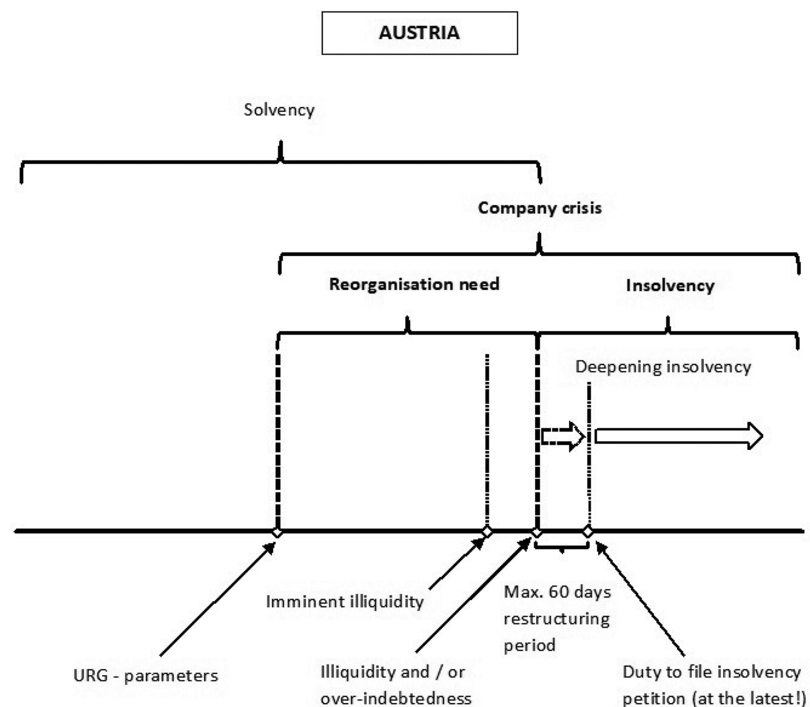
3.2.3 Graphical Comparison

The different approaches can be pictured as in *Graphics A* and *B*:

Graphic A: **Company Lifeline UK**



Graphic B: **Company lifeline Austria**



On an international level, most common criticism regarding a duty to file is that such a duty usually comes too late. The 'beauty' of the wrongful trading approach shall be 'that it does not interfere with on-going business decisions of directors, as long as an insolvency situation is not yet foreseeable'.[59] As *Graphics A* and *B* show, the wrongful trading provision can indeed potentially step in earlier than the duty to file. The 'truth' will be examined later and especially two case studies (*see* 5, *infra*) will show that in reality, this does not necessarily have to be right.

3.3 *Directors' Duties in the Company Crisis (the 'What')*

3.3.1 The UK

3.3.1.1 General Directors' Duties

After a long case law tradition, directors' duties have finally been codified thanks to the CA 2006. Section 170 (1) CA 2006 makes clear that the general duties (seven in all, regulated in sections 171–177 CA 2006) are owed to the company.

For the scope of this article, mainly section 172 CA 2006 is relevant stating the 'duty to promote the success of the company'. According to section 172 (1) CA 2006, the director must 'promote the success of the company for the benefit of its members as a whole'. Whilst doing that, he must also have regard to other factors such as employees or business relationships.[60] This approach has been described as the 'enlightened shareholder value approach',[61] and makes clear that acting for the benefit of the company mainly means acting for the benefit of its shareholders. 'Remarkably',[62] creditors are not included in the list of section 172 (1) CA 2006, which implies that their interests do not have to be particularly considered as long as a company is not in a crisis.

Since *Charterbridge Corporation*,[63] standards for directors have been defined as both subjective and objective. Directors must act bona fide and therefore believe that what they did was in the best interests of the company. If courts are not convinced that the director met this subjective criterion, objective considerations come into play.[64] Also section 174 (2) CA 2006 ('Duty to exercise reasonable care, skill and diligence') applies both a subjective and an objective standard.

In comparison to Austria with its detailed creditor protection provisions (*see* 3.3.2.1, *infra*), there may be the impression that the UK does not provide creditor protection at all. Still, as Doralt[65] correctly states, this impression is wrong and just results from the very different approach which the UK applies. In the UK, it is mainly the creditors' responsibility to protect themselves by contractual provisions. Thus, UK law, and especially the CA 2006, provide lots of transparency rules which e.g. oblige companies and their directors to publicly register directors,[66] or security instruments such as the fixed and the floating charge.[67] These rules are mostly tied with a threat of committing a criminal offence.[68]

3.3.1.2 Shift of Directors' Duties in the Vicinity of Insolvency

As already mentioned, UK law provides a shift of directors' duties in the vicinity of insolvency. Ratio behind this shift is the assumption that in the company's crisis, shareholders with nothing to lose might try to influence directors to take higher risks and thus 'gamble their way out of insolvency'.[69] Indeed, 'directors do not have the right to gamble with the creditors' money'.[70] This applies in the vicinity of insolvency and even more when a company is materially insolvent.

Similar to the 'when' (*see* 3.2.1, *supra*), also the question of what directors are expected to do when this duty is triggered (the 'what') is far from certain. Consequently, Keay states that even after the codification of this duty, the 'when' and the 'what' 'have been clouded in a significant amount of uncertainty'.[71] This shift does at least not change the basic principle that directors owe their duties towards the company and not towards creditors.[72] According to *Colin Gwyer*,[73] the 'Charterbridge Corporation test'[74] does also apply for section 172 (3) CA 2006.

One important question regarding the 'what' is whether creditors' interests shall be treated as paramount or if they shall be just considered besides other (especially shareholders') interests. While it is broadly accepted that when the company is materially insolvent, creditors' interests are paramount,[75] for the vicinity of insolvency it is not clear yet. Although case law[76] varies in this question, there are strong arguments that in the vicinity of insolvency, creditors' and shareholders' interests must both be considered.[77]

But still, the question of paramountcy does not say anything about the substance of directors' duties. Courts tend to refer to the facts and e.g. hold that 'tightening the corporate belt'[78] might be advisable. Directors must try to find the right balance between taking too much risk and being too risk-averse.[79]

[59] *See Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* (Brussels, 2002), www.ecgi.org/publications/documents/report_en.pdf, accessed 13 Aug. 2017, 68.
[60] *See* full list in s. 172 (1) lit (a) to (f) CA 2006.
[61] *Supra* 19, at 49 et seq.
[62] *Ibid.*, at 61.
[63] *Charterbridge Corp Ltd v. Lloyds Bank Ltd* [1970] Ch. 62.
[64] *Ibid.*, at 74.
[65] Doralt, *supra* n. 19, at 53 et seq.
[66] S. 162 CA 2006.
[67] Ss 860–894 CA 2006.
[68] Doralt, *supra* 19, at 53 et seq.
[69] C. Gerner-Beuerle/E.-P. Schuster, *The evolving structure of directors' duties in Europe*, 15(2) E.B.O.R. 191, 223 (2014).
[70] Keay, *supra* n. 4, at 332.
[71] Keay, *supra* n. 26, at 444.
[72] Keay, *supra* n. 7, at 146.
[73] *Colin Gwyer & Associates Ltd v. London Wharf (Limehouse) Ltd* [2003] B. C.C. 885 at 87.
[74] *Supra* n. 63.
[75] *See* majority of UK case law such as *Liquidator of West Mercia Safetywear Ltd v. Dodd* (1988) 4 B.C.C. 30 at 33 and summary in Keay, *supra* n. 26, at 452 et seq.
[76] *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch) at 92 e.g. assumes paramountcy also in the vicinity of insolvency whilst e.g. *Re MDA Investment Management Ltd* [2004] 1 B.C.L.C. 217 at 245; [2004] B.P.I.R. 75 at 102 states that directors should include creditors' interests in addition to those of the shareholders.
[77] *See* argumentation in Keay, *supra* n. 26, at 454 et seq.
[78] *Re Idessa (UK) Ltd (In Liquidation)* sub nom. *Burke v. Morrison* [2012] B. C.C. 315 at 92, 112.
[79] G. Spindler, *Trading in the Vicinity of Insolvency,* 7(1) E.B.O.R. 339, 349 (2006).

Again Keay has tried to develop a general guideline and proposed an 'Entity Maximization Approach' which means directors should take action that 'value maximises the corporate entity so that the net present value to the company as a whole is enhanced (maximizing the total financial value of the firm and taking into account the sum of the various financial claims that are made on the company) and not just its equity'.[80]

3.3.1.3 Wrongful Trading[81]

The wrongful trading provision of section 214 IA 1986 can arguably be seen as the 'counterpart' of the Austrian duty to file (*see* 3.3.2.3, *infra*). The UK framework wants to hold unreasonable and irresponsible directors liable. As long as they act reasonable and responsible, UK provisions should not seek to put too much pressure on directors who already find themselves in difficult circumstances because of their company being in financial difficulty.[82]

Section 214 (3) IA 1986 states that even if a company is in the wrongful trading zone (*see* 3.2.1.3, *supra*), a director shall not be liable when the court is satisfied that he 'took every step with a view to minimising the potential loss to the company's creditors as […] he ought to have taken'. The duty is again owed to the company which is why creditors cannot assert direct claims towards directors.[83]

According to section 214 (4) IA 1986, directors must meet both an objective and a subjective standard. It is the standard of a reasonably diligent person having both the 'general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company' and the general knowledge, skill and experience that the director has. This standard applies both for assessing the 'when' (time of sliding into the wrongful trading zone) and the 'what' (steps to minimize loss to creditors).

Goode has tried to formulate a guideline to meet the criterion of taking 'every step' and e.g. suggested to hold regular board meetings, ensure that the accounts are being properly kept, consult professional advisors or keep major creditors regularly informed.[84]

As already mentioned, section 214 IA 1986 is different from what the Cork Report suggested.[85] The Report recommended to prohibit incurring liabilities when there is no reasonable prospect to meet them and to furthermore set an objective standard for directors (standard of an ordinary, reasonable man).[86]

Commentators criticized the fact that the IA 1986 did not implement the provision proposed by the Cork Report. The subjective element regarding the standard directors must meet and the uncertainty regarding the question what taking 'every step with a view to minimising the potential loss to the company's creditors' means, would discourage officeholders from suing directors and explain the comparably low number of such proceedings.[87] One commentator even concluded that this provision was little more than a 'paper tiger'.[88] Reform proposals e.g. suggest implementing the model recommended by the Cork Report and renaming the provision 'insolvent trading'.[89]

3.3.2 Austria

3.3.2.1 General Directors' Duties

Also Austrian directors must act mainly for the benefit of the company.[90] Coming into effect on 1 January 2016, the Austrian legislator codified the 'business judgement rule'[91] which basically means that directors have to make their decisions on the basis of appropriate information. As long as such information provides that they could reasonably assume to act for the benefit of the company, directors basically do not have to fear liability. This general duty also applies within the company crisis but directors must consider changed circumstances and adapt their managerial acting (e.g. by reducing risk).[92]

Besides that, Austrian law provides a lot of specific duties which especially protect creditors' interests (creditor protection provisions). These provisions apply from the establishment of the company throughout all stages of the company's life. Most rules address the raising and maintenance of capital such as minimum nominal capital[93] or the strict prohibition of direct or indirect return of contributions to shareholders besides authorized distribution of profit.[94] Breaches of such creditor protection provisions lead to liability of directors towards the company[95] and can also lead to direct liability towards creditors (*see* 3.5.2, *infra*). Part of the general duties are also duties regarding an efficient *insolvency prophylaxis* (including an efficient accounting and internal control system, preparation of balance sheet tests, professional forecasts etc.).[96]

3.3.2.2 Directors' Duties Linked to the Period of Reorganization Need

As already mentioned, the Austrian legislation introduced the URG to establish an 'early warning system'[97] and incentivize directors to act timely and thus increase prospects of the success of reorganization and restructuring measures.[98] Still, the URG itself does not provide any explicit duties for directors as it does not oblige them to file for a reorganization proceeding. The fact that URG provisions still can lead to directors' liability will be discussed later (*see* 3.5.2, *infra*).

[80] Keay, *supra* 26, at 459 et seq. and A. Keay, *Formulating a Framework for Directors' Duties to Creditors: An Entity Maximization Approach,* 64 Camb. L. J. 614 (2005).

[81] Other improper trading provisions (misfeasance provision s. 212 and fraudulent trading s. 213 IA 1986) are not in the scope of the article and will not be further analysed.

[82] Woods, *supra* n. 1, *England and Wales* 4, at fn. 14.

[83] Goode, *supra* n. 34, at 14–02.

[84] *Ibid.,* at 14–46.

[85] *See* 3.2.1 (iii) *supra.*

[86] *Supra* n. 27, para. 1783.

[87] Keay, *supra* n. 33, at 67 et seq. and Werdnik, s*upra* n. 37, at 85 et seq.

[88] C. Cook, *Wrongful Trading – Is it a Real Threat to Directors or a Paper Tiger,* 3 Insolvency L. 99, 100 (1999).

[89] Keay, *supra* n. 33, at 75.

[90] C. Nowotny in *AktG Kommentar* § 70 AktG 11 (P. Doralt/C. Nowotny/S. Kalss eds, 2nd ed. Linde 2012), www.rdb.at.

[91] Paras 25 (1a) GmbHG and 84 (1a) AktG.

[92] Nowotny, *supra* n. 90, § 84 AktG at 8.

[93] Paras 6 (1) GmbHG and 7 AktG.

[94] 'Verbot der Einlagenrückgewähr', paras 82 GmbHG and 52 AktG.

[95] Paras 25 (3) GmbHG and 84 (3) AktG.

[96] Details in Jaufer, *supra* n. 58, at 10.15.

[97] 'Frühwarnsystem', *supra* n. 50, at 240.

[98] *Supra* n. 44, at 73.

Considering that the general duties oblige directors to react on changing circumstances, sliding into the period of reorganization need will mostly require an adaption of managerial acting and a more diligent *insolvency prophylaxis* (*see* 3.3.2.1, *supra*).

3.3.2.3 Duty to File

Paragraph 69 (2) IO provides a strict duty to file an insolvency petition at the latest sixty days after material insolvency (illiquidity or over-indebtedness). The sixty days are a maximum period and can basically only be taken advantage of when a director carries forward serious and promising restructuring efforts. The period starts when material insolvency is objectively visible,[99] but at the latest with actual knowledge.[100] During the restructuring period, companies are still allowed to perform transactions and contractual obligations which are necessary to continue the business (purchase of goods, payment of electricity etc.).[101]

Paragraph 69 (2) IO protects the interests of creditors and not the interests of the company itself.[102] Still, it is broadly accepted that a breach of the duty to file automatically triggers a breach of the general duties of paragraphs 25 GmbHG and 84 AktG, which is why the company as such is protected as well. Furthermore, paragraphs 25 (3) N2 GmbHG and 84 (3) N6 AktG explicitly state that directors are also liable for payments which the company performed after the duty to file was triggered and which diminished the debtor's assets. This does not apply for payments which meet the standards of a prudent businessman such as transactions with an immediate exchange of services which again must be necessary for the continuation of the business.[103]

During the sixty days restructuring period, directors either must diligently carry on the preparation of a judicial restructuring proceeding[104] or try a 'last restructuring attempt'. Such a last attempt is basically only permitted if:
- the restructuring is carried out seriously and diligently,[105]
- from an *ex ante* perspective the restructuring seems to be promising and realistic,[106]
- the restructuring (and therefore the elimination of material insolvency) must be possible within the sixty days restructuring period[107] and
- in a consideration of interests, advantages of starting or carrying forward the restructuring are greater than possible disadvantages for creditors.[108]

As soon as it becomes visible that the restructuring will not succeed, the restructuring period ends.[109]

Finally, it is broadly accepted that the rationale behind the duty to file is twofold:
- Less disputed is the protection of creditors from a further reduction of the company's assets and therefore from further loss due to the continuation of business after the triggering of the duty to file. The loss is represented by the so-called 'quota damage'[110] (*see* 3.5.2, *infra*).
- The more disputed part deals with so called 'new creditors'. These are creditors which have become so after the triggering of the duty to file. The Austrian Supreme Court made clear that the rationale of paragraph 69 (2) IO is in particular to remove insolvent companies from the markets and thereby protect those who would not have engaged with them in the first place.[111] Such 'new creditors' are entitled to claim their reliance loss (*see* 3.5.2, *infra*).

3.3.3 Comparison Table

The following table provides an overview of the duties analysed before:

3.4 Possible Actions in the Company Crisis (the 'Carrot')

Given that this article deals with directors' duties and not with the effectiveness of existing restructuring and insolvency proceedings, the following analysis will just give a short overview.

Following practical experience and international harmonization efforts,[112] especially the possibilities for a debtor to stay in possession (DIP), to overrule and therefore cram-down dissenting minorities and to have access to a moratorium[113] may incentivize directors to timely restructure a viable business and thereby serve as the 'carrot'. Thus, the analysis will especially focus on these parameters. Liquidation proceedings as the 'debtor's last resort' will not be examined.

3.4.1 The UK

Besides extrajudicial private workouts,[114] the UK provides various tools for early restructuring with DIP and the possibility to cram-down dissenting minorities.

Company voluntary arrangements (CVAs)[115] give access to compromises with unsecured creditors requiring a consent of 75%. Schemes of arrangement[116] allow such compromises also regarding secured creditors. In both proceedings, courts are only marginally involved. Schemes are particularly popular as they are not part of the UK insolvency proceedings but rather corporate proceedings regulated in PART 26, sections 895–899 CA 2006. Thus, schemes do usually not create such a strong insolvency stigma. CVAs provide a moratorium for 'small eligible companies'[117] whilst schemes do not provide a moratorium at all.[118]

[99] H. Schumacher in *Österreichisches Insolvenzrecht Kommentar II* § 69 KO 78 (R. Bartsch, R. Pollak & W Buchegger eds, 4th ed. Springer, Vienna 2004).
[100] Austrian Supreme Court (OGH) RS0065132.
[101] Austrian Supreme Court (OGH) NRsp 1990/70 = JUS 6/311.
[102] Austrian Supreme Court (OGH) 10 Ob 5/11z.
[103] Binder, *supra* n. 50, at 229 et seq.
[104] Para. 69 (2) IO.
[105] Schumacher, *supra* n. 99, at 92–94.
[106] *Ibid*., at 88–91.
[107] *Ibid*., at 95.
[108] *Ibid*., at 98.
[109] Austrian Supreme Court (OGH) RS0065129.
[110] 'Quotenschaden', Austrian Supreme Court (OGH) 8 Ob 108/08b.
[111] *See* Austrian Supreme Court (OGH) 1 Ob 134/07y and RS0023753 for the current as well as RS0023910 for the older and contrary jurisprudence.
[112] Details in Wabl, *supra* n. 52, at 251 et seq.
[113] A moratorium basically means that creditors cannot enforce their claims and contractual partners cannot terminate contracts.
[114] Details in Olivares-Caminal et al., *supra* n. 23, at 127 et seq.
[115] PART 1 of IA 1986 and details in *ibid*., at 214 et seq.
[116] Details in Olivares-Caminal et al., *supra* n. 23, at 248 et seq.
[117] S. 1a IA 1986.
[118] This may change as in the UK, currently a reform of the corporate insolvency framework providing broader access to statutory moratoria is being discussed (*see* the recent paper of The Insolvency Service, *A Review of the Corporate Insolvency Framework*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf, (accessed 13 Aug. 2017)).

Table 1 Comparison of Main Directors' Duties in the Company Crisis

	Solvency	*Vicinity of insolvency*	*Material insolvency*	*Deepening insolvency*
UK	– Seven general duties sections 170 et seq. CA 2006 – Main duty to promote the success of the company section 172 (1) CA 2006 (enlightened shareholder value = paramountcy of shareholders' interests) – No specific consideration of creditors' interests but strict transparency rules (contractual approach)	– Seven general duties sections 170 et seq. CA 2006 – Shift of directors duties towards creditors section 172 (3) CA 2006 (consideration of creditors' interests besides shareholders) – If already in wrongful trading zone: Every step to minimize loss for creditors	– Seven general duties sections 170 et seq. CA 2006 – Shift of directors duties towards creditors section 172 (3) CA 2006 (paramountcy of creditors' interests) – If already in wrongful trading zone: Every step to minimize loss for creditors	– *See* before 'material insolvency'
Austria	– General duties (para 25 GmbHG, para 84 AktG; business judgement rule) – Creditor protection provisions (esp. capital raising and maintenance paras 6 (1) and 82 GmbHG; paras 7 and 52 AktG)	– *See* before 'solvency' – Consideration of changed circumstances especially when facing reorganization need (less risk-taking, *insolvency prophylaxis*, perform restructuring measures? etc.)	– *See* before 'vicinity of insolvency' – Start of the restructuring period (paragraph 69 (2) IO = max. 60 days) – Duty to file or serious and promising restructuring efforts – Prohibition of payments (unless permitted e.g. for continuation of the business)	– *See* before 'material insolvency' – Duty to file

Besides that, there is an administration proceeding[119] for insolvent companies providing a general and automatic moratorium. An appointed administrator replaces the management trying to rescue the company as a going-concern. In practice, also pre-packed administrations have become highly relevant.[120]

3.4.2 Austria

In Austria, statutory tools are mainly focused on insolvent companies and early restructuring is mostly performed by private workouts.[121]

Reorganization proceedings have not been accepted in practice yet. Probable reasons have already been analysed elsewhere and include high costs while at the same time not providing access to a moratorium or a mechanism to cram-down dissenting minorities.[122]

Restructuring proceedings with[123] and without[124] self-administration can both be accessed by insolvent companies but also by companies facing imminent insolvency. They provide a moratorium and the opportunity to restructure the company via a restructuring plan under the supervision of, or with replacement by, an officeholder.[125] In a restructuring plan, the debtor must offer payment of a minimum quota of 30 respectively 20%. If the plan is approved by a simple majority of the creditors and the quota is paid, the rest of the debt is discharged.[126] Dissenting minorities can be crammed-down.[127]

3.4.3 Comparison Table

The following table shows a compact comparison:

3.5 Directors' Liability in the Company Crisis (the 'Stick')

3.5.1 The UK

Questions of liability are closely linked to the duties analysed before (*see* 3.3.1, *supra*). As duties are owed towards the company, directors are also primarily liable towards the company which can raise claims itself or through an officeholder (administrator or liquidator). The shift of directors' duties

[119] PART 2 of the IA 1986 and details in Olivares-Caminal et al., *supra* n. 23, at 231 et seq.
[120] Olivares-Caminal et al., *supra* n. 23, at 231 et seq.
[121] Details in Wabl, *supra* n. 52, at 247 et seq.
[122] *Ibid*., at 248 et seq.
[123] *Ibid*., at 249 et seq.
[124] Paras 166 et seq. IO.
[125] Paras 140 et seq. IO.
[126] Para. 147 IO.
[127] Para. 156 IO.

Table 2 Comparison of Available Tools in the Company Crisis

	Vicinity of insolvency	*Insolvency*
UK	– Private workout (DIP) – Schemes of arrangement (DIP, cram-down) – CVAs (DIP, cram-down plus moratorium for small eligible companies)	– *See* 'vicinity of insolvency' – Administration (incl. pre-packed) (moratorium)
Austria	– Private workout (DIP) – Reorganization proceeding (DIP) – Restructuring proceeding with and without self-administration if insolvency is imminent (partly DIP, 20 or 30% minimum quota, moratorium and cram-down)	– Private workout (DIP) – Restructuring proceeding with and without self-administration (partly DIP, 20 or 30% minimum quota, moratorium and cram-down)

towards creditors (section 172 (3) CA 2006) does not change this principle.

Civil liability claims arising from the duties of the CA 2006 or the wrongful trading provision of the IA 1986 both lead to compensation claims. These claims are purely compensatory and not punitive. Although the wording of the relevant legal provisions is different,[128] liability is usually calculated on the basis of the loss suffered by the company. As the wrongful trading provision is solely focused on the damage suffered by the creditors while the duties of the CA 2006 target the damage of the company itself, in rare cases liabilities might vary.[129]

Other than in Austria, there is no 'quota damage'[130] and UK provisions also do not intend to secure 'the elimination of insolvent companies'.[131] Thus, UK law also provides no specific protection for new creditors which have contracted with an insolvent company.[132]

Neither section 172 (3) CA 2006 nor section 214 IA 1986 allow creditors to assert claims directly towards directors.[133]

3.5.2 Austria

A main principle of Austrian company law is that directors are not per se liable for the company's success. The business risk is borne by the company itself.[134] Similar to the UK, Austrian directors are mainly liable to the company (internal liability) for the loss caused by their non-compliant conduct. Basically, creditors are therefore indirectly protected and benefit from the company's liability claims and funds which are collected by the company or an officeholder.

Besides that, creditors can also assert direct claims against directors if the claim arises from a breach of a protective legislation which intends to protect the interests of creditors.[135] One of such protective provisions is the Austrian duty to file provision (paragraph 69 (2) IO).

Thus, in case of a breach of the duty to file, directors can be liable towards the company itself (because continuation of trading represents a breach of general duties (*see* 3.3.2.3, *supra*) and towards creditors. As this dualism can lead to conflicts of interests, paragraph 69 (5) IO states that creditors cannot raise liability claims out of a deterioration of the insolvency quota (quota damage) before completion of the insolvency proceedings. This restriction does not apply to the so-called new creditors who can also claim their reliance loss (*see* 3.3.2, *supra*).

Although the URG does not provide a duty to file for reorganization proceedings, directors can still be liable for not filing. Paragraph 22 URG states that directors[136] are, under certain circumstances, strictly liable up to an amount of EUR 100,000 if they, despite a reorganization need, do not file for reorganization proceedings and within two years the company enters insolvency proceedings. A director may be able to relieve himself from liability by proving that the non-filing for reorganization proceedings did not cause later insolvency.[137]

4 International harmonization efforts

4.1 UNCITRAL

Directors' duties in the company crisis have been extensively addressed by international studies and working groups. The arguably most substantiated article is the 'Legislative Guide on Insolvency Law Part four: Directors' obligations in the period approaching insolvency' published by UNCITRAL in November 2013.[138]

[128] S. 214 (1) IA 1986 says: 'the court […] may declare that the person is liable to make such contribution […] to the company's assets as the court thinks proper', while s. 178 (1) CA 2006 refers to the 'corresponding common law rule and equitable principle'.

[129] Goode, *supra* n. 34, at 14–02.

[130] T. Bachner, *Wrongful Trading – A New European Model for Creditor Protection?,* 5 E.B.O.R. 293, 310 et seq. (2004).

[131] *Ibid*., at 317.

[132] *Ibid*., at 316 et seq.

[133] *See* Keay, *supra* n. 26, at 444 and a convincing argumentation for the ratio behind in A. Keay, *Another Way of Skinning a Cat: Enforcing Directors' Duties for the Benefit of Creditors,* 17 Insolv. Int. 1, 3 (2004).

[134] Nowotny, *supra* n. 90, § 84 AktG at 6.

[135] The principle of 'Schutzgesetzverletzung' is one of the main principles of Austrian tort law (para. 1311 of the Austrian Allgemeines Bürgerliches Gesetzbuch (ABGB)).

[136] The provision only applies for directors of companies which are subject to mandatory auditing rules.

[137] Para. 27 URG.

[138] www.uncitral.org/pdf/english/texts/insolven/Leg-Guide-Insol-Part4-ebook-E.pdf (accessed 13 Aug. 2017).

In this Guide, UNCITRAL names two main goals: To 'protect the legitimate interests of creditors and other stakeholders and to provide incentives for timely action to minimize the effects of financial distress experienced by the enterprise'.[139] Amongst other considerations, UNCITRAL defines basic principles and especially states that:

– effective insolvency laws must also address the period before material insolvency,
– company crisis requires robust management and the balancing of various interests,
– in the crisis, the risk shifts from the shareholders to the creditors, and
– timely action is only possible when directors' duties are connected with relevant and effective procedures which directors are incentivized to use.[140]

In the following, the most relevant topics will be analysed.[141]

4.1.1 Nature of the Obligations

The Guide names three important aspects: The question if there should be an obligation to commence insolvency proceedings (duty to file), the requirements for civil liability and the avoidance of transactions (for this article, only the first two aspects are relevant):

– Obligation to commence insolvency proceedings: The Guide addresses the different approaches (wrongful trading and duty to file) but does not give a recommendation on this matter. Still, it refers to previous considerations in the 'UNCITRAL Legislative Guide on Insolvency Law Part Two: Core provisions for an effective and efficient insolvency law'[142] which are quite sceptical regarding a duty to file and explicitly state 'that imposing an obligation on the debtor to apply after a certain number of days or weeks of inability to pay or cessation of payments simply leads to debtor applications that do not reflect a true position of insolvency (and thus a real need for liquidation or reorganization)'.[143] 'The adoption of incentives […] may be a more effective means of encouraging debtors to initiate proceedings at an early stage than the imposition of sanctions for failure to meet the obligation to apply'.[144]
– Civil liability: According to UNCITRAL, directors must have the 'obligations to have due regard on the interests of creditors and other stakeholders and to take reasonable steps: (a) to avoid insolvency; and (b) where it is unavoidable, to minimize the extent of insolvency.'[145] Reasonable steps might among others include:
– 'evaluating the current financial situation of the company',
– 'holding regular board meetings to monitor the situation',
– 'seeking professional advice, including insolvency or legal advice',
– 'calling a shareholder meeting',
– 'modifying management practices to take account of the interests of creditors and other stakeholders',
– 'continuing to trade in circumstances where it is appropriate to do so to maximize going concern value',
– 'holding negotiations with creditors or commencing other informal procedures, such as voluntary restructuring negotiations', or
– 'commencing or requesting the commencement of formal reorganization or liquidation proceedings'.[146]

4.1.2 When the Obligations Arise: The Period Approaching Insolvency

The Guide describes the relevant period as the 'twilight zone', the 'zone of insolvency' or the 'vicinity of insolvency', admits that it is 'a potentially imprecise concept' and summarizes that it is 'intended to describe a period in which there is a deterioration of the company's financial stability to the extent that insolvency has become imminent'.[147]

Referring to material insolvency based on a cash flow or balance sheet test might not be appropriate to encourage steps to be taken at a sufficiently early time.[148] The Guide finally recommends the relevant period as a 'point in time when the person […] knew, or ought reasonably to have known, that insolvency was imminent or unavoidable'.[149]

4.1.3 Liability

Regarding directors' liability, the Guide mainly states that:

– liability should be limited to the extent to which the breach caused loss or damage and therefore be compensatory rather than punitive,[150] and
– defences of directors may include that they took reasonable steps such as mentioned before (*see* 4.1.1, *supra*).[151]

4.2 The European Union

Up until now, insolvency law harmonization on the European level has been mainly limited to procedural aspects. Still, there has already been a lot of work done regarding substantive insolvency law and also insolvency related directors' duties.

In 2002, the 'High Level Group of Company Law Experts' proposed a 'European framework rule on wrongful trading' as this approach would be triggered earlier and simultaneously not interfere with and not overly restrict on-going business decisions.[152]

According to the subsequent 'Communication from the Commission to the Council and the European Parliament' on 'Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward', the 'Commission supports these ideas […] and therefore intends to present the relevant proposal for a Directive in the medium term'.[153]

[139] *Ibid.*, at 1.
[140] *Ibid.*, at 4 et seq.
[141] The analysis will focus on topics relevant for this article and thus exclude certain parts of the Guide.
[142] www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf (accessed 13 Aug. 2017).
[143] *Ibid.*, at 35.
[144] *Ibid.*, at 36.
[145] *Supra* n. 138, Recommendation 255.
[146] *See* full list in *ibid.*, Recommendation 256.
[147] *Ibid.*, at 14.
[148] *Ibid.*, at 15.
[149] *Ibid.*, Recommendation 257.
[150] *Ibid.*, Recommendation 259.
[151] *Ibid.*, Recommendation 261.
[152] *Supra* n. 59, at 68f.
[153] COM (2003) 284 final, 21 May 2003, at 16.

In April 2013, a study initiated by the European Commission (EC) was published which addressed directors' duties in Europe and showed that twenty-one out of (at that time) twenty-seven countries applied the 'duty to file' approach:[154]

– Duty to file: Austria, Belgium, Bulgaria, Germany, Estonia, Greece, Spain, France, Finland, Croatia, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Sweden, Slovenia and Slovakia
– Wrongful Trading: Cyprus, Ireland, Netherlands, Romania, United Kingdom
– Both: Denmark

This study compares both strategies[155] examining that on the basis of country reports and discussions with experts, both remedies seem to have at least similar effects. Although in theory the wrongful trading provision could be triggered earlier than material insolvency, the study suggests that in practice the provision tends to be triggered at a later stage than a strict duty to file because courts would mainly enforce wrongful trading when companies are already insolvent. Still, following the study recovery rates in the UK are higher than in countries such as Germany using the duty to file approach.[156]

In November 2016, the EC published a Proposal for a 'Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU'.[157] The Proposal explicitly highlights the important role of directors and the need of creditor protection in the company crisis.[158] Also the preliminary reports of expert groups available on the Commission's website repeatedly highlight the importance of the area[159] and at the same time refer to UNCITRAL's work.[160] A part of the expert groups pointed out that with UNCITRAL 'the work in this area has already been done'.[161] Thus, UNCITRAL's guidelines might potentially serve as a source of interpretation for a possible future directive.

In December 2018 and under the Austrian Presidency, the European council announced that an agreement has been reached and that the directive will likely be adopted before the elections for the EU Parliament in May 2019.[162] The final compromise text with a view to agreement[163] includes a relevant provision regarding directors' duties in Article 18 ('Duties of directors where there is likelihood of insolvency') stating that directors, as a minimum, shall have due regard to the following:

(a) the interests of creditors and other stakeholders and equity holders;
(b) the need to take steps to avoid insolvency; and
(c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business.[164]

The compromise text emphasizes that the upcoming directive shall give Member States the greatest flexibility possible.[165] Article 18 is considered as 'soft language'[166] and the recitals state that Member States are free to 'implement this provision by ensuring that judicial or administrative authorities, when assessing whether a director is held liable for breaches of duty of care, take the provision on duties of directors in this Directive into account'.[167] Although the above wording of Article 18 might remind somehow of the UK provisions discussed previously (*see* 3.3.1.2 and especially 3.3.1.3, *supra*), the compromise text does neither address nor answer the question of whether Member States shall implement strict wrongful trading or duty to file provisions. Article 7 N1 of the compromise text rather explicitly states that in case of a stay of individual enforcement actions, a debtor's obligation to file for insolvency shall be suspended for the duration of that stay.[168] Assuming that this also applies for the debtor's directors, this underlines that the European legislator wants to leave it to the Member States how to deal with relevant duties in detail.

4.3 Critical Analysis

Following this analysis it seems that, so far, harmonization efforts are strongly based on the work performed by UNCITRAL. This work also highlights the importance of the categories highlighted in this article (the 'when', the 'what', the 'carrot' and the 'stick').

Although most European countries use the duty to file approach, UNCITRAL as well as the EU seem or at least seemed to favour the wrongful trading approach. The main arguments are again the same (duty to file triggers too late and tends to prevent the rescue of viable businesses). The recognized observation that in practice wrongful trading provisions even tend to be triggered at a later stage, does not change this preference. In its recommendations, UNCITRAL uses a

[154] Taken from *supra* n. 11, at 210.
[155] Besides that, the study also addresses the strategy of 're-capitalise or liquidate' which mainly obliges directors to call a shareholders' meeting after the loss of half (or more) of the nominal capital (*Ibid*, xiv). This strategy is not within the scope of this article.
[156] Gerner-Beuerle, Paech & Schuster, *supra* n. 11, at 211.
[157] COM/2016/0723 final, 22 Nov. 2016.
[158] *Ibid.*, 33 at 36.
[159] Working document for the meeting on 13 Jan. 2016, http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=23173&no=2 (accessed 13 Aug. 2017, 2 at 3).
[160] Report of the meeting on 13 Jan. 2016, http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=23174&no=3 (accessed 13 Aug. 2017, 4 at 5.3) and report of the meeting on 14 June 2016, http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=28583&no=2 (accessed 13 Aug. 2017, 4 at VIII).
[161] *Ibid.*, Report 13 Jan. 2016.
[162] *See* press release of the European Council of 19 Dec. 2018, https://www.consilium.europa.eu/de/press/press-releases/2018/12/19/eu-agrees-new-rules-on-business-insolvency/ (accessed 14 Jan. 2019). Note that at the time of the submission of this article, the European Parliament has not yet adopted the directive.
[163] Confirmation of the final compromise text with a view to agreement dated 17 Dec. 2018 (document number 15556/18), https://www.consilium.europa.eu/register/en/content/out?typ=SET&i=ADV&RESULTSET=1&DOC_TITLE=&CONTENTS=&DOC_ID=15556%2F18&DOS_INTERINST=&DOC_SUBJECT=&DOC_SUBTYPE=&DOC_DATE=&document_date_from_date=&document_date_from_date_submit=&document_date_to_date=&document_date_to_date_submit=&MEET_DATE=&meeting_date_from_date=&meeting_date_from_date_submit=&meeting_date_to_date=&meeting_date_to_date_submit=&DOC_LANCD=EN&ROWSPP=25&NRROWS=500&ORDERBY=DOC_DATE+DESC (accessed 14 Jan. 2019).
[164] *Ibid.*
[165] *Ibid.*, at 3.
[166] *Ibid.*, at 3.
[167] *Ibid.*, 39 at 36.
[168] *Ibid.*

wording very similar to the UK wrongful trading provision. But UNCITRAL's wording is different in an important aspect: Trying to achieve earlier action, UNCITRAL states 'knew, or ought reasonably to have known, that insolvency was imminent or unavoidable' while UK law refers to 'insolvent liquidation or administration' which is linked to balance sheet insolvency.[169] As shown in the following, this small but key difference in wording may potentially reveal the major inconsistency regarding the UK wrongful trading approach: a separation of insolvency and viability.

One key argument to support the wrongful trading approach is to promote earlier action to rescue viable businesses before material insolvency. To the complete opposite, UK case law (*see also* case studies 5.1, *infra*) has developed section 214 IA 1986 into a provision rather addressing a period after material insolvency. Thus, even if a company is obviously insolvent, directors can still be allowed and even encouraged to continue trading as long as they see light at the end of the tunnel. If the argument is still the rescue of viable businesses, this reality would imply that a company can be insolvent and at the same time still viable. It will be shown later (*see* 6.1, *infra*) that this is a distinction which is at least worth discussing and might arise from the shown distinction of 'insolvency' and 'insolvent liquidation or administration'.

Regarding the duties themselves, the UNCITRAL Guide provides very detailed recommendations which seem to mostly correspond with the UK system. Especially the modification of management practices to take into account the interests of creditors reminds of the shift of duties in the vicinity of insolvency (section 172 (3) CA 2006). The choice between continuing to trade when appropriate to do so to maximize going concern value or otherwise commencing of formal insolvency proceedings gives directors the flexibility desired by the UK system.

Summarizing, it can be said that the discussed international work and harmonization efforts quite precisely point out strengths and weaknesses of existing strategies. The upcoming EU directive wants to give Member States the greatest flexibility possible and does not seem to show any preference regarding existing approaches anymore.

5 Comparative case studies

Two case studies shall underline some key findings analysed so far. The studies will only address facts and characteristics which are in the scope of this article and therefore deliberately exclude certain elements of the cases.

5.1 The UK 'Ralls Builders' Case

In a case[170] quite recently decided, the liquidators of the Ralls Builders Ltd (In Liquidation) sued the former directors under section 214 IA 1986. The argument was that by the end of July (or the end of August) 2010, the directors knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. According to the liquidators, the directors caused loss to creditors by continuing trading in the amount of up to GBP 1.13 million.

5.1.1 The Facts

Ralls Builders, a construction company, went into an administration proceeding in October 2010. At the end of June 2010, the draft audited accounts for the financial year ending 31 October 2009 were produced and it was apparent that the company was heavily balance sheet insolvent.[171] In the period around June 2010, the company received numerous invoices and letters of demand from unpaid creditors.[172]

In July 2010, the directors asked for professional legal advice which, amongst other things, stated that continuing trading would only be possible if the bank continued providing the overdraft (GBP 600,000) and creditors agreed deferred terms.[173]

The directors continued trading until October 2010 because they were in negotiations with a potential investor. The investor never bindingly committed and finally, negotiations failed. Still, the bank extended the overdraft, which was secured by a fixed and a floating charge, until the end of August 2010.[174]

In September 2010,[175] the company completed a number of contracts and collected receivables in the total amount of GBP 1.3 million which were paid into the company's bank account. The money was used:

- to pay off the bank overdraft (GBP 530,000) and
- to pay further amounts for salaries as well as old and new creditors (all in all GBP 751,000).

In this period, the company also incurred new credit which remained unpaid.

5.1.2 Outcome in the UK

The court stated that the company was insolvent on both a balance sheet and cash flow basis by 31 July 2010.[176] As the summer months are the most profitable period for a constructing firm, net profits of GBP 327,000 were expected through continuing trading during August until October.[177] Still, the court made it clear that 'at no relevant time was there any realistic basis for concluding that the Company could, by trading alone, eliminate the huge hole [...] in its balance sheet, even assuming that the Company's creditors and the Bank would have been willing to give it the very extended time that it would have needed to do so.'[178] Still, following the court, as at the end of July there was 'no basis for a finding that [...] the Directors actually [...] knew that there was no reasonable prospect of a deal' with the investor,[179] the directors did not trade wrongfully in August 2010.

As nothing changed regarding the investor, the court concluded that in the following weeks, the directors' faith could have only been based on 'hope and optimism' and

[169] *See* 3.2.1.3, *supra*.

[170] *Ralls Builders Ltd (In Liquidation), Re* [2016] EWHC 243 (Ch). There is a second related judgment (*Ralls Builders Ltd (In Liquidation), Re* [2016] EWHC 1812 (Ch)) which ended up the same way and therefore will not be particularly addressed.

[171] *Ibid.*, at 4.

[172] *Ibid.*, at 57.

[173] *Ibid.*, at 73.

[174] *Ibid.*, at 11, 128.

[175] *Ibid.*, at 133 et seq.

[176] *Ibid.*, at 180.

[177] *Ibid.*, at 184, 185.

[178] *Ibid.*, at 187.

[179] *Ibid.*, at 190.

that 'a realistic assessment at the end of August 2010 should have led the Directors to conclude that [...] there was no reasonable prospect of the Company avoiding an insolvent liquidation.'[180] Thus, from September 2010 on, the company was in the wrongful trading zone.

Although the court concluded that the directors traded wrongfully, it did not approve the claim as the trading caused no loss. The case includes a detailed balance sheet[181] which even shows an improvement in the company's net position.[182] By continuing trading and realizing book debts, not only the bank overdraft was repaid but also a surplus was achieved to the benefit of unsecured creditors who otherwise (scenario liquidation 31 August 2010) probably would not have received anything.[183]

Concluding, the court stated that 'whatever other criticisms can be made of the manner in which the Directors conducted the business [...] such continued activity did not cause loss to the Company overall or worsen the position of the creditors as a whole.' According to the court, the 'real sin' was the way in which some existing creditors were paid 'whilst leaving new creditors unpaid'. Still, this cannot justify a contribution under section 214 (1) but that 'may be thought to be a shortcoming in the structure of section 214′. To the court, 'any such change would be for Parliament'.[184]

5.1.3 Fictional Outcome in Austria

The outcome in Austria would have been quite different. First of all there are valid arguments that paragraph 69 (2) IO would have required the directors to react much earlier than 31 August 2010. As the duty to file is triggered when illiquidity or over-indebtedness are objectively visible, it can even be argued that the maximum restructuring period (sixty days) had already started even at the end of October 2009 (date of balance sheet insolvency according to the facts). The fact that the company had serious payment difficulties in the period around June 2010 indicates that it might also have been illiquid in this period.

Even if one would assume that paragraph 69 (2) IO was triggered at the end of July 2010, Austrian law would have obliged the directors to take earlier action. As analysed before (*see* 3.3.2.3, *supra*), directors can only take advantage of the restructuring period if they diligently prepare a judicial restructuring proceeding or carry forward serious and promising restructuring efforts. The restructuring must be achievable within the sixty-days period. The hopeful prospect for an investor to provide new funds without any legal commitment and concrete timeframe would highly likely neither meet the criteria of a plan being 'serious and promising' nor the required timeframe. Thus, it can be assumed that also in this scenario the directors would have been obliged to react earlier and file for insolvency at the latest immediately after 31 July 2010.

Consequently, directors would mainly be liable towards the company for the loss occurred within the zone of deepening insolvency and towards the creditors for the 'quota damage'. The result could be similar to the UK arguing that during the summer, the company did not make any loss and also did not harm the creditors as a whole. Given that the deepening of insolvency might have already started much earlier, it is still not unlikely that a factual liability would have arisen. Another difference regarding the amount of damage could make payments which did not cause loss to the company but diminished the company's assets and thus violated paragraphs 25 (3) N2 GmbHG and 84 (3) N6 AktG (*see* 3.3.2.3, *supra*).

Other than in the UK, also new creditors, which contracted with the company after the duty to file had been triggered, would be able to directly assert compensation claims for their reliance loss towards the directors (*see* 3.3.2.3, *supra*).

5.2 The Austrian 'Restructuring Plan' Case[185]

This case[186] is actually a criminal law case dealing with a director who committed numerous criminal offences as formal and actual director of a large number of clothing companies. The reason for using this case is that the legal principles regarding the former criminal offence of 'fahrlässige Krida',[187] which at that time criminalized deepening insolvency, are also applicable for paragraph 69 (2) IO.[188] The case is especially interesting regarding the (non-) impact of restructuring efforts.

5.2.1 The Facts

After his companies became insolvent, the accused director continued trading and especially:
- accepted numerous bills of exchange and thereby imposed new liabilities for his companies,
- bought economically worthless company shares paying ATS 1.65 million, and
- accepted the delivery of goods by debiting suppliers' discount lines of ATS 8.5 million and accepting liability lines of ATS 2.5 million and thereby paid old, whilst simultaneously contracting with new, creditors.[189]

The illiquidity of the companies was apparent not later than at the end of September respectively October 1985. The director filed for insolvency for all affected companies at the end of March 1986 after realizing that the implementation of an out-of-court restructuring plan failed.[190]

5.2.2 Outcome in Austria

The court held that the director was guilty for deepening insolvency after September respectively October 1985 and harming the companies' creditors by entering new and paying old liabilities.[191] The judgment does not say anything about civil liability but it is very likely that the director also had to face such claims regarding harming old as well as new creditors.

[180] *Ibid*., at 216.
[181] *Ibid*., at 255.
[182] *Ibid*., at 263.
[183] *Ibid*., at 260.
[184] *Ibid*., at 279.

[185] This indication is created by the author as Austrian cases usually anonymize names of parties and involved companies.
[186] Austrian Supreme Court (OGH) 11 Os 87/90.
[187] Wording of para. 159 (1) N2 StGB until 31 July 2000.
[188] Austrian Supreme Court (OGH) RS0059532.
[189] *Supra* n. 186, at 2 et seq.
[190] *Ibid*., at 5 et seq.
[191] *Ibid*., at 5.

The interesting point about this case is that the director argued that his companies were not insolvent or at least that he was allowed to take advantage of the sixty days restructuring period because of an existing restructuring plan. He argued that the court (and the consulted expert) would have had to consider the restructuring plan and possible effects on the companies' forecast. The court did not accept this argument and stated that such restructuring plans cannot delay the point of insolvency.[192] Furthermore, such plans can only be given as a reason for taking advantage of the restructuring period if they are serious and promising which the court denied.[193]

5.2.3 *Fictional Outcome in the UK*

It can be assumed that also in the UK, courts would have at least partially disagreed with the directors' acting after the companies' illiquidity. Given that his actions very likely caused loss for his companies and their creditors, liability for wrongful trading but also for a breach of his duties under section 172 (3) CA 2006 might be possible.

The interesting question is if it would have been possible that the restructuring plan would have led to the conclusion that the companies were not (yet) in the wrongful trading zone. As shown before in *Ralls Builders*, UK courts are less strict regarding such restructuring efforts. In particular, it is not required that they must lead to a turnaround within sixty days. This could have led to the fact that the director did not trade wrongfully and timely filed for insolvency in March 1986 when realizing that there was no reasonable prospect of avoiding an insolvent liquidation or administration. Thus, he would not have been liable under section 214 IA 1986. It cannot be finally answered if this would also have an effect on a possible liability under section 172 (3) CA 2006.

Also in this case, new creditors would not be able to claim compensation for their reliance loss.

5.3 Critical Analysis

Both cases underline the main differences and some of the main points of criticism which have already been highlighted earlier. Arguments that wrongful trading is triggered earlier than the duty to file do not necessarily correspond with legal practice. *Ralls Builders* can thereby serve as an extreme example as the difference between the triggering events can be up to ten months (between end of October 2009 and end of August 2010). Here it must be stated that this might not only be grounded on different provisions regarding directors' duties but also regarding different definitions of material insolvency and the application of objective or subjective tests. It is especially worth mentioning that in *Ralls Builders*, the court separates the point of balance sheet insolvency and the point when insolvent liquidation was unavoidable although section 214 (7) IA 1986 explicitly states that both shall correspond with each other. This is again proof of the inconsistency which will be pointed out as a main weakness of the UK approach (*see* 6.1, *infra*).

The *Restructuring Plan* also shows that the way countries deal with restructuring efforts can immensely influence liability. Even if a restructuring might be successful, Austria pulls the plug quite quickly (maximum sixty days restructuring period) while in the UK, directors have more time to rescue a company.

6 To file, or not to file: is this the question?

6.1 Are the Jurisdictions Fit to Reach the Goals?

The examination has shown that the approaches in Austria and the UK are partly similar but in the core rationale very different. As quoted at the beginning of this article, particularly in the area of insolvency, law has to make a choice.[194] Regarding directors' duties in the company crisis, it looks as if the choice must be between flexibility and certainty. Still, there seems to be agreement regarding the main goals,[195] which is why both jurisdictions shall be finally challenged on their fitness to achieve them:

6.1.1 *Protection of Legitimate Interests of Creditors and Other Stakeholders*

Both jurisdictions appreciate that in a company crisis, there is need for an adaption of managerial acting. This adaption shall allow the turnaround of the business and mirror the fact that the closer to insolvency, the more stakeholders and especially creditors are at risk. The legitimate interests of creditors are basically of property right. As long as the debtor is solvent, creditors have the legitimate right to be satisfied in full. As soon as the debtor is insolvent, creditors have the legitimate right to receive as much as possible. If the debtor is not just illiquid but also over-indebted (as is mostly the case), creditors have the right to share with other creditors on a pro rata basis.

At the early stage of company crisis, Austrian and UK law have different approaches which still may finally lead to a very similar result. Austrian law generally provides detailed rules regarding *insolvency prophylaxis* and creditor protection. UK law appreciates the need for creditor protection by applying a shift of directors' duties in the vicinity of insolvency which leads to similar duties as in Austria. Austrian provisions are more detailed regarding the 'when' and the 'what' but both regimes allow directors flexibility without strict liability provisions.

Regarding insolvency itself, the approaches are very different. Austria defines the point of material insolvency, the start of the restructuring period and the criteria for taking advantage of this period with arguably detailed and objective criteria. The duty to file shall in particular back up the grounds for material insolvency.[196] The strict restructuring period shall protect creditors and is seen as legitimate arguing that restructuring efforts can also be continued within an insolvency proceeding.[197] The UK, on the contrary, also appreciates

[192] *Ibid.*, at 5 et seq.

[193] *Ibid.*, at 6. Unfortunately the court did that without further elaborating on the reasons but rather just confirming the (not publicly available) view of the first instance court.

[194] *Supra* n. 1.

[195] As summarized by UNCITRAL (*see* 4.1, *supra*).

[196] M. Dellinger in *Insolvenzgesetze Kommentar* § 69 KO 10 (A. Konecny & G. Schubert eds, Manz 2005), www.rdb.at.

[197] *Ibid.*, at 20.

the need for creditor protection but seems to be willing to weaken it in favour of more flexibility.[198]

As already mentioned and especially underlined in the analysis of *Ralls Builders*,[199] although wrongful trading aims to promote earlier action, UK courts tend to apply the provision even at a later stage than a duty to file would be triggered. This is especially possible because the wording of the wrongful trading provision refers to a point when 'insolvent liquidation or administration' is unavoidable. The idea behind this wording was to enable action by directors before the onset of material insolvency.[200] Courts used this wording to establish a distinction between the point of material insolvency (even the point of balance sheet insolvency despite section 214 (6) IA 1986) and the point when insolvent liquidation or administration is unavoidable. The result of this distinction is that the provision is triggered after material insolvency and therefore even an insolvent company can be considered as viable and therefore rescuable.

Coming from Austria and being used to strict and objective guidelines, this might firstly sound unsatisfactory. As shown in the following, also a deeper analysis does not change this 'first emotion'. Is a distinction between insolvency and viability desirable or rather problematic? Should not the definition of insolvency as either being illiquid or over-indebted in its essence imply that a company is not autonomously viable anymore? In both jurisdictions, not only the cash flow test but also the balance sheet test analyse on the basis of the status quo and a future prognosis if a debtor is still a reliable debtor, contractual partner and employer. If not, a company is deemed to be insolvent and one should think that this point requires the law to bring strict rules into place. This is exactly what Austria did with the duty to file provision.[201] The distinction between insolvency and viability as exercised in the UK may be in conflict with this argumentation. When shall a company be deemed as viable? In theory, every company can be somehow seen as viable as long as external factors (e.g. new funds or waivers of creditors) are considered. The scope of this article is not to examine this question in detail but to highlight that in a critical regime such as insolvency, the law must set strict boundaries in such questions. The question must be: Is a company autonomously viable? If not and if there is no sufficient external support to change that, then this should be deemed as insolvency. One could even say that this is the very purpose of defining the term insolvency.

The distinction made by the UK combined with a strong subjective element regarding the standards for directors has been identified as a main reason for the small number of wrongful trading cases.[202] Commentators acknowledge this and suggest reform measures based on the Cork Report arguing that this would make it especially easier for office-holders to prove non-compliance.[203] But also the Cork Report includes a major inconsistency because it recommends a provision which only refers to a cash flow test.[204] Thus, the balance sheet test of section 123 (2) IA 1986 would be simply 'exchanged' for the cash flow test without dissolving the inconsistency.

Of course, the law should somehow enable the rescue of insolvent businesses in considering restructurings plans, external funds etc. Thus, e.g. Austrian law provides a sixty days restructuring period. One could argue that this period is too long[205] or too short. Still, there must be a stop sign or a strict guideline to prevent that the possibly reasonable but subjective belief of directors turns out to be no more than 'hope and optimism'.[206] Here, Bachner in particular can be followed who highlights the risk of such a subjective standard.[207] Restructuring plans therefore should only allow the continuation of trading when they meet strict and objective standards. This is definitely a fine line because if standards are too low, it may lead to the acting out of 'hope and optimism' while if they are too high, restructuring can only be possible when it is definitely sure, which may in any case lead to a positive forecast and therefore an elimination of material insolvency.

6.1.2 Provision of Incentives for Timely Action

There is no doubt that timely action is desirable in any jurisdiction. Both jurisdictions have tried to encourage it, especially with the URG in Austria and the codification of the shift of directors' duties in the vicinity of insolvency in the UK. As mentioned, the URG has not been accepted in Austrian practice yet. Also the shown weaknesses of the UK regime raise doubts regarding its efficiency. Unfortunately, there is no evidence showing if these approaches led to an improvement of timely action.

As analysed, the UK wrongful trading approach does not lead to earlier action than the Austrian duty to file approach. Bachner came to the same conclusion in comparing the German and the UK approach.[208] Davies[209] agreed with Bachner's observation but simultaneously stated that the second criticism of the duty to file approach – reducing the chances of saving viable businesses – was still valid. As already argued, this might also be questionable considering that the argument of viability should, from the authors point of view, address a period before material insolvency. Summarizing, both the analysed wrongful trading and the duty to file provisions may not lead to earlier action. Following the discussion undertaken above (6.1.1), this also may not be the primary function of these provisions.

Key in this area may rather be an efficient restructuring framework (the 'carrot').[210]

6.2 Recommendation: A hybrid Approach

Whatever the 'better' approach may be, it can be said that in this area, the difference of legal cultures becomes visible.[211] It might bring it to the point to state that '[w]henever the legislator uses such broad language as in section 214 IA

[198] *See* 3.3.1, *supra*.
[199] *See* 5.1, *supra*.
[200] Bachner, *supra* n. 130, at 295 et seq.
[201] *See* 3.3.2.2, *supra*.
[202] *See* 3.2.1.3 and 3.3.1.3, *supra*.
[203] *Ibid*.
[204] *Supra* n. 27.
[205] Germany 'only' provides three weeks.
[206] *Supra* n. 168, at 216.
[207] *Supra* n. 130, at 308 et seq.
[208] *Ibid*., at 295 et seq.
[209] P. Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency,* 7(1) E.B.O.R. 301, 320 et seq. (2006).
[210] *See* 3.4, *supra*.
[211] Bachner, *supra* n. 130, at 315.

flexibility is achieved at the cost of legal certainty'.[212] This quote equally applies to the wording of section 172 (3) CA 2006.

As already mentioned, in many elements the outcome of both jurisdictions is mainly the same. As the examined provisions all derive out of tort law, the amount of liability is mainly oriented on the company's loss.[213] Thus, out of practical experience it can be said that also in Austria, companies sometimes continue trading after the triggering of the duty to file (even with professional legal advice) just being cautious not to cause any loss and not to diminish the company's assets. Therefore, it seems that even in managerial acting, the outcome of both approaches might be similar.

Appreciating the reality of different legal cultures, ideas for improvement can still be sought across borders and legal cultures. Thus, the question should not be 'what is the better approach' ('to file or not to file'?') but rather 'how to achieve the desired results?' This brings enough flexibility which has also been highlighted by the European legislator in the final compromise text regarding the upcoming EU directive.[214] Besides the two goals mentioned before (*see* 6.1, *supra*), a third main goal should be certainty for all involved parties (debtors, directors, shareholders, creditors and not least officeholders).

The following main principles shall try to help achieving these goals and to build a hybrid approach:

- The 'when': In order to create certainty, comprehensible and objectifiable parameters are recommendable. Talking about the vicinity of insolvency, accounting parameters, like the Austrian URG parameters, triggering the presumption of being in the period of vicinity would be helpful to give directors guidance. The advantage of such a presumption is that directors can always prove the presumption wrong. As the regular review of the company's finances and accounting is one of the directors' key responsibilities anyway, the attention to such parameters would also not interfere in the managerial acting.

Regarding the point of material insolvency, even more certainty is needed. As already mentioned, this is the point where the law should make a choice and where everything changes. Thus, clear and objective parameters are required. One can question if the parameters developed by Austrian case law are ideal,[215] but they are arguably more precise than the UK approach and seem therefore to be preferable.

- The 'what': In the vicinity of insolvency, both jurisdictions seem to lead to similar results. Regarding the protection of legitimate interests, none of the approaches seems to be preferable. Still, in both jurisdictions codified guidelines for directors might be desirable. The guideline of 'reasonable steps' formulated by UNCITRAL (*see* 4.1.1, *supra*) could serve as orientation. Timely action can be incentivized by certainty regarding the trigger of the vicinity of insolvency (the 'when') and by providing effective restructuring tools (the 'carrot').

In insolvency itself, duties must be explicitly focused on creditors' interests. Regarding the creditors as a whole, both systems are quite similar. The big difference relates to new creditors. Again, crucial is consistency and that duties are tied to the point of insolvency and not anything else (as in the UK's wrongful trading provision). If this is ensured (either by a strict duty to file or by a wrongful trading provision referring to a point where 'insolvency' is unavoidable[216]), the rest may be secondary.

In order to appreciate that arguably also a duty to file should not force directors to stop promising restructuring measures, the Austrian system could possibly be improved by allowing directors to exceed the maximum restructuring period by providing evidence to the contrary in certain but very limited cases. Still, at this point rules must be strict, detailed and objective and at one point, law must set a stop sign.

- The 'carrot': Jurisdictions must provide sufficient and flexible tools to incentivize directors to react early and to leverage their negotiations with creditors. As key parameters, DIP trading, the possibility to cram-down dissenting minorities and the access to a statutory moratorium have been identified. The upcoming EU directive might help in that regard.
- The 'stick': Liabilities basically mirror the above considerations regarding directors' duties. In insolvency, there should be – within strict boundaries – a safe haven for directors when they act reasonably and especially perform reorganization or restructuring measures. Again, a codified guideline is desirable. The question if (especially new) creditors should be able to assert claims directly towards directors is not within the scope of this article.

7 Conclusion

Not surprisingly, at first sight the analysed approaches seem to be very different. Surprisingly, taking a deeper look, they often lead to a similar outcome. The main identified weakness of the UK wrongful trading approach is that the wording (reference to the point when insolvent liquidation or administration is unavoidable) has led to a jurisprudence which may have created the exact opposite effect to that desired. Because of its very own purpose, the point of reference of such provisions must be the point of material insolvency. As often criticized, the Austrian duty to file on the other hand can indeed force directors to stop even promising restructuring efforts.

The 'perfect approach' does not exist as legal cultures require different frameworks. Thus, probably the question should not be 'to file, or not to file?'. Rather, an optimal hybrid approach should state basic principles by:

- defining the relevant periods (vicinity of insolvency and material insolvency) objectively and comprehensibly,
- giving directors strict and objective guidelines tied to the point of material insolvency,
- providing flexible restructuring tools, and finally
- providing a safe haven for directors which might release them from liability.

Because of different legal cultures, full harmonization in all aspects may be unrealistic. Still, common harmonized minimum standards are desirable. UNCITRAL's work may serve as a solid baseline and the upcoming EU directive[217] might be an important step in the right direction and can therefore be highly anticipated.

[212] *Ibid.*, at 314.

[213] Besides the liability in Austria for prohibited payments which diminish the company's assets and 'special' liability in Austria towards new creditors.

[214] *See* 4.2 *supra*.

[215] This is not within the scope of the article.

[216] As suggested by UNCITRAL (*see* 4.1.2 *supra*).

[217] *Supra* n. 163.