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**United Nations Commission on  
International Trade Law**  
**Working Group V (Insolvency Law)**  
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## **Insolvency Law: possible future work**

### **Addendum**

#### **Proposal by the delegation of the United Kingdom for the development of guidelines on directors' and officers' responsibilities and liabilities in insolvency and pre-insolvency cases (including prior to entering formal insolvency proceedings, where the company is in the "the twilight zone")\***

*[Background for this proposal is set forth in the paper produced for the thirty-eighth session by the International Insolvency Institute (III) (A/CN.9/582/Add.6)]*

1. With the development of the Model Law and the Legislative Guide, UNCITRAL has delivered a modern, harmonized and fair framework to address effectively cases of cross-border insolvency, while respecting the differences in national laws. In order to compliment further this work, the United Kingdom delegation recommends as future work for Working Group V the consideration and development of guidelines relating to the responsibilities and liabilities of directors and officers of companies in insolvency and pre-insolvency situations.
2. The Model Law is built upon a number of key principles including fair and efficient administration of cross-border insolvencies to protect the interests of all creditors and other interested persons, including the debtor, and protection and maximization of the value of debtors' assets. To help meet these principles the United Kingdom believes that it is important to set out in guidance the responsibilities of directors and officers where a company becomes insolvent or is approaching insolvency. Such guidelines would enhance the operation of the Model Law and Legislative Guide by setting out what should be the principles underlining

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\* This document was submitted as soon as possible following receipt of the proposal.



director and officer duties, to whom such duties should be owed and the sanctions States might consider when these duties are not met by the director or officer in breach.

3. The United Kingdom recognizes that such guidelines would need to be both basic and broad in their construction. Officers and directors of companies will already be subject to wide-ranging domestic laws setting out their individual and collective duties and any guidelines on how the duties of directors or officers are affected when a company approaches insolvency will need to be complementary with pre-existing laws or policies on this subject. Equally, the guidelines should not impact negatively on the freedom of directors and officers to undertake their duties and exercise their judgement appropriately, nor discourage entrepreneurial activity. The guidelines should provide a balance between encouraging responsible behaviour by directors and officers without discouraging reasonable risk taking or steps to re-finance or restructure companies facing insolvency.

## **I. Features of proposed guidelines**

4. As presented in the III proposal (A/CN.9/582/Add.6) a set of such guidelines would need to contain guidance on various matters from which States could choose or modify to suit particular circumstances. Below is a list of areas which might be a useful starting point for Working Group V to consider, although this is not intended to be exhaustive.

### **A. Directors and officers**

5. The definitions of a director and officer are important considerations in identifying the individuals or groups of individuals the guidance is intended to address. The guidelines should be wide enough to encompass the full variety of formal and non-appointed controlling individuals and entities of a company.

### **B. Director and officer duties and responsibilities**

6. Many Member States will have, within their national laws or policies, some reference to standards or duties for directors and officers. For example, in the United Kingdom the general duties of directors are set out in the Companies Act 2006. They include a duty that a director should exercise reasonable care, skill and diligence. Common principles of fiduciary duty are the duty of care and the duty to act in good faith to promote the success of the company (in most cases for the benefit of its members). But under United Kingdom law, this duty has effect subject to any rules of law that directors must, in certain circumstances, consider, or act in, the interests of the creditors of the company. The overriding fiduciary duty of a director or officer of an insolvent company is to the creditors of that company. Where a company is approaching insolvency, the interests of its members become increasingly displaced by those of the creditors. In the United Kingdom this is further recognized by rendering unlawful certain actions by a director once a company is insolvent, for example the wrongful trading provisions of the Insolvency

Act 1986. The United Kingdom believes that the provision of guidelines on fiduciary duties will be of great benefit to States.

## **C. The period approaching and insolvency**

### **1. The twilight zone**

7. As discussed above, the duties of a director or officer of a company are affected by the insolvency of a company or its impending insolvency. INSOL International has produced reports on this subject where this period is described as “the twilight zone”. It is in the context of this period in the life of the company that the guidelines should address the behaviour and actions of a director or officer and the guidelines might usefully consider when this period begins.

8. Defining when this period begins is subject to a great many variables — including the nature and circumstances of the company and the skills and knowledge of its directors and officers. A basic approach might be the point at which a director or officer knew, or ought to have known, that the company was insolvent or was likely to become insolvent. Beyond this, is the question of when does a company actually become insolvent? In United Kingdom law, insolvency has been viewed as the point in time when a company becomes unable to pay its debts as and when they fall due, or the point in time when a company’s liabilities exceeds the value of its assets. Both bases are subjective and require wider consideration of circumstances and context.

### **2. Formal insolvency**

9. It is easier to determine when the twilight zone ends and formal insolvency commences. This is already dealt with in the Legislative Guide.

10. Furthermore, the Guide addresses the obligations of directors and officers of companies in insolvency within recommendations 108-114, by reference to the obligations of the debtor (110) to cooperate and assist the insolvency representative along with the application of sanctions where they fail to do so (114).

## **D. Director and officer misconduct**

11. The guidelines might usefully consider the types of misconduct most commonly associated with directors or officers of insolvent companies. By detailing these types of misconduct, the guidelines could effectively provide a set of standards against which director or officer conduct could be judged. The World Bank report “Principles for Effective Insolvency and Creditor Rights Systems” recommends that “at a minimum, standards should address conduct based on knowledge of or reckless disregard for the adverse consequences to creditors”.

12. We suggest, as a starting position, that Working Group V might wish to consider the following matters in developing guidelines:

(a) Fraudulent trading — where a director or officer has been dishonest or reckless in the running of a business which has become insolvent, to the extent that

the purpose of the business has been carried on with the intent to defraud creditors or for a fraudulent purpose;

(b) Transactions defrauding creditors — where a director or officer of a company has fraudulently caused the transfer or disposal of company property;

(c) Wrongful trading — where a director or officer ought to have known that insolvency was unavoidable and the director or officer has failed to take reasonable steps to minimize losses to creditors;

(d) Breach of duty/misfeasance — where a director or officer has misapplied or retained money or property of the company or where a misfeasance or breach of duty, fiduciary or otherwise, has caused the misapplication of assets or a loss to the company;

(e) Misconduct involving company money or property — where a director or officer causes or allows a preference or a transaction at an undervalue to the detriment of creditors;

(f) Failure by a director or officer to comply with statutory obligations;

(g) Misconduct involving company records — falsification, failure to preserve or failure to deliver up company records;

(h) Failure to pay taxes.

13. Additionally, matters relating to conduct after the insolvency might include:

(i) Re-use of company name — where a director or officer of company that is insolvent re-uses the company name without permission or exemption to do so;

(j) Acting when prohibited to act as a director or officer of a company.

## **E. Criminality, personal liability and disqualification**

14. Where a director or officer of a company that is insolvent or approaching insolvency has committed an act of fraud or fraudulent trading, it is likely that the domestic laws of the State will have adequate provisions to deal with such criminal acts. In the United Kingdom, in some areas of insolvency law, the insolvency office holder has a statutory duty to bring such matters to the attention of a prosecuting authority. With this may come a personal liability for the director or officer responsible and there is often an overlap between proven criminality and personal liability for the director or officer. Likewise where a director or officer has failed to take reasonable steps to limit losses to creditors, they may be ordered to make a contribution to the assets of the insolvent company. Any guidelines on personal liability of directors and officers should, however, consider the need for balance. Companies facing insolvency need robust management, often there are difficult decisions and judgements to be made. Directors afraid of the possible financial repercussions of making such business decisions may prematurely close down a company rather than seek to trade out of difficulties. The guidelines might seek to give guidance to States on the circumstances which could lead to personal liability, while at the same time recognizing the pitfalls and threats to entrepreneurship which may result from rules which are too draconian.

15. The Working Group might also consider the subject of director disqualification, where protection from the rogue director may be achieved by imposing a period of disqualification from being a director or taking part in the running of a company. In the United Kingdom, the Company Directors Disqualification Act 1986 enables disqualifications between 2 and 15 years where the individual is evidenced as being “unfit” to act as a director. Disqualification may sit alongside other sanctions and personal liability as described above, or may be brought independently where the overall conduct of the individual as a director or officer merits such a sanction. It may also be appropriate, as part of this work, for the group to consider the question of recognition of disqualification sanctions across the jurisdictions of States, such as already exists under Australian law.

## II. Proposal

16. This delegation therefore proposes that:

**Working Group V consider recommending that the Commission considers this type of proposal at its next session with a view to approving a mandate for Working Group V to provide guidelines on directors’ and officers’ responsibilities and liabilities in insolvency, including prior to entering formal insolvency proceedings.**

17. We appreciate the consideration by the Working Group of this proposal.

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