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MAK, C.H.W.

2023

Trusts across borders: steering through the EU's Insolvency Directive and its implications for trustees

Charles Ho Wang Mak*

Abstract

This article delves into the multifaceted roles and responsibilities of trustees in cross-border insolvencies, with a spotlight on the EU's proposed directive aiming to harmonise insolvency law. It acknowledges the unique position of trustees who, while not forming an insolvency-prone entity, are personally liable and entitled to an indemnity from the trust assets. The article will explore the complexities arising from the interplay of insolvency law and trust principles revealing potential challenges and opportunities. It offers practical guidance for navigating this evolving landscape while emphasising the careful consideration of trustees' fiduciary duties.

Keywords

Corporate insolvency; Cross-border insolvency; EU law; Insolvency practitioners; Pre-pack administrations; Trustees' liability; Trustees' powers and duties

Introduction

Insolvency law provides a complicated and challenging arena, particularly in the context of cross-border transactions. An integral part of this landscape is the role of insolvency practitioners, often identified as trustees in bankruptcy under insolvency legislation. Unlike their counterparts in express trusts, insolvency practitioners are tasked with a specific set of responsibilities that emanates from insolvency laws. These include the collection and distribution of assets from an insolvent estate, a critical role distinctly different from that of trustees in other contexts. The liabilities faced by insolvency practitioners are equally unique. They could face claims from creditors for mismanaging estate assets, potential tax liabilities, and other claims resulting from failing to fulfil their statutory duties correctly during insolvency.

The EU has put forward a proposed directive on the harmonisation of insolvency law, recognising the complications arising from disparate insolvency laws across its Member States.[1] This proposal marks an ambitious endeavour by the EU to standardise business law across its Member States, with the ultimate goal of establishing a harmonised and efficient marketplace in the EU. The proposed directive in focus aims to make cross-border insolvency proceedings more manageable, offering a reliable framework for insolvency practitioners, creditors and debtors.

The purpose of this article is to shed light on the unique role of insolvency practitioners when dealing with cross-border insolvencies, paying particular attention to the EU's upcoming directive aimed at unifying insolvency law. The proposed directive will be scrutinised, and its potential effects on insolvency practitioners will be critically analysed. In doing so, this discourse will uncover potential hurdles and opportunities, thereby providing actionable advice for those navigating these shifts.

The role of trusts and trustees in cross-border insolvencies

Insolvency practitioners are integral players in cross-border insolvencies, dealing with the intricacies of disparate insolvency laws, regulations and procedures across jurisdictions.[2] Their remit, often complicated by the cross-border nature of insolvency proceedings, includes the management and resolution of the debtor's assets, wherever they might be located, and ensuring these assets are distributed to creditors in line with the jurisdiction's rules governing the proceedings.

The United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Cross-Border Insolvency in 1997, which helps establish processes in international insolvency cases.[3] While it might not be a regular task, insolvency practitioners occasionally may have the responsibility of determining the debtor's centre of main interest (COMI) under this model.[4] They may also have to deal with non-main proceedings where the debtor has a commercial establishment.[5] The Model Law emphasises assistance ***J.I.B.L.R. 388*** from courts, rather than the government, to bankruptcy authorities from other countries and strives to ensure fair treatment between local and international creditors.[6]

The role of insolvency practitioners becomes even more demanding when faced with differing legal frameworks in international cases. For example, the cross-border insolvency framework in India relies on bilateral treaties with foreign

countries.[7] Negotiating such treaties can be lengthy, leading to uncertainty and complications for trustees and courts. Furthermore, when the assets of a debtor are located in a country without a bilateral agreement, trustees often lack guidance on available remedies.

The United Nations Model Law on Cross-Border Insolvency provides a framework for dealing with such cross-border insolvency cases.[8] It grants foreign insolvency professionals and creditors direct access to domestic courts and enables them to participate in and initiate proceedings against a debtor.[9] The Model Law plays a critical role in bridging the gaps between different jurisdictions by fostering cooperation and collaboration between domestic and international courts and insolvency practitioners.[10]

Given their critical involvement in cross-border insolvency proceedings, insolvency practitioners must be acutely aware of the implications of the forthcoming directive intended to harmonise aspects of insolvency law. Such a proposed directive aims for greater consistency, enhanced cross-border cooperation and improved efficiency and transparency. As these changes loom, a deeper exploration of the potential impacts on practitioners operating within the EU and other jurisdictions is imperative. This exploration must also offer practical guidance for these transitions and consider the possible effects on the landscape of trust law under the proposed directive.

The implications of the EU's proposed insolvency law harmonisation directive on insolvency proceedings and trusts

On 7 December 2022, the European Commission proposed a directive to harmonise insolvency laws across the EU. It focuses on three main aspects: augmenting asset recovery, improving insolvency proceedings' effectiveness, and ensuring equitable distribution of reclaimed assets among creditors. The proposed directive outlines six key proposals. The first establishes regulations on avoidance actions during insolvency, enabling companies to regain assets from undervalued, intentionally detrimental, fraudulent, or displayed creditor preference transactions. Depending on the nature and intent of the action, varied hardening periods from three months to four years are suggested. In countries like France, this could extend the existing lookback period, creating potential legal complexity.

The second proposal bolsters asset tracing by allowing insolvency practitioners to access beneficial ownership data and providing insolvency courts with bank account information, thereby enhancing international asset tracing and recovery. It is important to note here that insolvency practitioners, sometimes referred to as trustees in bankruptcy, hold personal liability for the assets of the insolvent estate and are entitled to an indemnity from these assets. This information would facilitate their efforts in reclaiming assets to meet their obligations, especially when the insolvent estate is insufficient.

The proposed directive proposes a new framework for pre-pack proceedings. This allows for the negotiation of a sale of the debtor's business prior to the start of insolvency proceedings, with implementation shortly after insolvency proceedings begin. It is critical for trustees to understand this process as it could have implications for their responsibilities and strategies during insolvency proceedings.

In a notable shift, the proposed directive requires directors to initiate insolvency proceedings within three months of identifying the company's insolvency. Insolvency can be determined by either a balance sheet test or a cash flow test. In the balance sheet test, insolvency is indicated if the total liabilities exceed the total assets. The cash flow test, on the other hand, evaluates if the company is unable to pay its debts as they come due. This consideration is particularly significant for companies held in trust with substantial soft borrowings that cannot be repaid. Directors could face personal liability for damages in case of non-compliance. Insolvency practitioners, often termed trustees in bankruptcy, must be cognizant of this requirement, given their distinct role and the potential implications for the insolvency proceedings.

The final two proposals pertain to simplified winding-up proceedings for micro-enterprises and establishing creditors' committees to boost transparency and provide a structured platform for creditors to express their concerns and interests.

While the direct implications of the proposed directive on trusts and insolvency practitioners are not entirely clear, several potential effects warrant attention. As insolvency practitioners hold personal liability in their role under insolvency legislation, instances of their own insolvency might compel them to recover assets to fulfil their indemnity. It is crucial to highlight that, unlike a corporation, a trust is not a legal entity, which could introduce complexities in insolvency proceedings. This proposed directive could notably alter the responsibilities of insolvency practitioners, particularly when trust assets ***J.I.B.L.R. 389*** are insufficient to meet the practitioners' indemnity. In these circumstances, the practitioners retain personal liability, which could bring about new challenges during insolvency procedures. This circumstance is unique to the insolvency practitioners due to the nature of their roles and responsibilities and is different from corporate insolvency where the insolvency risks are borne by the corporate entity and not by individuals.

Furthermore, the proposed directive introduces a mandatory requirement to file for insolvency within a three-month period from the onset of insolvency. However, the directive does not clearly specify the criteria for determining the state of insolvency, leaving room for ambiguity and potential challenges. The means by which insolvency is determined is a critical detail that requires clarification. It is essential to ascertain whether the test for insolvency is based on a cash flow evaluation, which assesses whether the entity has enough liquid assets to meet its current liabilities, or a balance sheet evaluation, which considers whether the entity's total assets surpass its total liabilities. The choice between these two approaches could substantially influence the application of the three-month filing rule. For instance, a cash flow evaluation might lead to earlier detection of insolvency situations, while a balance sheet evaluation could potentially delay the filing until the entity's assets are insufficient to cover its debts. Therefore, it is crucial that this aspect of the proposed directive be clarified in order to ensure its effective and fair implementation.

In the global context, individual jurisdictions might experience varied impacts due to their unique legal structures. For instance, art.32 of the Trusts (Jersey) Law 1984 has resulted in cases involving insolvent trusts in Jersey, the most high-profile being the recent Privy Council decision in the *Re Z Trusts* case.[11] These specific legal contexts and their resulting impacts on insolvency proceedings need to be carefully accounted for when assessing the implications of any directive. Also, the newly implemented Corporate Transparency Act (CTA) in the US, along with its proposed regulations on beneficial ownership reporting, could carry implications for foreign trusts. The CTA mandates that certain entities, including trusts with significant interests in US companies, provide beneficial ownership information to the Financial Crimes Enforcement Network. Failure to provide accurate information could lead to criminal penalties, thus introducing additional considerations for insolvency practitioners in the context of insolvency.

Challenges and opportunities arising from the directive for trusts and insolvency practitioners

Among the challenges, the proposed directive introduces an obligation for directors to initiate insolvency proceedings within three months of recognising insolvency. While insolvency practitioners are not directors per se, they might also serve as directors in some cases, and this requirement could add a layer of personal liability if they fail to comply. This necessitates insolvency practitioners to monitor closely the financial status of the entities where they hold directorial roles.

Furthermore, the proposed directive's objective to standardise asset recovery, procedural efficiency and distribution of recovered assets among creditors can complicate the role of insolvency practitioners. Particularly in cross-border situations, insolvency practitioners would need to familiarise themselves with and navigate these harmonised rules and procedures. The introduction of three grounds for transaction avoidance could affect insolvency practitioners, as it could influence their oversight of transactions and the management of assets, especially when dealing with an insolvent company.

However, the directive also opens up opportunities. By harmonising insolvency laws across the EU, insolvency practitioners operating across different EU jurisdictions might find this beneficial. The directive's provisions improving access to beneficial ownership information and bank account details could assist insolvency practitioners in asset tracing and recovery during insolvency proceedings. Moreover, the proposed directive introduces a new regime permitting the negotiation of a debtor's business sale before insolvency proceedings. This could enable insolvency practitioners to manage and dispose of assets more effectively when insolvency is on the horizon.

Practical guidance for trustees navigating the changing landscape

This section offers practical guidance to assist insolvency practitioners in managing these changes that will be brought by the proposed directive. First, insolvency practitioners must fully acquaint themselves with the specifics of the proposed directive and its potential implications. Insolvency practitioners must consider how these changes might affect the management of insolvent estates and any associated liabilities.

Insolvency practitioners should note that the proposed directive's requirement for directors to initiate insolvency proceedings within three months of insolvency could lead to a rise in the number of insolvency cases. Importantly, the proposed directive does not specify the test for insolvency—whether it is cash flow or balance sheet insolvency. This ambiguity can be an issue for insolvent estates held in trust with lots of soft borrowings which cannot be repaid. Hence, insolvency practitioners should seek further clarification on this matter.

As mentioned above, the proposed directive also introduces the concept of pre-pack proceedings. This may require insolvency practitioners to act swiftly to ensure efficient and lawful management of the insolvent estates. It is recommended that insolvency practitioners undertake ***J.I.B.L.R. 390*** training to understand the full implications of the proposed directive. Given its focus on asset recovery and distribution, insolvency practitioners should also seek training in areas such as asset tracing and understanding the rules governing transaction avoidance. Such training will help insolvency practitioners manage

the debtor's assets effectively and navigate any liability issues.

Cross-border cooperation is emphasised in the proposed directive. It is beneficial for insolvency practitioners to foster strong relationships with their counterparts in other Member States. Understanding how they interpret and apply the proposed directive can provide invaluable insights and aid in handling cross-border insolvency issues.

Monitoring the evolution of the directive will allow insolvency practitioners to adjust their strategies accordingly and manage their responsibilities effectively. In the context of insolvent estates, where insolvency practitioners must navigate complex financial circumstances, the proposed directive presents new complexities. Insolvency practitioners must focus on understanding these changes and adopting a proactive approach to manage their potential impact effectively.

Future outlook of trust law in the EU

The proposed directive does not directly reshape trust law, as trusts are not considered legal entities that can become insolvent. Instead, insolvency practitioners themselves are liable for the obligations of the insolvent estates they are managing, with the estate assets serving as resources for asset distribution among creditors. Thus, where an estate lacks sufficient assets to meet these obligations, the insolvency practitioner may face challenges in discharging their duties. This is a critical distinction and reframes how we understand the directive's impact on trusts and insolvency practitioners. Rather than viewing trusts as entities prone to insolvency, we should focus on the proposed directive's potential effect on the management of trust assets, insolvency practitioners' obligations and cross-border cooperation.

The proposed directive emphasises cross-border cooperation and introduces measures that increase focus on asset tracing and recovery. By broadening insolvency practitioners' access to beneficial ownership information and granting insolvency courts access to bank account data, the directive aims to enhance efficiency and asset distribution among creditors. This focus on asset recovery underscores the role of insolvency practitioners in managing insolvent estates effectively, particularly in a cross-border context. Insolvency practitioners should anticipate more interactions and collaborations with their counterparts in other Member States, underscoring the need to build strong networks within the EU insolvency practitioner community.

The proposed directive's thrust towards greater efficiency and transparency introduces measures that directly impact directors of insolvent companies. One such measure is the requirement for directors to initiate insolvency proceedings within three months of discovering the company's insolvency. Failure to comply can result in personal liability for damages. While this requirement does not directly apply to insolvency practitioners, it indicates an accelerated pace for insolvency proceedings, which insolvency practitioners must be prepared to handle.

The proposed directive also aims to bolster transparency for creditors, with measures providing better access to asset registers and enhancing transparency for creditors. While this does not directly affect insolvency practitioners, it does underline the importance of insolvency practitioners being transparent in their dealings with creditors and other stakeholders.

Furthermore, the proposed directive requires an understanding of the tests for insolvency which have not been detailed. These tests usually fall under two main categories: cash flow insolvency and balance sheet insolvency. The directive's requirement to file for insolvency within three months hinges on these insolvency tests. However, the particular test that would trigger this requirement within the context of the proposed directive should be clarified.

As the proposed directive undergoes the legislative process, it may be amended before being adopted by the EU Parliament and Council, and the Member States will then be required to implement it, usually within a period of two years. Consequently, insolvency practitioners should remain proactive in their planning and strategy development. They should work closely with legal advisers to understand the full implications of the proposed directive and adjust their strategies accordingly. The proposed directive signals a future marked by greater harmonisation, improved cross-border cooperation, increased efficiency and transparency. While the implications of the proposed directive for specific Member States still need to be fully clarified, as these will depend on existing national laws and the final form of the proposed directive, insolvency practitioners should remain alert and adaptable to these changes to uphold their responsibilities effectively.

Conclusion

In conclusion, the proposed directive signals a new era for insolvency proceedings in the EU marked by greater harmonisation, efficiency and transparency. This changing landscape demands a more dynamic role for insolvency practitioners. Armed with a thorough understanding of their duties, potential liabilities and the directive's international implications, proactive insolvency practitioners will be better positioned to navigate this new terrain and fulfil their responsibilities effectively. While the intricacies of this evolving landscape present undeniable challenges for insolvency

practitioners, they also afford opportunities for stronger insolvency resolution and wider cooperation. Through meticulous planning, active engagement and adaptability, insolvency ***J.I.B.L.R. 391*** practitioners can ensure they are primed to navigate these changes and continue to perform their roles with proficiency and effectiveness.

Charles Ho Wang Mak

Footnotes

1 European Commission, Proposal for a Directive of the European Parliament and of the Council on the harmonisation of certain aspects of insolvency law COM(2022) 702 final. For the discussion of the challenges and progress of harmonising insolvency law in the EU, particularly in light of the COVID-19 pandemic, see Emilie Ghio, Gert-Jan Boon, David Ehmke, Jennifer Gant, Line Langkjaer and Eugenio Vaccari, "Harmonising insolvency law in the EU: New thoughts on old ideas in the wake of the COVID-19 pandemic" (2021) 30(3) International Insolvency Review 427.

2 For further reading on cross-border insolvency issues in a trust context, see *Lynton Tucker, Nicholas Le Poidevin and James Brightwell, Lewin on Trusts, 20th edn (Sweet & Maxwell, 2023)*.

3 UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997).

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6 UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997).

7 For further reading on the challenges and opportunities regarding the cross-border system in the Insolvency and Bankruptcy Code in India, see Das Ishita, "The Need for Implementing a Cross-Border Insolvency Regime within the Insolvency and Bankruptcy Code, 2016" (2020) 45(2) Vikalpa: The Journal for Decision Makers 104.

8 UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997).

9 UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997).

10 UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997).

11 *Re Z Trusts [2018] J.R.C. 119*.