

Company Directors' and Supervisors' Liabilities to Creditors : Centering on the Zone of Financial Difficulties

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Abstract

The core of this paper is to analyze directors' and supervisors' liabilities to creditors when a company is on the verge of insolvency. Taiwan's Civil Code (Article 35) imposes a compulsory insolvency filing obligation on corporate directors. As a result, when a company is unable to pay its debts and its directors do not act immediately to file the insolvency application, creditors are entitled to sue those directors for the shortfall between the amount originally available to be distributed to them (at the time of filing the application for insolvency) and the amount finally paid based on the insolvency procedure.

By contrast, the U.K. and some commonwealth countries adopt a different approach to dealing with the same situation. Directors are not obliged to file an application for insolvency when the company is on the verge of insolvency. Instead, if directors knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation, yet did not take every step to minimize the potential loss to corporate creditors, then those directors will be liable. Thus, wrongful trading and fraudulent transactions constitute the framework of the creditor protection. The directors are trusted to make a good faith decision.

Accordingly, the way creditors exercise their rights to claim damages from directors is also different. Under the compulsory insolvency filing system, creditors have personal cause to take action against directors. However, based on wrongful trading, creditors may only seek compensation from directors via liquidators. This reveals the nature of the directors'

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fiduciary duties, i.e., to whom they owe the duties, and to what extent the duties should be performed.

Taiwan's new Insolvency Law is in its final stages. In viewing the draft, we see the shadow of wrongful trading together with quite a few misunderstandings of foreign laws, and thus some theoretical contradictions among the Civil Code, the Company Law and the draft Insolvency Law are quite apparent. This paper intends to solve this problem and concludes with suggestions for legislation. It suggests that we should abolish the obligation imposed by the Civil Code and then restructure the fiduciary duties of directors and supervisors towards creditors when the company is facing financial difficulties. From that, the British legislation can certainly provide some insights.

Keywords: wrongful trading, fraudulent trading, insolvency, financial difficulties, reorganization, insolvent liquidation, director, compulsory insolvency filing, supervisor, cash-flow test, balance sheet test, direct duty