

Applicable Law for Liability Claims in Insolvency Proceedings: Directors' Duties of Care and Pre-Insolvency Obligations

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Abstract: *This paper examines the determination of applicable law for liability claims in pre-insolvency proceedings. It analyses the boundary between the company law statute (lex societatis) and the insolvency statute (lex concursus), with particular emphasis on directors' liability for breach of the duty of care and on pre-insolvency obligations. Building on the case law of the Court of Justice of the European Union, the paper highlights the material approach to conflict-of-law qualification. Further attention is devoted to the duty to file for insolvency, the shift of loyalty from shareholders to creditors, and the risks of forum shopping. A solution may lie in the minimal harmonization of selected rules at the EU level, or alternatively through clearer guidance in national conflict-of-law norms.*

Keywords: *applicable law, directors' liability, duty of care, insolvency law.*

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1. INTRODUCTION

International jurisdiction in proceedings related to insolvency is primarily determined in EU law by Article 6 of Regulation (EU) 2015/848¹. This provision, interpreted in the light of Recital 35, embodies the principle of *vis attractiva concursus*, actions which derive directly from insolvency proceedings and are closely connected with them must be heard by the courts of the Member State

¹ Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast). OJ L 141, 5.6.2015, pp. 19–72(hereinafter EIR).

where the insolvency proceedings have been opened. The purpose is to concentrate disputes with an insolvency core before one court while simultaneously excluding any gaps between the European Insolvency Regulation (EIR) and the Brussels I bis² Regulation, which otherwise governs jurisdiction in civil and commercial matters.³

The demarcation between the EIR and Brussels I bis regulations is autonomous and functional. The decisive criterion is not the procedural context but the legal basis of the claim.⁴ This approach follows the case law of the Court of Justice of the EU (CJEU)⁵ based on the Gourdain doctrine,⁶ according to which Article 6 EIR applies to claims whose rights and obligations are specifically governed by insolvency law and whose precondition is the existence of insolvency or a direct insolvency context. The claims arising under general civil or commercial law fall under the Brussels I bis regime. The close connection test is reinforced by the aim of avoiding inconsistent judgments in separate proceedings, and is also supported by case law on related actions.

For the assessment of the applicable law, it is therefore essential to determine whether pre-insolvency proceedings fall within the scope of the EIR or not. If they do, the existing case law will apply. If such pre-insolvency proceedings are not listed in Annex A EIR the applicable law will have to be solved separately.

If pre-insolvency proceedings are deemed to fall under the EIR Annex A, the established framework of Article 6 EIR will apply. In this case, many claims are covered by Article 6 EIR, including exclusion actions, avoidance actions, actions for supplementing the estate by directors where insolvency is a prerequisite, actions seeking a declaration that certain assets belong to secondary insolvency proceedings, and sanctions for failure to file for insolvency in due time.⁷ By contrast, contractual performance claims arising from contracts concluded before insolvency, tort claims with a different purpose e.g., unfair competition, actions

² Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast). OJ L 351, 20.12.2012, pp. 1–32 (hereinafter Brussels I bis).

³ BĚLOHLÁVEK, J. Alexander. *Evropské a mezinárodní insolvenční právo: komentář. Nařízení Evropského parlamentu a Rady 2015/848 o insolvenčním řízení*. 1. vydání. Praha: C. H. Beck, 2020, p. 311. Also, GARCIMARTIN, Francisco. *Insolvency-related judgments and Vis Attractiva Concursus: The EU Approach. Insolvency Intelligence*, 2018(1). Available from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3221102.

⁴ BORK Reinhard, VAN ZWIETEN, K. (eds.) Kristin. *Commentary on the European Insolvency Regulation*, Oxford: OUP 2016 p. 204. Also, GARCIMARTIN, *op. cit.*, p. 4.

⁵ Compare the judgments of the CJEU in cases C-649/13 *Comité d'entreprise de Nortel Networks* of 11 June 2015, C-157/13 *Nickel & Goeldner Spedition* of 4 September 2014, and C-386/05 *Color Drack GmbH v Lexx International Vertriebs GmbH* of 3 May 2007.

⁶ See the judgment of the CJEU in case C-133/78 *Gourdain Nadler* of 22 February 1979.

⁷ See the judgment of the CJEU in case C – 47/18 *Skarb Państwa Rzeczypospolitej Polskiej – Generalny Dyrektor Dróg Krajowych i Autostrad* of 18 September 2019. See also the judgment of the CJEU in case C-296/17 *Wiemer & Trachte* of 14 November 2018. and in case C- 157/13, *Nickel & Goeldner Spedition* of 4. September 2014.

brought after the closure of insolvency proceedings, and claims following assignment usually fall under Brussels I bis regulation.⁸ On the other hand, the administrator may bring both claims before the courts of the defendant's domicile under Brussels I bis regulation. This balances the concentration of insolvency matters with the requirements of procedural efficiency and the avoidance of contradictory judgments.⁹

Scholarly writing highlights the cost and predictability implications of applying *lex fori concursus* for the debtor's contractual partners and creditors — shifting jurisdiction to the insolvency court and the application of foreign law may increase transaction costs and undermine contractual autonomy.¹⁰ Critical literature Madaus, Wessels¹¹ stresses the inconsistency in applying Article 6 EIR to borderline cases. The CJEU, however, emphasises that the EIR and Brussels I bis regulations must be interpreted to avoid overlaps and legal vacuums, thereby establishing their mutual exclusivity.

In the case of pre-insolvency proceedings, the question arises whether such proceedings fall within the scope of Annex A of the EIR. In these cases, the absence of inclusion in Annex A raises significant uncertainty and the jurisdiction must then be determined under the Brussels I bis regulation or, in certain instances, through national conflict-of-law rules. This gap creates the risk of inconsistent classifications across Member States and highlights the pressing need for further scholarly analysis and, potentially, targeted harmonisation.

On the basis of above mentioned theory and judicature, the article aims to examine the applicable law to liability claims in pre-insolvency proceedings focusing on directors' Duties of Care.

This article employs an analytical and comparative methodology. The analysis is based primarily on the interpretation of EU secondary law, in particular the Insolvency EIR, Rome II Regulation and the Brussels I bis Regulation, and on the case law of the CJEU.

2. APPLICABLE LAW IN PRE-INSOLVENCY PROCEEDING

The issue of jurisdiction in liability claims against directors in the context of insolvency remains unsettled in EU law. While the insolvency courts of the center of main interest (COMI) state have exclusive jurisdiction under Article 6 EIR for actions directly derived from insolvency proceedings, questions arise as

⁸ See the judgement of the CJEU in case C-296/17 *Wiemer & Trachte* of 14 November 2018 or case C-98/06 *Freepport plc v. Olle Arnoldsson* of 11 October 2007.

⁹ OMAR Paul J. The Insolvency Exception in the Brussels Convention and the definition of „Analogous Proceedings“. *International Company and Commercial Law Review*, 2011(5), p. 175.

¹⁰ GARCIMARTIN, *op. cit.*

¹¹ MADAUS, Stephan, WESSELS, Bob. *Report on identifying annex actions under Article 6(1) of the European Insolvency Regulation*, Conference on European Restructuring and Insolvency Law, 2015, pp. 4-23.

to whether other liability claims should fall within the competence of the courts of the state of incorporation or the COMI courts (*lex concursus*).¹² The CJEU has consistently favoured a material approach, examining the legal basis of the claim which it set in *Kornhaas*¹³ and held that liability for the late filing of an insolvency petition is governed by *lex concursus*, while in *H v. HK*¹⁴ it accepted that a foreign director may be sued before the COMI courts once insolvency has materialised. So the boundaries of the insolvency statute are defined both positively (*lex fori concursus*) and negatively, by the company statute and contractual statute.¹⁵

In practice, this may lead to the parallel application of the Brussels I bis regulation or even the Lugano II Convention, the interpretation of which follows the CJEU's case law on Brussels I bis regulation. Such overlaps allow multiple actions and create scope for forum shopping, as directors may seek jurisdictions with more lenient liability standards, for example longer deadlines to file for insolvency.¹⁶

The diversity of national regimes makes it difficult for directors to identify their obligations, particularly in the pre-insolvency phase and once insolvency has occurred. Duties arise under both company law including duty of care and loyalty and insolvency law including duty to file an insolvency petition, prohibitions on detrimental transactions, and their scope changes over time.

The determination of the applicable law is contingent upon both the legal nature of the pre-insolvency proceeding and the specific question of liability at stake. From the perspective of insolvency law, the *lex fori concursus* requires an assessment of whether the proceeding falls within the scope of Annex A of the EIR. If it does, the applicable law will be governed accordingly under the framework of the EIR. If it does not, further classification will be necessary to establish whether the proceeding is to be regarded as commercial in nature or as a restructuring process. A subsequent consideration concerns the type of liability in question and whether such liability is intrinsically linked to the conduct of insolvency proceedings, for instance the filing of an insolvency petition, or whether it arises

¹² GERNER-BEUERLE, Carsten, SIEMS, Mathias. The Private International Law of Companies in Germany in BEUERLE, G.C., MUCCIARELLI, F., SCHUSTER, E. SIEMS, M.(eds)., The Private International Law of Companies in Europe, Munich and Oxford: C.H. Beck/Nomos/Hart Publishing, 2019, p. 394 Also BĚLOHLÁVEK J. Alexander. Odpovědnost členů statutárních orgánů korporací v případě insolvenčních řízení s mezinárodním prvkem. *Bulletin advokacie* 7-8, 2015, p.17.

¹³ See the judgment of the CJEU in case C-594/14 *Simona Kornhaas v. Thomasu Dithmarovi* of 10 December 2015.

¹⁴ See the judgment of the CJEU in case C-295/13, *H v. H.K* of 4 December 2014.

¹⁵ Compare SCHMIDT, Jessica. Preventive restructuring frameworks: Jurisdiction, recognition and applicable law. *International Insolvency Review*. 2021, p. 5. Available from <https://doi.org/10.1002/iir.1447>.

¹⁶ KOKORIN, Ilya. Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices In: LAZIĆ, V. – STUIJ, S. (eds.) *Recasting the Insolvency Regulation Improvements and Missed Opportunities*. The Hague: T.M.C. Asser Press, 2020, p. 27.

independently thereof.

3. APPLICABLE LAW FOR LIABILITY CLAIMS IN PRE-INSOLVENCY

Havel¹⁷ points out that in the pre-insolvency phase the liability of the statutory body undergoes a shift, moving increasingly in favour of creditors. This is reflected in the fact that, in addition to the general duty of care of a prudent manager, directors are compelled to safeguard the interests of creditors. The difficulty, however, lies in the absence of sufficient incentives from the shareholders, whose interests may diverge from those of the creditors. The principle of entrepreneurial professionalism is closely linked to the principle of prevention, not merely in the general sense of *neminem laedere*, but as a requirement of active and skilled performance. The duties and liability of directors fall within company law. Directors are expected to engage only in projects with proportionate risks, since otherwise they risk losing both expected returns and invested capital.¹⁸ Under normal circumstances, a prosperous company does not endanger creditors. However, once the company's equity is exhausted, shareholders may push for riskier strategies to salvage their investment, which can conflict with the interests of creditors. In times of financial distress, creditor interests should therefore prevail over shareholder interests, although the choice between high-risk and low-risk strategies remains problematic.¹⁹ Liability for breaches of the duties of care and loyalty likewise falls under *lex societatis*, as do more specific rules of liability, such as those concerning false disclosures upon incorporation.

Moreover, Schmidt²⁰, in the context of pre-restructuring proceedings, argues that preventive restructuring should be characterised as a commercial agreement, thereby falling within the ambit of *lex societatis*. Such an interpretation appears persuasive, insofar as the proceeding is not expressly included in Annex A of the EIR.

The determination of applicable law for liability claims requires distinguishing whether *lex societatis* (the internal corporate regime) or *lex concursus* (the insolvency statute threw the concept of *vis attractiva concursus*) applies.

Pursuant to Article 7 EIR, *lex concursus* governs also preconditions for

¹⁷ HAVEL Bohumil, *Správa korporace při hrozbě úpadku (sanační schémata a posuny standardů péče a loajality) in HAVEL, B. Fiduciární povinnosti orgánů společnosti na pomezí korporálního, insolvenčního a trestního práva*. Praha: Wolters Kluwer 2020, p. 155.

¹⁸ SPINDLER Gerald. Trading in the Vicinity of Insolvency, *European Business Organization Law Review* 2006(7), p. 339. Compare: HERTIG, Gerard, KANDA, Hideki. Creditor Protection, in KRAAKMAN, Reiner et al. *The Anatomy of Corporate Law. A Comparative and Functional Approach*. Oxford: Oxford University Press, 2004, p. 73.

¹⁹ LICHT Amir N. My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency *Working Paper Nr. 551/2020*, 2021. Available from http://ssrn.com/abstract_id=3680768.

²⁰ SCHMIDT, *op. cit.*, p. 5.

opening insolvency proceedings and their effects, according to CJEU case law. This situation also arises after the opening of pre-restructuring proceedings, the company's seat is transferred to another Member State. In such a case, the *lex concursus* remains that of the Member State in which the proceedings were originally opened. This principle has been confirmed by the CJEU in *Galapagos*²¹ which held that a subsequent transfer of the debtor's COMI after lodging the request for the opening of proceedings does not affect the jurisdiction already established under the EIR. It is possible to assume, that pre-insolvency proceeding may settle also COMI for insolvency proceedings.

On the other hand, it is important to investigate, whether the breach of directors' duties, and the annulment of resolutions by shareholders are related to the pre-insolvency or insolvency. In this situation a question arises whether this liability falls within the scope of *lex societatis* or *lex concursus*. The interpretation should follow the principle that insolvency law applies if it deviates from the general rules of civil and commercial law and applies only from a specific triggering moment, defined with regard to the financial situation of the company.²²

On the other hand, the fiduciary nature of directors' duties requires distinguishing between ordinary business judgment, protected by the business judgment rule, and reckless decision-making that jeopardises creditors once financial distress becomes apparent. This functional shift from entrepreneurial freedom to stewardship obligations reflects the dual role of directors as agents of shareholders in normal times and as custodians of creditors' interests in crisis situations. Unfortunately, given the fragmentation of national regimes (particularly in the pre-insolvency phase), borderline cases and risks of overlap or gaps arise, which must be addressed through proper conflict-of-law qualification. In practice, the choice is therefore between *lex societatis*, *lex fori concursus*, and, where relevant, *lex loci delicti*, with correct qualification determining the applicable law.

The boundary between *lex societatis* and *lex fori concursus* is set in Annex A of the EIR. In the case that pre-insolvency proceeding is not included, then it should be decided on the nature of restructuring measures and their connection to law.²³

For completeness it is important to examine also *lex loci delicti* and boundaries between *lex societatis* and *lex concursus*. A breach of duty that does not arise from company law, insolvency law, contractual obligations, or fiduciary duties should be characterised as a non-contractual obligation, to which the Rome II Regulation²⁴ would apply.

²¹ See the judgment of the CJEU in case C-723/2020 *Galapagos BidCo. S.a.r.l. v DE and Others* of 24 March 2022.

²² MUCCIARELLI, Federico M., Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension *European Business Organization Law Review*, 2013(14), p. 175.

²³ See the judgment of the CJEU in case C-47/14 *Holterman Ferho Exploitatie BV and Others v. F.L.F. Spiess von Büllesheim* of 10 September 2015.

²⁴ Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on

With respect to the injured party, the damage may be suffered either by the company itself or by a third party, which must be clearly defined. *Lex loci delicti* governs harm caused to third parties, whereas *lex societatis* governs reflective loss suffered by the company. The key issue is therefore who qualifies as a third party — this may include shareholders, who can suffer losses in the value of their shares, or creditors standing outside the company.

For classification purposes, reference must be made to the Rome II and Brussels I bis regulations. Article 1(2)(d) of the Rome II regulation excludes from its scope non-contractual obligations arising out of company law, including the personal liability of directors and members for the company's obligations. The Brussels I bis regulation, in Article 7(2), confers jurisdiction on the courts of the place where the harmful event occurred or may occur. The rationale for excluding corporate matters from this regime lies in the inseparability of liability from the corporate forms governed by company law, where responsibility arising from the operation of the company should primarily fall under *lex societatis*.

A particularly contentious issue is the liability of shareholders for damage caused to the company, especially where such liability involves intentional conduct contrary to good morals, for instance when a shareholder gives unlawful instructions to a director or acts as a director themselves.

4. CONCLUSION

From a theoretical perspective, there is a clear and sharp distinction between a corporation as a functioning business and the situation in the vicinity of insolvency.²⁵ In the ordinary course of business, the business judgment rule applies, whereas in the pre-insolvency phase conduct must be shifted in favor of creditors.²⁶ Members of the management body should therefore refrain from overly risky projects, even if such projects might be consistent with the goal of saving the company.²⁷

The pre-insolvency shift of directors' duties towards creditors, with its implications for insolvency creditors, also affects the choice of conflict-of-law rules, as the matter increasingly acquires the character of an insolvency issue. Also, there is a risk that the EU Member State where the debtor's COMI is located may classify a legal concept differently for the purposes of private international law and insolvency law than the state of incorporation. This may lead to negative

the law applicable to non-contractual obligations (Rome II). OJ L 199, 31.7.2007, pp. 40–49.

²⁵ SPINDLER, *op. cit.*, p. 339.

²⁶ EIDENMÜLLER, Horst. Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers. *European Business Organization Law Review*, 2006(7), pp. 239-258.

²⁷ KOKORIN, Ilya. The future of harmonisation of directors' duties in the European Union: The Preventive Restructuring Directive and Group Insolvencies. *International Insolvency Review*, 2021, 30(3): 361-382.

or positive conflicts in determining jurisdiction, which could either relieve directors of liability or duplicate applicable liability norms. Such problems may persist in borderline cases, even if criteria for distinguishing between *lex societatis* and *lex fori concursus* or *lex loci delicti* are applied. A particularly contentious issue is the liability of shareholders for damage caused to the company, especially where such liability involves intentional conduct contrary to good morals, for instance when a shareholder gives unlawful instructions to a director or acts as a director themselves is based on criterion of *lex loci delicti*.

In other cases, however, it will be necessary to assess whether *lex societatis* or *lex concursus* applies. Where pre-insolvency proceedings fall under the scope of the EIR, or where the matter qualifies as “closely connected” within the meaning of Article 6 EIR, *lex concursus* will govern. If pre-insolvency proceedings do not fall within the EIR, jurisdiction must instead be determined under the Brussels I bis regulation. It must not be overlooked that breaches of the duty of care may still fall within the ambit of corporate law and thus *lex societatis*. In light of the case law mentioned, one decisive factor will be the impact of liability on potential insolvency creditors: where creditors are directly affected, the matter should be regarded as falling within *lex concursus*.

Furthermore, EU Member States may also apply legal norms that differ in their approach to directors’ liability. While conflicts arising in the pre-insolvency stage are often governed by a combination of company law and insolvency law, once formal proceedings are opened, insolvency law instruments tend to prevail. EU Member States may nevertheless place varying emphasis on one or the other approach, leading to further inconsistencies.

Given these uncertainties and divergences among the EU Member States, minimum harmonisation of selected rules — or at least convergence in the scope of conflict-of-law norms — together with a clearer delineation between *lex societatis*, *lex concursus*, and *lex loci delicti* appears to be the most rational way forward in pre-insolvency proceeding.

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