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Insolvency law in times of COVID-19

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Ibero-American Institute for Law and Finance

Working Paper 2/2020

Insolvency Law in Times of COVID-19

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[2] The current version of this article includes references to the insolvency reform implemented in Belgium, Peru and Poland, the second package of insolvency reforms adopted in Colombia and Spain, the reform approved in India on 6 June 2020 and the UK Corporate Insolvency and Governance Bill 2019-2020. Therefore, it mentions insolvency reforms suggested and/or implemented in Australia, Belgium, Colombia, Czech Republic, France, Germany, Luxembourg, India, New Zealand, Peru, Poland, Portugal, Russia, Singapore, Spain, the United Kingdom, and the United States. Previous versions of this article were published on 2 April 2020, mentioning the reforms announced in Singapore, India and the United Kingdom, and on 18 April 2020, including references to the reforms implemented and/or suggested in Singapore, New Zealand, Czech Republic, Colombia, Russia, Italy and Luxembourg. The first draft of this article, with a more limited scope in terms of jurisdictions covered in the paper, was published on 27 March 2020.

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Abstract

The international spread of the coronavirus is not only generating dramatic consequences from a social perspective but it is also heavily affecting the global economy. For this reason, governments, financial regulators and international organizations are responding to the coronavirus with a package of legal, economic and financial measures. Among the legal responses included in these packages, many countries, such as Australia, Belgium, Colombia, Czech Republic, France, Germany, Luxembourg, India, Italy, New Zealand, Peru, Poland, Portugal, Russia, Singapore, Spain, the United Kingdom, and the United States, have proposed or implemented temporary changes to their insolvency frameworks. This paper starts by discussing whether using the insolvency system should be the optimal solution to deal with companies affected by the coronavirus. For that purpose, it will analyze the role and limits of insolvency law. It then discusses the most relevant insolvency reforms taking place around the world as a response to the global pandemic, as well as other insolvency and insolvency-related reforms that could be implemented to minimize the harmful economic effects of COVID-19. The paper will conclude by arguing that, even though these measures can provide companies and corporate directors with a valuable breathing space, these reforms need to be accompanied by a more comprehensive package of legal, financial, tax and economic responses.

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1. Introduction

The international spread of the coronavirus ("COVID-19") is not only generating dramatic consequences from a social perspective but it is also heavily affecting the global economy. For this reason, Governments, financial regulators and international organizations are responding with a package of legal, economic and financial measures.[3] Even though these responses differ across jurisdictions, they can be classified into three main categories: (i) those protecting consumers and employees affected by the closure of companies and layoffs; (ii) those protecting self-employed workers and companies against the economic losses and liquidity needs generated by the COVID-19 crisis; and (iii) those measures seeking to protect the stability of the financial system as a consequence of the lack of confidence and the number of defaults likely arising in the following months.[4]

While addressing these fundamental problems require a comprehensive package of legal, financial and economic reforms, this article focuses on the insolvency and insolvency-related reforms that have been (or could be) implemented as a response to the COVID-19 outbreak. Even though some of the measures suggested in this paper will apply to both individuals and corporations, this article emphasizes the role that insolvency law can play (if so) in assisting *companies* facing financial trouble as a result of COVID-19.

2. The power and limits of insolvency law in times of COVID-19

Insolvency law provides a variety of mechanisms to minimize the destruction of value generated in a situation of financial distress.[5] First, when debtors are unable to pay their debts, creditors become entitled to enforce their claims and ultimately seize the debtor's assets. Therefore, their individual enforcement actions may end up destroying the going concern value of economically viable companies. For this reason, insolvency law responds by imposing a moratorium or automatic stay that will stop creditors from enforcing their claims while forcing them to act in a more coordinated manner.[6] Thus, the use of a moratorium not only preserves value for the debtor but it can also promote a more efficient strategy by the creditors.

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[3] For an overview of the policy responses adopted by national legislators, see https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19 and https://som.yale.edu/faculty-research-centers/centers-initiatives/program-on-financial-stability/covid-19-crisis. For an analysis of the responses implemented by financial regulators and supervisors, see https://www.iif.com/covid-19 and Nydia Remolina, *Financial Regulators' Responses to COVID/19*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE, WORKING PAPER 1/2020 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3554557).

[4] See Aurelio Gurrea-Martínez, *Disolución de sociedades y concurso de acreedores en tiempos del coronavirus*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE BLOG, 15 March 2020 (available at https://www.derechoyfinanzas.org/disolucion-de-sociedades-y-concurso-de-acreedores-en-tiempos-del-coronavirus/).

[5] According to some studies, the costs of financial distress represent 10-20% of the market value of the firm. See Gregor Andrade and Steven N. Kaplan, *How Costly Is Financial (not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed*, 53 JOURNAL OF FINANCE 1443 (1998). In liquidations, however, these costs can even be higher. See Julian Franks and Oren Sussman, *Financial Distress and Bank Restructuring of Small to Medium Size UK Companies*, 9 REVIEW OF FINANCE 65 (2005), reporting that, at least in the context of small and medium size companies in the United Kingdom, insolvency liquidations subtract 20% to 40% of the company´s proceeds.

[6] In the absence of this moratorium, creditors would be incentivized to start a 'race to collect' that may end up destroying the going concern value potentially existing in the insolvent firm, in addition to increasing collection costs for the creditors. See Thomas H. Jackson, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (Harvard University Press, 1986), pp. 16-17.

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Second, the existence of a situation of insolvency may incentivize key employees to abandon the firm. Similarly, suppliers and lenders might decide to terminate their business relations with the debtor if they know their claims face the risk of going unpaid. Therefore, as these circumstances can also destroy value, insolvency law helps minimize these costs by providing various regulatory responses. Among others, insolvency law generally allows post-petition claimants to obtain a priority for their new claims, usually in the form of administrative expenses.[7] Likewise, other solutions to deal with these problems may include the restriction of *ipso facto* clauses and the availability of rescue (or DIP) financing.[8]

Third, debtors facing financial trouble may have incentives to engage in a series of opportunistic behaviors that can destroy or opportunistically transfer value at the expense of creditors. These opportunistic behaviors may include the transfer of assets to related parties, borrowing money in an irresponsible manner and investing in risky projects as a last attempt to rescue the firm.[9] In order to solve these problems, insolvency law provides several mechanisms, including avoidance actions and, in some jurisdictions, special duties and liabilities for directors of financially distressed firms. Likewise, once the debtor is subject to the bankruptcy procedure, most jurisdictions around the world also require the appointment of an insolvency practitioner to manage or supervise the debtor. By doing so, the risk of engaging in opportunistic behaviors will be notably reduced. Therefore, insolvency law can provide once again a valuable response to preserve or restore value.

Finally, insolvency law provides viable but financially distressed companies with powerful tools to facilitate a debt restructuring. Hence, they can emerge from bankruptcy with a new financial structure. This goal is achieved through several mechanisms. First, insolvency law provides an adequate forum for negotiation.[10] Second, insolvency law provides several tools that can help facilitate the renegotiation of the debtor's financial commitments. These tools include the possibility that a majority (or qualified majority) of creditors may impose a decision on dissenting minority creditors[11] and, in some jurisdictions, even the possibility that a reorganization plan can be imposed on dissenting *classes* of creditors.[12] By providing these tools, insolvency law avoids holdout problems,

[7] This solution exists in many jurisdictions around the world.
[8] The insolvency responses exist in various jurisdictions (e.g., Singapore and the United States).
[9] John Armour, Gerard Hertig, and Hideki Kanda, *Transactions with Creditors*, in John Armour, Luca Enriques et al, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Oxford: OUP, 2017), at 111.
[10] This forum involves many aspects, including the existence of reliable third parties (e.g., judges, insolvency practitioners), the imposition of certain disclosure requirements to avoid inefficient decisions as a result of asymmetries of information, and the availability of various tools to protect the debtor's assets while the company is reorganized.
[11] This solution is adopted in most (if not all) insolvency jurisdictions around the world, since it is one of the primary features of an insolvency proceeding compared to a workout. See José María Garrido, OUT-OF-COURT DEBT RESTRUCTURING (World Bank Studies 2012), pp. 12, 39, 43-44, 48-49.
[12] The possibility of imposing a plan on dissenting classes of creditors, usually known as 'cramdown' or 'cross-class cramdown', is generally subject to certain conditions, and it is a solution existing in various jurisdictions around the world, including the United States and Singapore. It has also been proposed in the United Kingdom and it was adopted in the European Directive for Preventive Restructuring Frameworks. See Aurelio Gurrea-Martínez, *The Future of Reorganization Procedures in the Era of Pre-Insolvency Law*, EUROPEAN BUSINESS ORGANIZATION LAW REVIEW (Forthcoming, 2020) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3290366).

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encourages *ex ante* bargaining, reduces negotiation costs, and ultimately facilitates the financial restructuring of economically viable companies unable to pay debts.[13]

Based on the previous arguments, it seems that insolvency law can indeed serve as a powerful tool to protect financially distressed debtors affected by COVID-19.[14] On the one hand, it would help them preserve value. On the other hand, it would facilitate the renegotiation of their debts. For this reason, suspending the debtor's right to initiate an insolvency proceeding, as India has done,[15] does not seem a desirable policy. In fact, some authors have even argued that insolvency law is not the problem but the solution,[16] especially for large companies.[17]

However, the bankruptcy system still has some limitations. First, the use of insolvency proceedings can be particularly costly for many small and medium size enterprises.[18] Second, even if insolvency law allows financially distressed debtors to emerge from bankruptcy with a new capital structure, the debtor might still need liquidity to initiate

[13] See Aurelio Gurrea-Martínez, *supra* note 12.

[14] For an analysis of the concept of financial distress, how this concept differs from 'economic distress', and why non-viable (or *economically* distressed) firms should be liquidated and viable companies just facing a problem of financial distress should be reorganized, see Michelle J. White, *The Corporate Bankruptcy Decision*, 3 (2) JOURNAL OF ECONOMIC PERSPECTIVES 129 (1989); Michelle J. White, *Does Chapter 11 Save Economically Inefficient Firms*? 72 WASHINGTON UNIVERSITY LAW QUARTERLY 1319 (1994); Michelle, J. White, *Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganization and Out-of-Court Debt Restructuring*, 10 (2) JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION 268, 269-274 (1994); Douglas G. Baird, *The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of Financially Distressed Firms*, CHICAGO WORKING PAPER IN LAW & ECONOMICS NO 43 (1997), pp. 9-10; John Armour, *The law and economics of corporate insolvency*, ESRC CENTRE FOR BUSINESS RESEARCH UNIVERSITY OF CAMBRIDGE, WORKING PAPER 197 (2001), p. 4; Alan Schwartz, *A Normative Theory of Corporate Bankruptcy*, 91 VIRGINIA LAW REVIEW 1199, 1200-1201 (2005).

[15] See the Insolvency and Bankruptcy Code (Amendment) Ordinance 2020 enacted on 5 June 2020 (available at https://ibbi.gov.in/uploads/legalframwork/741059f0d8777f311ec76332ced1e9cf.pdf). For an overview of the Indian insolvency reforms in times of COVID-19, see Anchal Jindal, *IBC (Amendment) Ordinance 2020: Straddling Between Manoeuvre and Ambivalence*, 6 June 2020, available at https://ibclaw.in/ibc-amendment-ordinance2020-straddling-between-manoeuvre-and-ambivalence-by-cs-anchal-jindal/. For some critical assessments of the reform, see Ritin Rai, *Fear of Flattening the Business Curve*, The Economic Times, 8 June 2020, available at https://economictimes.indiatimes.com/news/economy/policy/fear-of-flattening-the-business-curve/articleshow/76249430.cms; Anirudh Wadhwa, *Not the Best Solution for Insolvencies,* The Economic Times, 17 May 2020, available at https://economictimes.indiatimes.com/blogs/et-commentary/not-the-best-solution-for-insolvencies/; Akshaya Kamalnath, *Another reason why suspension of filings under the IBC is a bad idea*, 3 June 2020 (available at https://corporatelawacademic.wordpress.com/2020/06/03/another-reason-why-suspension-of-filings-under-the-ibc-is-a-bad-idea/

[16] Jared A. Ellias and George Triantis, *Congress is ignoring the best solution for troubled companies: bankruptcy*, Fortune, 15 May 2020, available at https://fortune.com/2020/05/14/bankruptcy-cares-act-aid-coronavirus/.

[17] Arguing that the insolvency system can make airlines stay in business without using taxpayers' money, see Richard Squire, *US Airlines don't need a bailout to stay in business*, WASHINGTON POST, 22 March 2020 (available at https://www.washingtonpost.com/opinions/2020/03/22/us-airlines-dont-need-bailout-stay-business/). For an analysis of the dilemma between bailing out companies or letting them fail in the current situation, some authors have argued that, instead of bailing out companies, the Government should bailout first the vulnerable people potentially affected by the company's closure (*e.g.*, employees). Otherwise, public money would be used to bailout some actors, such as shareholders, that voluntarily decided to take a risk when making an investment decision. Therefore, apart from being unfair bailing out these actors instead of more vulnerable citizens, it can also create moral hazard. See https://promarket.org/economics-and-finance-professors-from-major-universities-write-to-congress-bail-out-people-before-large-corporations/. For the discussion on bailouts versus bankruptcy, see Kenneth Ayotte and David Skeel, *Bankruptcy or Bailout?* 35 JOURNAL OF CORPORATION LAW 469 (2010), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1362639; Anthony Casey, *Large Corporations Did Not Need A Bailout*, The CLS Blue Sky Blog, 14 April 2020, available at https://clsbluesky.law.columbia.edu/2020/04/14/large-corporations-did-not-need-a-bailout/

[18] Edward R. Morrison and Andrea C. Saavedra, *Bankruptcy's Role in the COVID-19 Crisis* (Columbia Law School, 2020), p. 6-7, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3567127).

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and manage the bankruptcy process.[19] Third, the bankruptcy system may not have the capacity needed to handle the wave of insolvency cases generated by the COVID-19 crisis.[20] Fourth, many countries, particularly emerging economies, might not have an efficient insolvency framework in place.[21] Thus, overwhelming the judicial with a wave of insolvency cases generated by the COVID-19 crisis can exacerbate the inefficiencies of these insolvency systems. Therefore, while insolvency can provide a valuable solution for many debtors and creditors affected by COVID-19, it has some limitations, especially in emerging economies.[22] For this reason, as it will be mentioned in section 3.4.1, the adoption of restructuring tools outside of formal insolvency proceedings can be a desirable solution, especially in countries with inefficient insolvency frameworks.

3. Insolvency and insolvency-related reforms to minimize the harmful economic effects of the coronavirus

3.1. Introduction

Due to the limitations of insolvency law described in section 2, some adjustments to the insolvency legislation might be needed in times of COVID-19.[23] These adjustments are discussed in section 3.3. Other responses to facilitate financial restructurings in times of COVID-19 will be discussed in section 3.4. Before getting the details of these reforms, however, section 3.2 discusses the appropriate scope of the insolvency and insolvency-related responses implemented in times of COVID-19. Finally, it should be kept in mind that, while insolvency law can be helpful, it is not the panacea. Therefore, the adoption of insolvency and insolvency-related responses should be accompanied by a comprehensive package of legal and economic reforms. These reforms will be discussed in section 4.

3.2. Scope of the reforms

In my view, the insolvency and insolvency-related reforms implemented in times of COVID-19 should be subject to two limitations. First, unlike the approach followed in some jurisdictions,[24] only companies whose financial situation have deteriorated as a result of the coronavirus should be able to use these exceptional remedies.[25] Otherwise, these reforms might be opportunistically used by companies that do not deserve the extraordinary departure from the general law provided by these measures. Nonetheless,

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[19] This point has been mentioned by Kenneth Ayotte and David Skeel in a fantastic article about the role and limits of bankruptcy law in times of COVID-19. See https://www.wsj.com/articles/bankruptcy-law-needs-a-boost-for-coronavirus-11585608800.

[20] See Ayotte and Skeel *supra* note 19.

[21] Aurelio Gurrea-Martinez*, Insolvency Law in Emerging Markets*, Ibero-American Institute for Law and Finance, Working Paper 3/2020, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606395

[22] For an analysis of the insolvency challenges in times of COVID-19, see Antonia Menezes and Sergio Muro, *COVID-19 Outbreak: Implications on Corporate and Individual Insolvency* http://pubdocs.worldbank.org/en/912121588018942884/COVID-19-Outbreak-Implications-on-Corporate-and-Individual-Insolvency.pdf; David Skeel, *Bankruptcy and the coronavirus*, Brookings Economic Studies (April, 2020), https://www.brookings.edu/research/bankruptcy-and-the-coronavirus/

[23] For an overview of the insolvency reforms taking place around the world, see Aurelio Gurrea-Martinez, Simon Brodie and Pooja Mahajan, *Global Guide: Measures Adopted to Support Businesses Through the Covid-19 Crisis: Report*, World Bank and INSOL, April, 2020 (available at https://www.worldbank.org/en/topic/financialsector/brief/finance-and-covid-19-coronavirus).

[24] For example, Spain and Australia. See section 3.3 below. In Spain, however, recent insolvency-related reforms, including the possibility of enjoying a moratorium, has been adopted for some 'eligible debtors'.

[25] This approach has been followed by other jurisdictions, including Germany, Singapore, Russia, and New Zealand. See section 3.3 below.

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due to the difficulties associated with identifying which companies have been affected by the pandemic, I argue that, as a default rule, all companies should enjoy the benefits of the reform. However, if it is shown that the company was already insolvent before the COVID-19 outbreak, or a company does not need the insolvency or insolvency-related measures implemented in the package of reforms, these debtors should be prevented from using this emergency legislation. In order to encourage this outcome, some sanctions can even be imposed to debtors opportunistically using these exceptional rules. Second, these measures should also be subject to temporal limitations (*e.g.*, six months) that can then be revised based on the evolution of COVID-19 in a particular country.

3.3. Insolvency law in times of COVID-19

Corporate insolvency law in the time of COVID-19 should be adjusted in several ways. First, legislators should suspend the duty to file for bankruptcy in countries where, as it happens in many European jurisdictions, corporate directors are required to initiate insolvency proceedings once a company becomes insolvent.[26] This policy recommendation, that was suggested in the early debates on the impact of COVID-19 on insolvency law,[27] has been recently implemented in various jurisdictions, including Germany,[28] France,[29] Spain,[30] Luxembourg[31], Poland,[32] Portugal[33], Russia,[34] and the

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[26] See Aurelio Gurrea-Martínez, *Directors' Duties of Financially Distressed Companies in the Time of COVID-19,* OXFORD BUSINESS LAW BLOG, 24 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/directors-duties-financially-distressed-companies-time-covid-19); Catarina Serra, COVID-19 Para uma legislação para a crise das empresas e a prevenção da insolvência (2020) (available at https://media-exp1.licdn.com/dms/document/C561FAQGuGyN6MawSbw/feedshare-document-pdf-analyzed/0?e=1587204000&v=beta&t=7A0veKuquudZKHrdqD8oyCSnWID6i1cmgDWcBVfugIQ); Bob Wessels and Stephan Madaus (chairs), *CERIL Executive Statement on COVID-19 and insolvency legislation*, 20 March 2020 (available at https://www.ceril.eu/uploads/files/2020-03-20-ceril-executive-statement-on-covid-19-and-insolvency-legislation.pdf). Analyzing the desirability of this rule, see Thomas Bachner, *Wrongful Trading – A New European Model for Creditor Protection?* 5 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 293 (2004); Paul Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, 7 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 301 (2006); Aurelio Gurrea-Martinez, *Los deberes y la responsabilidad de los administradores en situaciones de insolvencia: Una perspectiva economica y comparada*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE BLOG, 5 September 2017 (available at https://www.derechoyfinanzas.org/los-deberes-y-la-responsabilidad-de-los-administradores-en-situaciones-de-insolvencia-una-perspectiva-economica-y-comparada/).

[27] See Aurelio Gurrea-Martínez, *Disolución de sociedades y concurso de acreedores en tiempos del coronavirus*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE BLOG, 15 March 2020 (available at https://www.derechoyfinanzas.org/disolucion-de-sociedades-y-concurso-de-acreedores-en-tiempos-del-coronavirus/); Wessels Bob Wessels and Stephan Madaus (chairs), *CERIL Executive Statement on COVID-19 and insolvency legislation*, 20 March 2020 (available at https://www.ceril.eu/uploads/files/2020-03-20-ceril-executive-statement-on-covid-19-and-insolvency-legislation.pdf).

[28] The German reform can be found at https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/Corona-Pandemie.pdf?__blob=publicationFile&v=3

[29] See Ordinance No 2020-341 and Ordinance No 2020-596 indirectly suspending the duty to file for bankruptcy for companies becoming cash-flow insolvent between 12 March 2020 and 24 August 2020, since they will not technically be deemed 'cash-flow insolvent' for the purpose of the obligation to initiate insolvency proceedings within 45 days.

[30] In Spain, this reform was implemented in the first package of insolvency responses. However, the suspension of the duty to file for bankruptcy only lasted until the end of the state of emergency. See article 43.1 of the Royal Decree 8/2020 (available at https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf). In the second package of insolvency reforms, the suspension of this duty has been extended until 31 December 2020. See article 11.1 of the Royal Decree 16/2020 (available at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4705).

[31] See Grand Ducal Regulation of 25 March 2020.

[32] See Act of 16 April 2020 on Special Support Measures in response to the SARS-CoV-2 Outbreak.

[33] Law n.º 4-A/20201, amending Law n.º 1-A/20202.

[34] See Order of the Government of the Russian Federation of 3 April 2020 No. 428 about introduction of the moratorium on initiation of proceedings about bankruptcy according to the statement of creditors concerning

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Czech Republic.[35] It should be noted, however, that while countries like Germany have decided to suspend the duty to file for bankruptcy for a reasonable period of time,[36] other jurisdictions initially decided to suspend this duty until the end of the state of emergency[37]. In my opinion, the suspension of the duty to file for bankruptcy should last long enough to let companies recover from the effects of the COVID-19 crisis. Therefore, the German response seems more desirable than those implemented in jurisdictions just suspending this duty during the state of emergency.[38]

Second, several jurisdictions around the world, particularly in Continental Europe and Latin America, require corporate directors to promote the recapitalization, liquidation or bankruptcy of the company whenever, due to the existence of losses, the firm's net assets fall below a certain percentage of the company's legal capital.[39] In fact, in some countries (*e.g.*, Spain), the directors can even be personally liable for the company's new debts if they fail to promote the recapitalization, liquidation or bankruptcy within two months after the company's net assets fall below 50% of the company's legal capital.[40] As I suggested in an earlier piece about corporate and insolvency law in times of COVID-19, this duty to recapitalize or liquidate companies in situations of qualified losses should also be temporarily suspended.[41] In the past weeks, various countries around the world,

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certain debtors (as amended of the Order of the Government of the Russian Federation of 22.05.2020 No. 729), available at https://cis-legislation.com/document.fwx?rgn=124300.

[35] See the Lex Covid-19, effective from 24 April 2020.

[36] Namely, the duty to file for bankruptcy has been suspended in Germany until 30 September 2020 (with the possibility of extending it until 31 March 2021). See https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/Corona-Pandemie.pdf?__blob=publicationFile&v=3

[37] An example of these jurisdictions is Spain in its first package of insolvency reforms. See article 43 of the Royal Decree 8/2020 (available at https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf). In the second package of insolvency reforms, however, the suspension of this duty has been extended until 31 December 2020. See article 11.1 of the Royal Decree 16/2020 (available at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4705).

[38] Aurelio Gurrea-Martínez, *Directors' Duties of Financially Distressed Companies in the Time of COVID-19,* OXFORD BUSINESS LAW BLOG, 24 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/directors-duties-financially-distressed-companies-time-covid-19).

[39] Countries with a 'recapitalize or liquidation' rule include Argentina, Colombia, Ecuador, France, Italy, Mexico, Spain, Sweden and Uruguay. In Argentina, see article 94.5 and 96 of the Law 19550. In Colombia, see article 34 of Law 1248 of 2008 and article 24 of the Law 1429 of 2010. In Ecuador, see articles 361.6 of the Companies Act. In France, see L225-248 of the Commercial Code. In Italy, see articles 2447 and 2448.4 of the Civil Code. In Mexico, see article 229.5 of the Companies Act. In Spain, see article 363.1.e) of the Companies Act. In Sweden, see Chapter 15, sections 13-16, of the Companies Act. In Uruguay, see articles 159.6 and 160 and of the Companies Act.

[40] Aurelio Gurrea-Martínez, *Directors' Duties of Financially Distressed Companies in the Time of COVID-19,* OXFORD BUSINESS LAW BLOG, 24 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/directors-duties-financially-distressed-companies-time-covid-19).

[41] Aurelio Gurrea-Martínez, *Disolución de sociedades y concurso de acreedores en tiempos del coronavirus*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE BLOG, 15 March 2020 (available at https://www.derechoyfinanzas.org/disolucion-de-sociedades-y-concurso-de-acreedores-en-tiempos-del-coronavirus/). Aurelio Gurrea-Martínez, *Directors' Duties of Financially Distressed Companies in the Time of COVID-19,* OXFORD BUSINESS LAW BLOG, 24 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/directors-duties-financially-distressed-companies-time-covid-19). If this rule is controversial in normal times, it may become particularly harmful in times of COVID-19. Analyzing the desirability of this rule in normal times, see Luca Enriques and Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL LAW REVIEW 1165 (2001).

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including Spain,[42] Italy[43] and Colombia,[44] have decided to temporarily suspend or at least relax the liquidate or recapitalize rule. In my opinion, unlike other reforms suggested in this article, the suspension of this rule should last for one or two years, since most of the losses borne by companies during the toughest part of the COVID-19 crisis will only be reflected in the balance-sheet prepared in 2021. For this reason, the reform recently adopted in Colombia, that suspends the recapitalize or liquidate rule for 24 months, seems more desirable than those implemented in other jurisdictions.

Third, legislators should also suspend creditors' rights to file involuntary bankruptcy petitions, as it has been adopted in various jurisdictions, including Belgium,[45] India,[46] Spain,[47] Italy,[48] Russia,[49] and the Czech Republic.[50] Other jurisdictions, however, such as Australia[51] and Singapore,[52] have opted for restricting, rather than prohibiting, the

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[42] Spain initially decided to suspend the recapitalize or liquidate rule during the state of emergency. See articles 40.11 and 40.12 of the Royal Decree 8/2020 (available at https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf). In a second package of reforms, however, it has only relaxed this rule. Nonetheless, it also extends its temporal application, since it covers losses incurred in 2020. See article 18 of the Royal Decree 16/2020 (available at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4705).

[43] See article 6 of the Decree 23/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/04/08/20G00043/s) and Law 40/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/06/06/20G00060/sg).

[44] See article 15.3 of the Decree 560/2020, 15 April 2020, available at https://www.supersociedades.gov.co/nuestra_entidad/normatividad/normatividad_decretos/DECRETO_560_DEL_15_DE_ABRIL_DE_2020.pdf

[45] Under the Royal Decree n°15 adopted by the Belgian Government on 24 April 2020, companies cannot be declared in bankruptcy unless the debtor consents or the petition is initiated by the public prosecutor or the administrator appointed by the president of the Enterprise Court. See Kathy Stones, *INSOL Europe/LexisNexis coronavirus (COVID-19) Tracker of Insolvency Reforms-Belgium*, available at https://www.lexisnexis.co.uk/blog/restructuring-and-insolvency/insol-europe-lexisnexis-coronavirus-(covid-19)-tracker-of-insolvency-reforms-belgium.

[46] India, following the Australian approach, initially restricted creditors' rights to initiate insolvency proceedings. However, the Insolvency and Bankruptcy Code (Amendment) Ordinance 2020 enacted on 5 June 2020 has suspended the ability of debtors and creditors to initiate insolvency proceedings resulting from any default arising during the COVID-19 crisis. For an overview of the Indian insolvency reforms in times of COVID-19, see Anchal Jindal, *IBC (Amendment) Ordinance 2020: Straddling Between Manoeuvre and Ambivalence,* 6 June 2020, available at https://ibclaw.in/ibc-amendment-ordinance2020-straddling-between-manoeuvre-and-ambivalence-by-cs-anchal-jindal/.

[47] In Spain, this reform was implemented in the first package of insolvency responses. However, it just lasted until the end of the state of emergency. See article 43.1 of the Royal Decree 8/2020 (available at https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf). In the second package of insolvency reforms, this suspension has been extended until 31 December 2020. See article 11.2 of the Royal Decree 16/2020 (available at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4705).

[48] See article 10 of the Decree 23/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/04/08/20G00043/s) and Law 40/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/06/06/20G00060/sg). For an overview of the Italian reform, see Daniele Vattermoli, *Pandemic and Insolvency Law: the Italian Answer*, Oxford Business Law Blog, 14 May 2020, available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/05/pandemic-and-insolvency-law-italian-answer.

[49] See https://www.mondaq.com/russianfederation/insolvencybankruptcy/930202/the-russian-government-introduces-a-moratorium-on-bankruptcy

[50] Analyzing this reform in the Czech Republic, see https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/04/Client%20Briefing%20-%20Czech%20Law%20measures%20Insolvency%20law%20(EN).pdf

[51] In Australia, the Government has temporarily increased the current minimum threshold for creditors issuing a statutory demand on a company under the Corporations Act 2001 from A$2,000 (US$ 1,227.46) to A$20,000 (12,227.46). This will apply for six months. See https://treasury.gov.au/sites/default/files/2020-03/Fact_sheet-Providing_temporary_relief_for_financially_distressed_businesses.pdf.

[52] In Singapore, the Covid-19 Act increases, in the context of corporate debtors, the monetary threshold for insolvency from S$10,000 to S$100,000, and it will extend the statutory period to respond to demands from creditors from 3 weeks to 6 months. Likewise, it also providers eligible debtors materially affected by COVID-19 with a type of moratorium against the initiation of involuntary insolvency petitions.

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initiation of insolvency proceedings by creditors. In my view, the Australian response does not seem very effective in protecting businesses affected by the COVID-19 crisis, since creditors can easily start an insolvency petition due to the low quantitative threshold required to do so (A$20,000). In Singapore, however, while the solution is not the formal suspension of creditors' rights to file involuntary petitions, the Covid-19 (Temporary Measures) Act increases the threshold from S$10,000 to $100,000 and it extends the statutory period to respond to demands from creditors from 3 weeks to 6 months.[53] Besides, if an eligible debtor is materially affected by COVID-19 and asks for temporary relief from its contractual obligations, certain counterparties cannot initiate insolvency proceedings against the debtor.[54] Therefore, this notification for relief acts as a moratorium against the commencement of insolvency proceedings against eligible debtors materially affected by COVID-19.

In the absence of an actual or a *de facto* suspension of the right to file involuntary bankruptcy petitions, creditors will have the ability to force debtors to bear the direct and indirect costs associated with a procedure that, in the absence of COVID-19, would not even be needed.[55] Besides, depending on the jurisdiction, corporate directors can be exposed to several consequences such as being removed from the company's management to disqualifications and even special liability rules. In my view, while an insolvency proceeding can be helpful for many debtors affected by COVID-19, the decision to use the insolvency system should be made by the debtor. However, if it were shown that the debtor's state of insolvency was not generated by COVID-19 (for instance, because it was already insolvent before the outbreak), this exceptional legislation should not apply. Therefore, creditors should have the ability to put the debtor into bankruptcy under the general requirements existing in the pre-COVID-19 insolvency framework.

Fourth, in countries where secured creditors are allowed to lift the automatic stay due to the lack of adequate protection,[56] insolvency law should temporarily be reformed to prevent this possibility in the context of economically *viable* companies that, as a result of COVID-19, have decided to file for bankruptcy. In my opinion, while providing adequate protection is economically justified in normal times, it is very unlikely that a financially distressed company affected by the COVID-19 crisis will be able to provide adequate protection. And if so, secured creditors would be allowed to seize their collateral even if this action destroys the going concern value of an economically viable company facing financial trouble due to COVID-19. For this reason, in times of COVID-19, the automatic stay should not be lifted unless it is shown that: (i) prior to the COVID-19 outbreak, the company was not economically viable; or (ii) the asset affected by the security interest is not necessary for an effective reorganization.

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[53] COVID-19 (Temporary Measures) Act 2020 ss 22(1) and 24(1).
[54] COVID-19 (Temporary Measures) Act 2020 s 5(2).
[55] These costs can be very significant. See Jerold B. Warner, *Bankruptcy Costs: Some Evidence*, 32 JOURNAL OF FINANCE 337 (1977), showing that the direct costs of bankruptcy were 3% to 4 % of the pre-bankruptcy market value of total assets in large firms. These figures are relatively consistent with Lawrence A. Weiss, BANKRUPTCY RESOLUTION: DIRECT COSTS AND VIOLATION OF PRIORITY OF CLAIMS, 27 JOURNAL OF FINANCIAL ECONOMICS 285 (1990). However, in Gregor Andrade and Steven N. Kaplan, *How Costly Is Financial (not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed*, 53 JOURNAL OF FINANCE 1443 (1998), the authors show the costs of financial distress represents 10-20% of the market value of the firm. These costs, however, seem to be higher in the United Kingdom, at least for small firms. See Julian Franks and Oren Sussman, *Financial Distress and Bank Restructuring of Small to Medium Size UK Companies*, 9 REVIEW OF FINANCE 65 (2005), reporting that insolvency liquidations subtract 20% to 40% of the company´s proceeds in the context of small and medium size enterprises.
[56] For example, the United States. See 11 U.S. Code §362(d)(1).

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Fifth, in countries with a system of rescue or (DIP) financing,[57] courts should adopt a more permissive approach when assessing the possibility of using these provisions, even if the authorization of rescue financing affects pre-existing rights of secured creditors or administrative expense claimants.[58] In normal times, this authorization should only be given if: (i) the company is economically viable; (ii) the new funds are used for value-creating projects; and (iii) the creditors potentially affected by the super priority given to the new lenders are adequately protected. In other words, the rescue financing should be authorized if it is Pareto efficient.[59] However, in times of COVID-19, I do not think the third condition – that is, that adequate protection is provided– should be required for several reasons. First, while the absence of this latter requirement might not seem 'fair' for secured creditors, these exceptional moments require exceptional measures where redistribution might be justified in bankruptcy.[60] Second, it will be very unlikely that financially distressed debtors as a result of COVID-19 can provide adequate protection.[61] Third, if the secured creditor is a financial institution, the potential losses borne by this measure can be compensated through other financial reforms (e.g., relaxation of accounting rules and capital requirements). Therefore, the lender would not fully internalize the costs of this solution. Fourth, one of the economic justifications for requiring adequate protection is the preservation of pre-bankruptcy entitlements. If this goal is not achieved, insolvency law, from an *ex ante* perspective, can create uncertainty, and it can harm firms' access to debt finance. However, owing to the exceptional circumstances of the COVID-19 crisis, secured creditors should not have incentives to increase the cost of debt in the future since these types of pandemics are very rare events that should not affect their regular lending practices. Finally, it should be kept in mind that the super-priority for rescue financing should only be authorized if the new financing creates value for the creditors as a whole. Therefore, the affected creditor should not be

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[57] By a regime of 'rescue' or 'DIP' financing, this article means those regimes that allow courts to 'prime' existing liens or affect the rights of pre-existing administrative expense claimants in order to give a 'super priority' to new lenders providing financial resources to a company subject to an insolvency proceeding. This regime exists, for example, in the United States and Singapore. Likewise, it has recently been adopted by the European Directive on Preventive Restructuring Frameworks. Aurelio Gurrea-Martínez, *The Future of Reorganization Procedures in the Era of Pre-Insolvency Law*, EUROPEAN BUSINESS ORGANIZATION LAW REVIEW (Forthcoming, 2020) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3290366). Interestingly, some countries have implemented a regime of rescue financing as a response to the COVID-19 crisis. This innovative response has been implemented, for example, in Colombia. See article 5 Law Decree 560/2020, 15 April 2020, available at https://www.supersociedades.gov.co/nuestra_entidad/normatividad/normatividad_decretos/DECRETO_560_DEL_15_DE_ABRIL_DE_2020.pdf.

[58] The possibility of 'priming' existing liens or giving priority over administrative expense claimants is allowed, example, in Singapore and the United States.

[59] See Aurelio Gurrea-Martínez, *The Future of Reorganization Procedures in the Era of Pre-Insolvency Law*, EUROPEAN BUSINESS ORGANIZATION LAW REVIEW (Forthcoming, 2020) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3290366). For an analysis of the rationale and regulation of DIP financing in the United States, see George G. Triantis, *Theory of the Regulation of Debtor-in-Possession Financing*, 46 VANDERBILT LAW REVIEW 901 (1993); George G. Triantis, *Debtor-in-Possession Financing in Bankruptcy*, in Barry Adler (ed.), RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW (Elgar Publishing, 2018); George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 JOURNAL OF LEGAL STUDIES 225, 249-252 (1992); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO LAW REVIEW 1905 (2004); Richard Squire, CORPORATE BANKRUPTCY AND FINANCIAL REORGANIZATION (Wolters Kluwer, 2016), pp. 235-260; Barry E. Adler, Douglas G. Baird and Thomas H. Jackson, BANKRUPTCY: CASES, PROBLEMS AND MATERIALS, FOUNDATION PRESS (4th Edition, 2007), pp. 475-520.

[60] Whether insolvency law should redistribute or not in normal circumstances depends on the particular views on the objectives of insolvency law. For a summary of the debate, see Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 THE YALE LAW JOURNAL 573 (1998). In times of COVID-19, however, there might be more arguments to favor redistribution.

[61] Under US Bankruptcy law, for example, adequate protection can be provided through cash payments, an additional or replacement lien or indubitable equivalent. See 11 U.S. Code § 361.

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worse off. As a result of these factors, the requirement to provide adequate protection does not seem to be justified in times of COVID-19.

Sixth, countries without a simplified insolvency regime for micro and small companies should adopt some rules to facilitate the commencement and quick resolution of an insolvency proceeding for these companies.[62] Likewise, jurisdictions with simplified rules for small companies may consider the possibility of expanding the scope of these rules for medium-size enterprises, as it has been recently proposed in the United States.[63] Thus, more companies could temporarily benefit from the speed and lower costs associated with these proceedings.

Seventh, in several jurisdictions, particularly in Continental Europe and Latin America, shareholder loans are generally subordinated in bankruptcy.[64] If this rule is controversial in normal times,[65] it becomes more problematic in times of COVID-19, where many companies face liquidity problems. Therefore, countries subordinating shareholders loans

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[62] In its second package of insolvency responses to the COVID-19 crisis, Colombia has adopted new rules for micro and small companies. See https://www.supersociedades.gov.co/2020NormasEmergenciaCOVID/DECRETO-772-DEL-3-DE-JUNIO-DE-2020.pdf While not exclusively for small companies, Peru has also implemented a reform to simplify and reduce the timing of the commencement and duration of insolvency proceedings. See https://busquedas.elperuano.pe/normaslegales/aprueban-el-reglamento-del-decreto-legislativo-n-1511-decr-decreto-supremo-n-102-2020-pcm-1867439-1/. Before the COVID-19 crisis, the United States enacted the Small Business Reorganization Act of 2019 with the purpose of amending the US Chapter 11 to provide simplify insolvency rules for small companies. The existence of a simplified insolvency regime for small and medium size enterprises has been encouraged by various international organizations, including the World Bank and UNCITRAL. In fact, UNCITRAL is currently working on a text of simplified insolvency rules for small companies. See https://undocs.org/en/A/CN.9/WG.V/WP.170 The World Bank has also conducted extensive work in this space. See https://openknowledge.worldbank.org/handle/10986/26709 In the academic literature, proposing a 'modular approach' for the treatment of micro, small and medium enterprises in insolvency, see Riz Mokal, Ronald Davis, Alberto Mazzoni, Irit Mevorach, Madam Justice Barbara Romaine, Janis Sarra, Ignacio Tirado, and Stephan Madaus, MICRO, SMALL, AND MEDIUM ENTERPRISE INSOLVENCY: A MODULAR APPROACH (Oxford: OUP, 2018).

[63] In the United States, the CARES Act amends the Small Business Reorganization Act of 2019 and it increases the threshold from $2,725,625 of debt to $7,500,000. This threshold will return to $2,725,625 after one year, and it applies for small businesses filing for bankruptcy under the new subchapter V of chapter 11 of the U.S. Bankruptcy Code. See https://www.documentcloud.org/documents/6819239-FINAL-FINAL-CARES-ACT.html.

[64] Countries where, under certain circumstances, shareholder loans can be subordinated include Italy, Germany, Austria, Spain, Colombia, Chile, Uruguay, Brazil, Portugal and Mexico. Likewise, in some exceptional cases, this subordination can also take place in the United States under the 'equitable subordination doctrine'. For a comparative analysis of the treatment of shareholder loans in bankruptcy, see Juan Luis Goldenberg and Aurelio Gurrea-Martinez, *Reconocimiento y clasificacion de credito*s, in Aurelio Gurrea-Martinez and Adolfo Rouillon (eds.), FUNDAMENTOS DE DERECHO CONCURSAL (Forthcoming, 2021) (summary available at https://www.derechoyfinanzas.org/el-reconocimiento-y-clasificacion-de-creditos-en-los-procedimientos-concursales/). For a comparative analysis of the US and Europe, see David A. Skeel Jr. and Georg Krause-Vilmar, *Recharacterization and the Nonhindrance of Creditors*, 7 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 7, 259 (2006); Martin Gelter and Jürg Roth, *Subordination of Shareholder Loans from a Legal and Economic Perspective*, 5 JOURNAL FOR INSTITUTIONAL COMPARISONS 40 (2007).

[65] See David Skeel and Georg Krause-Vilmar, *Recharacterization and the Nonhindrance of Creditors*, 7 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 7, 259 (2006); Martin Gelter and Jürg Roth, *Subordination of Shareholder Loans from a Legal and Economic Perspective*, 5 JOURNAL FOR INSTITUTIONAL COMPARISONS 40 (2007)

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should suspend this provision, as adopted in Italy,[66] Germany[67], and Spain.[68] Otherwise, the existence of this subordination will discourage new financing from corporate insiders.

Eighth, insolvency legislators should suspend the running of the lookback period for avoidance actions during the COVID-19 crisis, especially in countries where the emergency legislation allows debtors to be protected from the involuntary commencement of insolvency proceedings.[69] If the running of the lookback period for avoidance actions is not suspended, the creditors can be harmed if some assets that the debtor opportunistically deviated *prior to* the COVID-19 crisis cannot be returned if the company eventually ends up in bankruptcy and the lookback period has already expired. Therefore, this mechanism seeks to protect creditors. However, the extension (or suspension) of the lookback period can also be beneficial for the debtor. Namely, since some market actors may want to opportunistically take advantage of the debtor's financial trouble during the COVID-19 crisis, the extension of the lookback period for avoidance actions will make sure that, even if the debtor ends up in bankruptcy once the pandemic is over, any harmful transaction entered into during the COVID-19 crisis can be reversed.[70]

Ninth, legislators should relax their system of liability of directors in the zone of insolvency, especially in jurisdictions where directors can be liable for trading while the company is factually insolvent. Therefore, the reforms implemented in Australia[71] and Singapore,[72] and recently announced in the United Kingdom[73], seem to provide a reasonable solution for the regulation and enforcement of directors' duties in the zone of insolvency in countries with wrongful trading provisions.

3.4. Insolvency-related reforms

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[66] See article 8 of the Decree 23/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/04/08/20G00043/s) and Law 40/2020 (available at https://www.gazzettaufficiale.it/eli/id/2020/06/06/20G00060/sg).

[67] See https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/03/coronavirus-german-insolvency-emergency-legislation.pdf.

[68] See article 12 of the Royal Decree 16/2020, available at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4705

[69] Similar reforms have been adopted in Singapore and Czech Republic. For Singapore, see COVID-19 (Temporary Measures) Act 2020 ss 5(9) and 5(10). See also Aurelio Gurrea-Martinez, *Global Guide: Measures Adopted to Support Businesses Through the Covid-19 Crisis: Singapore Chapter*, World Bank and INSOL, April, 2020 (available at https://www.worldbank.org/en/topic/financialsector/brief/finance-and-covid-19-coronavirus). For an overview of the reform in the Czech Republic, see https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/04/Client%20Briefing%20-%20Czech%20Law%20measures%20Insolvency%20law%20(EN).pdf. A similar reform has been implemented in Germany.

[70] The existence of avoidance actions not only seek to protect creditors but also debtors facing financial difficulties. See Aurelio Gurrea-Martinez, *The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach*, 93 CHICAGO-KENT LAW REVIEW 711 (2018).

[71] For a summary of the Australian reform, see https://treasury.gov.au/sites/default/files/2020-03/Fact_sheet-Providing_temporary_relief_for_financially_distressed_businesses.pdf. The Australian emergency legislation can be found at https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r6521_first-reps/toc_pdf/20044b01.pdf

[72] See COVID-19 (Temporary Measures) Act 2020 ss 22(2), 23(2), 24(2) and 25.

[73] See https://services.parliament.uk/bills/2019-21/corporateinsolvencyandgovernance.html Analyzing the desirability of suspending the liability of directors for wrongful trading, see Kristin Van Zwieten, *The Wrong Target? COVID-19 and the Wrongful Trading Rule*, OXFORD BUSINESS LAW BLOG, 25 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/wrong-target-covid-19-and-wrongful-trading-rule).

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In addition to the insolvency reforms suggested in the previous section, I think regulators should also implement other insolvency-related reforms as part of their package of emergency legislation. By 'insolvency-related reforms', this article refers to: (i) reforms consisting of a variety of 'insolvency tools' that could be exceptionally used *outside* of bankruptcy; and (ii) other reforms needed for a successful debt restructuring in or outside of bankruptcy.

3.4.1. Pre-insolvency tools and promotion of workouts

Due to the costs associated with insolvency proceedings, and the collapse of the judicial system potentially generated by a wave of corporate insolvencies, countries should implement a variety of pre-insolvency tools outside of bankruptcy. These tools should include at least a moratorium against legal actions and a prohibition to terminate contracts against debtors affected by COVID-19.[74] These pre-insolvency tools would perform several functions. Firstly, they can provide debtors with some of the protections generally existing in insolvency law without forcing them to bear the costs associated with filing for bankruptcy.[75] Secondly, the existence of these pre-insolvency mechanisms will reduce the number of companies using the formal insolvency framework. Therefore, the adoption of these tools can avoid the collapse of the judicial system. Finally, since creditors will be unable to terminate contracts or initiate enforcement actions against the debtors, they may have more incentives to negotiate. Hence, these pre-insolvency tools can facilitate workouts. In my opinion, while the adoption of this pre-insolvency framework is desirable for any economy heavily affected by the COVID-19 crisis, it will become

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[74] These tools have been implemented in several countries. For example, Singapore has provided a type of moratorium for debtors affected by the COVID-19 crisis. See COVID-19 (Temporary Measures) Act 2020 s 5(2). It should be noted, however, that these measures do not apply to all debtors, contracts and creditors. For the details of the Singapore reform, see Aurelio Gurrea-Martinez, *Global Guide: Measures Adopted to Support Businesses Through the Covid-19 Crisis: Singapore Chapter*, World Bank and INSOL, April, 2020 (available at https://www.worldbank.org/en/topic/financialsector/brief/finance-and-covid-19-coronavirus). The United Kingdom has proposed an amendment of its restructuring framework that seeks to implement some restructuring tools, including a moratorium, a cross-class cramdown, and a prohibition of *ipso facto* clauses. The details of reforms can be found at https://services.parliament.uk/bills/2019-21/corporateinsolvencyandgovernance.html While the UK reform was already planned before the COVID-19 outbreak, the current pandemic has probably accelerated the reform, and it has managed to include some temporary measures to respond to the COVID-19 crisis such as the suspension of liability directors for wrongful trading. Other jurisdictions providing some types of 'pre-insolvency tools' include Colombia, Belgium and New Zealand. For an analysis of the Belgian reform, see Stan Brijs, Sophie Jacmain and Arie Van Hoe*, Insolvency: Flattening the Insolvency Curve - The Belgian Statutory Moratorium* (available at https://www.nautadutilh.com/en/coronavirus/insolvency-flattening-the-insolvency-curve-the-belgian-statutory-moratorium). For an analysis of the Colombian reform, see Alvaro Pereira, *Flattening the Filing Curve for SMEs: Lessons from Colombia's Insolvency Reform*, Oxford Business Law, 30 April 2020, Blog, https://www.law.ox.ac.uk/business-law-blog/blog/2020/04/flattening-filing-curve-smes-lessons-colombias-insolvency-reform. For the system a 'hibernation of debts' implemented in New Zealand, that includes the adoption of some pre-insolvency tools, see http://www.legislation.govt.nz/bill/government/2020/0244/latest/whole.html. Analyzing the insolvency changes implemented in New Zealand, see Michael Murray, *New Zealand's COVID-19 insolvency measures – safe harbour; debt hibernation*, 3 April 2020, available at https://murrayslegal.com.au/blog/2020/04/03/new-zealands-covid-19-insolvency-measures-safe-harbour-debt-hibernation/; Akshaya Kamalnath, I*nsolvency Measures for Covid-19 in New Zealand - A Temporary DIP Model,* Oxford Business Law Blog, 26 May 2020, available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/05/insolvency-measures-covid-19-new-zealand-temporary-dip-model. Other jurisdictions providing

[75] See *supra* note 5.

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essential for emerging markets, due to the unattractiveness of their insolvency frameworks and the inefficiencies of their judicial systems.[76]

Likewise, countries should encourage companies to reach workouts.[77] In the context of small companies with concentrated debt structures, these workouts can be easier to achieve.[78] However, this option will be more unlikely in companies with dispersed debt structures, as it might be the case for companies with numerous bondholders. For this reason, as it has been proposed by Eidenmüller, Enriques, and Van Zwieten, countries should introduce emergency legislation to extend the maturity of bond debt. [79]

3.4.2. Financial and tax incentives to promote debt restructurings

In the second group of insolvency-related reforms seeking to facilitate a successful debt restructuring regulators should implement at least two primary measures. First, in countries where haircuts in financial restructurings (inside or outside of bankruptcy) are taxable, a legal reform should be implemented to avoid this taxation. Otherwise, companies facing financial trouble might need to pay taxes for some exceptional income (from an accounting perspective) that, nevertheless, did not generate any cash-flows. Second, in order to incentivize financial institutions to reach out-of-court agreements, certain capital and accounting regulations for banks may be relaxed.[80]

4. Other legal, economic, and financial reforms

While the insolvency and insolvency-related reforms suggested in this article provide companies with a breathing space, they do not solve the fundamental economic problems faced by companies affected by the COVID-19 crisis: the existence of losses (due to fixed

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[76] For an analysis of the features and problems of insolvency law in emerging markets, suggesting various policy recommendations to enhance the attractiveness of the corporate insolvency regime in developing economies, see Aurelio Gurrea-Martinez*, Insolvency Law in Emerging Markets*, Ibero-American Institute for Law and Finance, Working Paper 3/2020, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606395

[77] Many governments and financial regulators are encouraging debtors and creditors to reach out of court agreements. Countries incentivizing negotiations and workouts include Australia, China, Hong Kong, India, Malaysia, and Singapore. See Aurelio Gurrea-Martinez, Simon Brodie and Pooja Mahajan, *Global Guide: Measures Adopted to Support Businesses Through the Covid-19 Crisis: Report*, World Bank and INSOL, April, 2020 (available at https://www.worldbank.org/en/topic/financialsector/brief/finance-and-covid-19-coronavirus). Some authors go beyond and have even suggested that creditors should be *required* to cooperate in corporate workouts. See Horst Eidenmüller and Kristin van Zwieten, *The Case for Creditor Cooperation Duties in Corporate Workouts*, The CLS Blue Sky Blog, 13 May 2020, available at https://clsbluesky.law.columbia.edu/2020/05/13/the-case-for-creditor-cooperation-duties-in-corporate-workouts/

[78] John Armour, Gerard Hertig, and Hideki Kanda, *Transactions with Creditors*, in John Armour, Luca Enriques et al, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Oxford: OUP, 2017), at 140-141. Showing that debt restructurings can easily be achieved in companies with simple capital structures, see Edward R. Morrison, *Bargaining around Bankruptcy: Small Business Distress and State Law* 38 JOURNAL OF LEGAL STUDIES 255 (2009); Stuart C. Gilson, Kose John and Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 JOURNAL OF FINANCIAL ECONOMICS 315 (1990).

[79] Horst Eidenmüller, Luca Enriques and Kristin Van Zwieten, *COVID-19: A Global Moratorium for Corporate Bonds?* OXFORD BUSINESS LAW BLOG, 23 March 2020 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/covid-19-global-moratorium-corporate-bonds).

[80] Some jurisdictions, including Australia, Brazil, the European Union, Israel, Japan, Russia, the United Arab Emirates, the United States, and Switzerland have already relaxed capital requirements for banks and/or have adopted a more favorable tax and accounting treatment of loss provisions. See https://som.yale.edu/faculty-research-centers/centers-initiatives/program-on-financial-stability/covid-19-crisis and https://www.iif.com/covid-19. Some of these measures can serve as examples of accounting and financial measures that can be implemented.

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costs and lack of revenues) and the lack of cash-flows. For this reason, they need to be accompanied by a more comprehensive package of legal, financial, tax and economic reforms to support businesses and employees.[81] Moreover, as these measures will probably be insufficient to contain the wave of bankruptcy cases probably generated by the COVID-19 crisis, countries should also make sure that their judicial system is well-equipped to deal with a significant increase of insolvency cases.

5. Conclusion

The international spread of COVID-19 is not only generating dramatic consequences from a social perspective but it is also heavily affecting the global economy. For this reason, governments, financial regulators and international organizations are responding to COVID-19 with a package of legal, economic and financial measures. Among the legal responses included in these packages, many countries, including Australia, Belgium, Colombia, Czech Republic, France, Germany, Luxembourg, India, Italy, New Zealand, Peru, Poland, Portugal, Russia, Singapore, Spain, the United Kingdom, and the United States, have proposed or implemented temporary changes to their insolvency frameworks. This paper has started by discussing whether using the insolvency system should be the optimal solution to deal with companies affected by COVID-19. For that purpose, it analyzed the role and limits of insolvency law. It then discussed the most relevant insolvency reforms taking place around the world as a response to the global pandemic, as well as other insolvency and insolvency-related reforms that could be implemented to minimize the harmful economic effects of COVID-19. The paper has concluded by arguing that, even though these measures can provide companies and corporate directors with a valuable breathing space, these reforms need to be accompanied by a more comprehensive package of legal, financial, tax and economic responses.

[81] For a general overview of the legal, financial and economic measures implemented around the world to support businesses, see *Global Guide: Measures Adopted to Support Businesses Through the Covid-19 Crisis*, World Bank and INSOL, April, 2020 (available at https://www.worldbank.org/en/topic/financialsector/brief/finance-and-covid-19-coronavirus).

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