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Corporate insolvency responses in times of COVID-19

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INSOL International



WORLD BANK GROUP

**GLOBAL GUIDE:
MEASURES ADOPTED TO SUPPORT
DISTRESSED BUSINESSES
THROUGH THE COVID-19 CRISIS**

REPORT

- Countries are responding to the Covid-19 crisis with a package of legal, financial and regulatory measures that include temporary reforms of their corporate insolvency frameworks.
- Common corporate insolvency responses adopted across jurisdictions include the suspension or restriction of creditors' rights to initiate insolvency proceedings, as well as, where applicable, a suspension of directors' duties to initiate insolvency proceedings and a relaxation of the liability for wrongful trading.
- Other corporate insolvency responses implemented around the world include: special rules for small companies; new measures to reduce the timing associated with the commencement and duration of insolvency proceedings; amendments to transaction avoidance rules; the facilitation of rescue financing; and, where applicable, the suspension of the subordination of loans by corporate insiders.
- Responses complementary to corporate insolvency implemented across jurisdictions include: the adoption of a moratorium against legal actions and the termination of contracts; the facilitation of workouts; and, where applicable, the suspension of the 'recapitalize or liquidate' rule existing in several jurisdictions.
- A number of judicial systems around the world are increasing the use of electronic communications to handle legal cases, including insolvency proceedings.
- Subject to various exceptions and limitations, various trends have been identified based on legal origin, region, and country income classification.

1. Introduction

The Covid-19 pandemic has had a severe social and economic impact globally. First and foremost a global health crisis, it has caused significant financial distress for businesses. In seeking to mitigate the economic impact of Covid-19, governments and other authorities across the world have implemented numerous crisis containment measures – legal, financial, and regulatory – as the crisis continues to unfold. Many of these measures directly or indirectly relate to corporate insolvency. Such measures are essentially designed to support financially distressed businesses, preventing the unnecessary winding-up of distressed companies that in the ordinary course would be viable.

In April 2020, in the context of the Covid-19 crisis, the World Bank Group and INSOL International jointly produced a global guide (the 'Global Guide'). It consists of contributions from local experts in 38 countries and describes, in some detail, certain key crisis containment measures introduced by governments and other authorities with the objective of supporting financially distressed businesses through the crisis.²

Drawing primarily on the 38 country chapters of the Global Guide,³ this report (i) provides a high-level overview of measures related to corporate insolvency that have been adopted around the world in response to the Covid-19 crisis, and (ii) outlines certain similarities and divergences in such responses. The Global

Guide is a live document. As at the time of writing, it reflects measures in place as of 10 April 2020, and this report is accordingly current as of that date. Countries continue to implement crisis containment measures in response to Covid-19 on a weekly if not daily basis, and this should be borne in mind when reading the report. It is also important to note that the number of countries in the sample is relatively limited, and that the report may not accurately reflect the nature or extent of responses of countries outside the sample.

The report is organised as follows. Section 2 summarises a number of responses related directly to corporate insolvency, and section 3 summarises a number of responses that are complementary to corporate insolvency. Section 4 includes observations regarding the scope and duration of responses. Section 5 outlines certain similarities and divergences in the responses of different countries, by reference to legal origin, region, and country income classification. Section 6 concludes.

2. Responses related directly to corporate insolvency

2.1 Suspension or restriction of creditors' rights to initiate insolvency proceedings

Several countries, including Italy, Spain, Switzerland, and Turkey, have suspended creditors' rights to initiate insolvency proceedings. This response has also been announced in India. Other countries have imposed restrictions on creditors' rights to initiate insolvency proceedings. These restrictions are generally adopted by increasing the quantitative threshold required for creditors to initiate insolvency proceedings (e.g. India), by extending the statutory period to respond to written demands, or both (e.g. Australia and Singapore). Moreover, in certain jurisdictions (e.g. Singapore), debtors materially affected by Covid-19 can apply for a moratorium that will protect them from a variety of legal actions, including the commencement of insolvency proceedings. Therefore, while the initiation of insolvency proceedings has not been formally suspended, it has been significantly restricted in these latter jurisdictions.

2.2 Suspension of directors' duty to initiate insolvency proceedings

Several jurisdictions, especially in continental Europe, require corporate directors to initiate insolvency proceedings once a company becomes insolvent.⁴ As a response to the Covid-19 crisis, many countries, including Bulgaria, France, Germany, Luxembourg, Portugal, and Spain, have suspended this duty to initiate insolvency proceedings.⁵ This measure has also been announced in other jurisdictions (e.g. Poland).

2.3 Suspension or relaxation of liability for wrongful trading

In certain countries with liability for wrongful trading, which are mainly those inspired by the United Kingdom insolvency system, this liability has been temporarily suspended or at least relaxed in times of Covid-19. Jurisdictions adopting this approach include Australia and Singapore. This measure has also been announced in New Zealand and the United Kingdom. However, it should be noted that, whereas these countries are suspending or relaxing the liability for wrongful trading, directors are still subject to liability for fraudulent trading.

1. This report has been prepared by Aurelio Gurrea-Martinez, Simon Brodie, and Pooja Mahajan.

2. World Bank Group and INSOL International, Global Guide: Measures Adopted to Support Distressed Businesses Through the Covid-19 Crisis (April 2020), available at: <https://www.insol.org/library/opendownload/1511>.

3. While this report is based on the sample population included in the Global Guide, references to certain other jurisdictions have been made when relevant. Jurisdictions mentioned in this publication not covered in the Global Guide include Colombia and Portugal. Where responses adopted in these latter jurisdictions are mentioned, the sources of such responses are cited in the footnotes.

4. Aurelio Gurrea-Martinez, 'Insolvency Law in Times of Covid-19', Ibero-American Institute for Law and Finance, Working Paper 2/2020, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3562685; Conference on European Restructuring and Insolvency Law Executive Statement 2020-1 on Covid-19 and insolvency legislation, available at: <https://www.ceril.eu/news/ceril-statement-2020-1>.

5. Among these countries, only Luxembourg and Portugal are not included in the Global Guide. For Luxembourg, see the Grand Ducal Regulation of 25 March 2020. For Portugal, see the Law No 4-A/20201, amending Law No 1-A/20202.

2.4 Special rules for small companies

Some countries (e.g. Brazil) have proposed the implementation of simplified insolvency rules for small companies.⁶ Likewise, in the United States, the legislature has increased the threshold required for access to the simplified insolvency rules recently adopted through the Small Business Reorganization Act of 2019. Therefore, more companies will have access to these simplified proceedings in times of Covid-19.

2.5 Commencement and speed of insolvency proceedings

Some jurisdictions (e.g. Colombia) have implemented several rules to simplify – and reduce the length of time associated with the commencement and duration of – insolvency proceedings.⁷

2.6 Amendments to transaction avoidance rules

Some countries have suspended the running of the lookback period for the avoidance of transactions. For example, in Singapore, the lookback periods for transactions at an undervalue and unfair preference transactions have been temporarily extended by the relevant relief period enjoyed by debtors affected by Covid-19.

2.7 Implementation of rescue financing provisions

In many jurisdictions around the world, lenders providing new financing to debtors subject to insolvency proceedings receive a priority in the form of an administrative expense. Some countries, such as the United States and Singapore, go beyond this and allow lenders to obtain a ‘super priority’, provided that various requirements are met and the new financing is authorised by the court.⁸ In certain circumstances, this super priority can consist of allowing the new lender to ‘prime’ an existing lien or get paid ahead of pre-existing administrative expense claimants. In times of Covid-19, some jurisdictions (e.g. Colombia) have decided to implement a regime of rescue financing similar to those existing in the United States and Singapore.⁹

2.8 Suspension of rules subordinating loans by corporate insiders

In some jurisdictions, particularly in Continental Europe and Latin America,¹⁰ loans by corporate insiders are often subordinated in insolvency proceedings. In times of Covid-19, some countries (e.g. Italy) have decided to suspend this subordination in order to encourage new financing by corporate insiders.

3. Measures complementary to corporate insolvency

3.1 Moratorium against legal actions and / or termination of contracts

Many jurisdictions have imposed some form of moratorium against legal actions and/or termination of contracts outside of insolvency proceedings.¹¹ Bulgaria, France, Italy, Malaysia, Singapore, Spain, Switzerland, and the United States are included among the countries that have imposed a form of moratorium to protect debtors against a variety of legal actions, such as the termination of contracts and enforcement of debts or security interests. Other countries, including Brazil and New Zealand, have announced their intention to implement a similar response.

3.2 Adoption of legal, financial and tax mechanisms in relation to the financial sector

Many countries have adopted various legal, financial and tax mechanisms in relation to the financial sector. For example, some jurisdictions, including Australia, Brazil, the European Union, Hong Kong, India, Israel, Japan, Russia, Switzerland, the United Arab Emirates, and the United States, have relaxed capital requirements for banks and / or have adopted a more favourable tax and accounting treatment of loss provisions. While these measures have typically been designed to provide more liquidity and flexibility to the financial sector, they may support debt renegotiations and debt restructurings in times of Covid-19.

3.3 Use of electronic communications to handle legal cases, including insolvency proceedings

In many countries, due to lockdown or social distancing norms, in-person judicial activity has been temporarily suspended or severely restricted. Several jurisdictions are now adopting electronic tools to handle legal cases, including insolvency proceedings. Therefore, these tools can assist courts in managing the expected rise in the number of insolvency proceedings due to the Covid-19 crisis. Countries in the sample that are adopting or increasing the use of electronic tools in times of Covid-19 include Australia, British Virgin Islands, Canada, China, Hong Kong, India, New Zealand, Singapore, the United Kingdom, and the United States.

3.4 Suspension of ‘recapitalise or liquidate’ rule

Several jurisdictions, particularly in Europe and Latin America, require corporate directors to promote the recapitalisation or liquidation of the company once the company’s net assets fall below a certain proportion of its legal capital.¹² This ‘recapitalise or liquidate’ rule has been temporarily suspended in various countries, including Colombia, Italy, and Spain.¹³

3.5 Facilitation of workouts through informal mechanisms

In some jurisdictions, there is a push for facilitation of workouts through informal mechanisms. Many countries, sometimes through their regulators, central banks or courts, are encouraging lenders to reach

6. For example, in a Bill recently submitted to the Parliament, Brazil has proposed that, in judicial reorganisation plans, small and micro companies should be allowed to pay debts in up to 60 monthly instalments instead of the 36 instalments currently provided for by the insolvency legislation.

7. See articles 2 and 3 of the Law Decree 560/2020.

8. In the United States, see section 364 of the US Bankruptcy Code. In Singapore, see sections 211E(9) and 227HA(10) of the Companies Act, as well as sections 67(9) and 101(10) of the 2019 Insolvency, Restructuring and Dissolution Act, which is expected to come into effect in 2020.

9. This rescue financing regime has been adopted in Colombia. See article 5 of the Law Decree 560/2020.

10. These countries include Austria, Brazil, Chile, Colombia, Germany, Italy, Mexico, Portugal, Spain, and Uruguay. See Aurelio Gurrea-Martinez, ‘Insolvency Law in Times of Covid-19’ (note 4 above).

11. Such a feature is usually included in a country’s insolvency framework. However, in times of Covid-19, it has also been adopted outside of insolvency.

12. Countries with a ‘recapitalise or liquidate’ rule include Argentina, Colombia, Ecuador, France, Italy, Mexico, Spain, Sweden, and Uruguay. See Aurelio Gurrea-Martinez, ‘Insolvency Law in Times of Covid-19’ (note 4 above).

13. While details of the Italian and Spanish responses are analysed in the Global Guide, the measures adopted in Colombia can be found in article 15.3 of the Law Decree 560/2020.

out-of-court agreements with debtors materially affected by Covid-19, especially when these agreements just involve a deferral of loan repayments. Jurisdictions incentivising debt renegotiations and workouts whenever they might be needed, include Australia, China, Hong Kong, India, Malaysia, and Singapore.

4. Scope and duration of responses

4.1 Companies subject to the responses

In some jurisdictions, including Australia, Bulgaria, France, India, Italy, Portugal, and Spain, the corporate insolvency responses to the Covid-19 crisis apply to all companies. In other jurisdictions (e.g. Germany), however, the corporate insolvency responses specifically target companies materially affected by Covid-19. As such, it has been found that the type of company subject to the extraordinary insolvency measures adopted in times of Covid-19 differs across jurisdictions. Something similar has been observed for measures complementary to corporate insolvency that have been adopted to support businesses, including those discussed in section 3.1.

4.2 Duration of the responses

Regarding the duration of the responses, there are significant divergences across jurisdictions. For example, in countries including Spain and Turkey, many of the responses apply only while the country is in a state of emergency. In other jurisdictions, including Australia, Germany, Italy, and Singapore, responses have explicitly been adopted for extended periods. These periods range from six months (e.g. Australia, Germany, Singapore), with the possibility of being extended to one year (e.g. Germany, Singapore), to two years (e.g. Colombia).¹⁴

5. Similarities and divergences in responses

5.1 Legal origins

Several similarities have been found in countries with similar legal origins. For example, in various countries with common law origins, liability for wrongful trading has been relaxed or suspended. This has been the approach followed in Australia and Singapore, and it has been announced in New Zealand and the United Kingdom. In Australia, India, and Singapore, the threshold required to initiate insolvency proceedings by the company's creditors has been increased.

Various similarities have also been found in civil law jurisdictions. For example, France, Germany, Portugal, and Spain have suspended the duty imposed on corporate directors to initiate insolvency proceedings once the company becomes insolvent. Likewise, Colombia, Italy, and Spain have suspended the duty to recapitalise or liquidate once the company's net assets have fallen below a certain proportion of the company's legal capital.

5.2 Regions

Some regional trends have been found. For example, some countries within the European Union have adopted similar responses (e.g. suspension of the duty to file for insolvency proceedings and suspension of the recapitalise or liquidate rule). Likewise, it has been found that, within the sample, countries in certain regions (e.g. Africa, Latin America, the Middle East) have not implemented major legal reforms.

Nevertheless, there are some notable exceptions to these regional trends. For example, in Europe, many of the responses implemented in Italy are explicitly designed to last for an extended period of time, while those implemented in Spain are due to last only for the duration of the state of emergency (which may not be for an extended period of time). Likewise, various divergences exist within other regions. For instance, while many countries from the sample from Latin America and Asia have not implemented major legal responses, Colombia and Singapore have implemented some of the most comprehensive packages of legal reforms observed internationally.

5.3 Countries' income classifications

As a general rule, and within the sample, high-income countries have implemented more extensive responses than middle- and low-income economies in response to the Covid-19 crisis. However, there are some notable exceptions. For example, while Colombia has implemented one of the most extensive packages of legal responses, the United Kingdom has not implemented major reforms.

Some divergences have also been found between different income classification groups included in our sample. For example, the implementation of electronic tools to handle legal cases, including insolvency proceedings, seems to be more common in the high-income countries. However, there are many examples of high-income countries not promoting the use of electronic tools (e.g. Germany, Spain) and several examples of middle-income countries adopting this strategy (e.g. India).

6. Concluding remarks

Despite the aforementioned similarities and divergences in responses across jurisdictions, it should be noted that the existence (or extent) of such responses is not necessarily desirable or undesirable. It depends on the particular features of the country.

Factors affecting the need for and appropriate intensity of responses may include:

- (i) the legal and institutional framework of the country (e.g. insolvency laws, contract law, corporate law, employment law, judicial system);
- (ii) the types of companies prevailing in the country (e.g. small versus large companies, controlled companies versus companies with dispersed ownership structures, companies controlled by the state versus companies controlled by private actors, companies with concentrated debt structures versus

14. The periods for Australia, Germany, and Singapore can be seen in the Global Guide. For Colombia, see article 1 of the Law Decree 560/2020.

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companies with dispersed debt structures);

(iii) the culture of corporate rescue and the extent to which out-of-court mechanisms are used to deal with financial distress;

(iv) the existence and intensity of the package of economic and financial measures adopted to deal with the Covid-19 crisis (e.g. economic and financial support provided by the government); and

(v) the overall impact of Covid-19 in the country.

Finally, the limitations of this report should be noted. In particular, countries continue to implement crisis containment measures in response to Covid-19 on a frequent basis. In addition, the report may not accurately reflect the nature or extent of responses of countries outside the sample.

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