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Insolvency Law in Times of COVID-19

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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 this pandemic with a package of legal, economic and financial reforms. Among the legal measures included in these packages of reforms, many countries, including Australia, Germany, Spain, India, Singapore, the United Kingdom and the United States, have proposed or implemented several changes to their insolvency frameworks.

In a recent paper, entitled 'Insolvency Law in Times of COVID-19', I discuss whether using the insolvency system should be the optimal solution to deal with companies affected by the coronavirus. I then analyze a series of insolvency reforms taking place around the world as a response to the global pandemic. Finally, the paper discusses a variety of insolvency-related reforms that have been suggested, or could be implemented, to minimize the harmful economic effects with the coronavirus.

I argue that, even though insolvency law can be a useful tool to help certain companies facing financial trouble due to the coronavirus, some insolvency and insolvency-related reforms are still needed. These reforms can be classified into three main categories. First, reforms seeking to minimize the massive increase of insolvency proceedings by implementing various insolvency-related mechanisms to help financially distressed debtors outside of bankruptcy. Second, and consistently with what some authors have suggested, reforms seeking to provide the insolvency system with liquidity and resources to be able to handle the wave of bankruptcy cases generated by the coronavirus. And third, a variety of reforms to adapt insolvency law to the times of COVID-19.

These reforms implemented in times of COVID-19 should be subject to two limitations. First, only companies whose financial situation has been deteriorated as a result of the coronavirus should be able to use these exceptional remedies. 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, 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, 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 these exceptional remedies. In fact, any opportunistic attempt to use exceptional measures should be punished. Second, these measures should also be subject to temporal limitations (e.g. six months) that can then be revised based on the evolution of the coronavirus in a particular country.

In terms of insolvency reforms, my paper suggests seven policy recommendations. First, legislators should suspend the duty to file for bankruptcy existing in various jurisdictions. Second, many countries, particularly in Continental Europe and Latin America, impose a duty to recapitalize, liquidate or file for bankruptcy whenever a company's net assets fall below a certain percentage of the company's legal capital. In times of COVID-19, this duty should also be suspended.

Third, legislators should also suspend creditors' rights to file involuntary bankruptcy petitions against companies affected by the coronavirus. Therefore, legislators should go beyond the response adopted by Australia and India, where creditors will still be allowed to force companies into bankruptcy albeit subject to a higher quantitative threshold. And if these rights are not suspended, at least countries should adopt a very stringent approach to allow involuntary bankruptcy petition initiated by creditors, as it has been suggested by Singapore.

Fourth, in countries where secured creditors are allowed to lift the automatic stay due to the lack of adequate protection, insolvency law should temporarily be reformed to prevent this possibility in the context of economically viable companies that, as a result of the coronavirus, have decided to file for bankruptcy.

Fifth, courts should adopt a more permissive approach to rescue (or DIP) financing, even if the authorization of rescue financing affects pre-existing rights from secured creditors or administrative expense claimants.

Sixth, countries with more flexible insolvency proceedings for small businesses may consider the possibility of expanding the scope of these procedures to medium-size corporations, as it has been proposed in the United States. Thus, more companies could temporarily benefit from the lower costs associated with these proceedings.

Seventh, countries should relax their system of liability of directors in the zone of insolvency. While this reform should not have a major impact in jurisdictions where corporate directors are subject to a duty to file for bankruptcy that has been suspended, it will be particularly relevant for countries where directors can be liable for insolvent trading. Therefore, the reforms implemented in Australia, and recently announced in the United Kingdom and Singapore, 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.

In addition to these insolvency reforms, my paper urges legislators to implement other insolvency-related reforms. These latter reforms include some recommendations already suggested by the literature, such as the global moratorium for corporate bonds recently proposed by Horst Eindenmüller, Luca Enriques and Kristin van Zwieten, as well as some other responses that may help reduce the harmful economic effects associated with the coronavirus, including the imposition of certain restrictions to terminate contracts and enforce security interests in times of COVID-19 (as it has been suggested in Singapore), and a variety of tax, accounting and financial reforms affecting the treatment of haircuts and delayed payments from the perspective of both debtors and creditors.

The paper concludes by emphasizing that, while the aforementioned reforms can provide companies and corporate directors with a valuable breathing space, they do not solve the fundamental economic problems faced by companies affected by the coronavirus: the existence of losses (due to fixed costs and lack of revenues) and lack of cash-flows. Therefore, in order to effectively respond to this global pandemic, regulators should implement these insolvency and insolvency-related reforms in conjunction with a more comprehensive package of legal, financial and economic measures.

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