International Corporate Rescue

Published by

Chase Cambria Company (Publishing) Ltd

ChaseCambria

www.chasecambria.com

SOUTH SQUARE

Centre for Commercial Law

UCL LAWS

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

EDITORIAL

Coping Collectively with the COVID-19 Crisis

Bob Wessels, Emeritus Professor of International Insolvency Law, Leiden University, the Netherlands

Synopsis

This editorial is a call to practitioners, scholars and regulators to adopt an agenda for future research, and a call to global financial institutions to fund and further such research. The topic is one we have all come to understand wherever we are, walking at a physical distance from our fellow citizens, no beer with friends on a terrace, no movies, and working at home. The aim: to establish predictable frameworks for emergency situations. In this contribution related to restructuring and insolvency matters a call is made for substantial research into a sharp legal response to extraordinary situations (such as the corona pandemic), for a mirror-type of framework on how to go back in an orderly way to an 'ordinary' situation (post-corona) and for dealing with fraudsters, misusing the sheer unlimited liquidity governments have unconditionally infused into our economies.

What we do know

In early May 2020, the World Health Organization (WHO) reported over 2.5 million confirmed cases of COVID-19 and close to 200,000 deaths, affecting over 200 countries around the world. Across the globe, legislators, regulators and practitioners are consequently toning down and adjusting the rules of the restructuring and insolvency game: electronic notifications and hearings, virtual creditor meetings, deferring certain payments, suspending foreclosures and evictions, postponing filing duties as well as amending or including safe harbours for directors acting in good faith when their companies are facing liquidity problems due to the impact of COVID-19. In almost all of these countries one can access certain levels of detailed information on a myriad of measures being put in place.[1] It is a swift answer to the downfall of the economy and the sudden shortage of liquidity in a market that is locked. Conversely, we are looking in vain for suggested rules for an orderly way to relax or repeal these game changing rules. A set of rules to get businesses that are sustainable back on their feet again, although – it is to be feared – opening up will be slow and gradual once better times are on the horizon.

What we do not have: emergency law

There is very little knowledge on how to go about this in extreme emergency situations. What we do know is that the chosen and logical approaches to adapt legislation and practices are based on the premise that markets and economies are working well;and on the basis that businesses are functioning under normal economic circumstances. The restructuring and insolvency systems we know are for businesses experiencing some bad luck or which are led by bad management. In an emergency situation that assumption is rather unjustified.

It's a crisis we are dealing with, globally and within the legislative boxes of all the territorial jurisdictions we are acquainted with. An emergency disrupts the economy suddenly and severely and knocks away expectations in market behaviour. It shakes and shudders a country, a region, a continent or the globe. Such conditions require the restructuring and insolvency system to be placed under the spotlight and for emergency legislation to be enacted swiftly. We should agree on its framework as well as its content. Without doubt it should serve as an *ultimum remedium*, it's an ultimate solution. If we think about it now, we can also build in sufficient safeguards, both for putting the emergency measure into effect and for its application. It's not for now, hopefully not in the next decades, but it's there for when an emergency situation kicks in suddenly, in our

Notes

1 Several firms of lawyers or accountants are providing periodic overviews. The European Commission has several times provided an overview of national economic measures taken by Member States in response to the COVID-19 outbreak, also reporting on measures related to (preventing) insolvency. The overview, as per 24 April 2020, is: https://ec.europa.eu/info/sites/info/files/policy_measures_taken_against_the_spread_and_impact_of_the_coronavirus_14042020.pdf. See also the online publications of Oxford Business Law Blog (https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/covid-19-crisis-requires-legislators-adapt-insolvency-legislation), INSOL Europe (https://www.insol-europe.org/technical-content/introduction), International Insolvency Institute (III) (https://www.iiiglobal.org/COVID-19resources), and a website via American Bankruptcy Institute (https://globalinsolvency.com/covid19). See on USA's chapter 11 Jay Westbrook at https://www.creditslips.org/creditslips/2020/04/the-role-of-chapter-11-bankruptcy-in-addressing-the-consequences-of-covid19.html.

country, in a region, on a continent, on the globe. In restructuring land, emergency legislation is terra incognita. It would include the laws and regulations that apply to emergencies, say, in a country. It is designed and ready to enter into force in special situations, through ad hoc legislation, emergency regulations and decisions, and to be decided about and published within 48 hours (a weekend). Are there any examples?

Predictable framework for extra-ordinary situations

Twelve years ago, a global group of well-experienced practitioners and scholars, still biting the dust of the financial crisis, acknowledged the need to supplement existing restructuring processes and institutions or to implement such processes, if they were not already present. The suggested 'Extraordinary Restructuring Solutions' contained a mix of unconventional restructuring-oriented measures to deal with the extraordinary circumstances created, in that instance, by the global financial crisis. In short, the idea was to lay out a range of potential approaches that could be adopted by jurisdictions around the world based on their specific needs and circumstances. The solutions revolved around four key features: (i) to establish quasi-governmental institutions to coordinate out-of-court restructuring activities, (ii) to mobilise interim or bridge financing to support restructuring, (iii) to activate restructuring expertise to handle a potential surge in restructurings, and (iv) to institute expedited out-of-court restructuring procedures to deal with the potential widespread financial distress in the corporate sector.[2]

Another example is more recent. In March 2020, the Executive of the Conference on European Restructuring and Insolvency Law (CERIL) expressed its deep concern with the ability of existing insolvency legislation in Europe to provide adequate responses to the extremely difficult situation in which many companies may find themselves in the COVID-19 crisis. It issued a statement calling upon the EU and European national legislators to take immediate action and adapt insolvency legislation where necessary in light of the current extraordinary economic situation and to prevent unnecessary bankruptcies of entrepreneurs. It recommended a two step approach to be taken immediately by European national legislators: (1) to suspend the duty to file for insolvency proceedings based on over-indebtedness, and (2) to respond to the illiquidity of businesses. In addition, the EU and national legislators were urged to consider measures regarding: (a) interim financing, (b) suspending the duty to file based on the inability to pay, (c) 'hibernation' (or: winter sleep) for (small) businesses, and (4) supporting the livelihood of entrepreneurs and their employees.[3]

Inspired by the CERIL statement, I posted my blog of 25 March 2020, in Dutch.[4] For the Netherlands I suggested a three-step solution to get business back on its feet again, two of which are of interest for this column: (i) the legislator announces a general national debt moratorium, and (ii) the introduction of a temporary scheme of self-administration for companies.

The rationale: business (and the economy) urgently need certainty, clarity and predictability.

Large parts of the small and medium-sized enterprises see little money coming in due to the economic slowdown, while the costs remain or grow. These are fixed costs but also debts related to orders that are currently coming in, but for which the products cannot be sold. Generating turnover is difficult due to a drop in demand and restrictions on imports or exports. Contracts are based on existing relationships with suppliers and customers, which currently raise many questions: is this a *force majeure* event? Does the corona crisis justify an appeal to unforeseen circumstances (Article 6:258 Dutch Civil Code)? Do the many tens of thousands of contracts and general terms and conditions have specific clauses that apply? There is, I argued, a need for rest, no legal fighting: a collective standstill.[5]

In the Netherlands, such a national debt moratorium builds on what has been effective in Dutch legal history culture with regard to outstanding debts in an emergency.[6] The moratorium anticipates what will become the future Articles 6 and 7 Restructuring Directive (Stay and consequences of individual enforcement actions), albeit not 'individually' and not linked to restructuring plans, but generally, immediately and unconditionally. A national debt moratorium results in a standstill between uncertain, faultfinding or combatting contracting parties and provides immediate relief with regard to outstanding or soon to be paid debts. It applies retroactively from 15 March 2020 for a period of six weeks. This period's relief enables all involved to prepare the governmental financial support program that has come into effect and to tailor its infrastructure to provide – internet based – financial payments to

Notes

2 See Steven T. Kargman, 'Developing Extraordinary Restructuring Solutions to Address the Fallout in the Real Economy from the Global Financial Crisis: An Overview of a Project of the International Insolvency Institute', (2009) 6:5 *International Corporate Rescue* 267-269.

3 See https://www.ceril.eu/news/ceril-statement-2020-1. I was a co-penholder.

4 See https://bobwessels.nl/blog/2020-03-doc4-drie-stappen-om-uit-het-insolventie-dal-te-komen/.

5 For a recent example of a standstill agreement, see http://blogs.harvard.edu/bankruptcyroundtable/2020/04/28/dont-just-do-something-stand-there-a-modest-proposal-for-a-model-standstilltolling-agreement/.

6 At the beginning of the First World War 1914-1918, the Payment Delay Act of 1914, and – unsurprising for the Netherlands – emergency because of flood and inundation, the Zeeland Flood Emergency Regulation of 1953.

over 100,000 individual (small) companies and self-employed persons' businesses. It protects against legal measures for six weeks, meaning no collections, the freezing of executions, evictions, seizures, redress, etc., but also a prohibition on set-off. In short, a temporary, nationwide suspension of debt payment for small businesses. The key point being: potential economic activity and employment are thus preserved.[7]

My second suggestion is to introduce a temporary scheme for self-administration (in Dutch '*zelfbewind*') of companies. Such a scheme would function as a 'hibernation' or 'spring-summer sleep' period for businesses (for example, for two months), which protects individual smaller companies from the usual insolvency measures. It should contain the following instruments: (i) the debtor would be able to file a petition to proceed with self-administration, in combination with the request to suspend the commencement of any pending bankruptcy against it by one or more creditors for a period of up to, say, two months, (ii) the request implies the suspension of all claims and the suspension of all executions for the remainder of the proceedings, including tax and social security obligations, (iii) it also covers a prohibition of all payments by the debtor himself on all legal and contractual obligations, except those that are necessary for the continuation of the maintenance of the key business functions and essential goods such as electricity, emergency services, servers, etc. The company must be able to continue as well as possible under the specific circumstances of its market, whereby the entrepreneur remains in control (this rings the bell of the 'debtor in possession'). In order to monitor this somewhat, instrument (iv) is the appointment of a 'monitor' (lawyer or accountant) who, during this period of 'self-government' (instituted at the request of the debtor), performs a limited consultation role, providing guidance and acting as a supervisor of the business,if necessary consulting on which transactions or payments are within the normal course of a business. The debtor has a duty to provide information and where the debtor is considering / taking action regarding the sale of assets, making voluntary payments to third parties, assuming financial obligations (for example by agreeing new credits or acting as a guarantee for others), the monitor has the power to give or withhold permission.

The self-administration instrument may seem too expensive and cumbersome, however an experienced restructuring expert is there to help out for a short period, filling the gap for business debtors unacquainted to the unprecedented circumstances and helping to prevent failures or misuse. After expiry of the term, automatic revival of all rights will take place, unless the monitor advises the judge to extend the self-administration for a limited period of up to a further two months.

Predictable framework for going back to normal

Emergency laws are transitional by definition. The key question is how and when to get rid of them once they are implemented. This calls for a phasing out, as the return of (some form of) normalised social life will not mean the return of normal business life overnight. If as expected we see some countries slowly opening their curtains in early May 2020 – this may take place gradually. Furthermore, lifting the state of emergency by itself does not provide immediate clarity about the market in which a business operates and the revenue situation of a locked down business. It takes more time to see whether and to what extent former market positions are again achievable. This item I discussed with my German colleague Stephan Madaus (University of Halle-Wittenberg), co-penholder of the CERIL Executive statement. Again, I argue, there is a need for rest and a predictable 'exit'. We favour keeping restructuring and insolvency-related COVID-19 measures in place for a longer transition period of up to four months. This will provide predictablility and clarity to business and give businesses at least two things: (i) time to see whether and to what extent their revenues return, and (ii) time to test the sustainability of their new debt structure (probably expanded by government support loans). In this phase a good entrepreneur really can test his or her skills.

Evidently, both tests are connected and they have to be adapted in a post-corona-crisis world. We know it's not an emergency situation anymore, however the lookout for business presently is unpredictable. If an entrepreneur sees a need for a debt restructuring or alteration to his business model, efficient restructuring options should be available. On the continent, they should at least meet the standard of the European Restructuring Directive for preventive frameworks. For formal proceedings, recommendations were made in the Wessels/Madaus European study on Rescue of Business in Insolvency Law.[8] In the Netherlands, this requires the adoption of the WHOA-legislation and in Germany a new procedure and reform of the so-called ESUG provisions in the German Insolvency Code (Insolvenzordnung). In addition, governments should

Notes

7 In Belgium since 24 April 2020 a temporary debt moratorium has been enacted till 21 May 2020, see https://corporatefinancelab.org/2020/04/26/kb-nr-15-een-tijdelijk-wettelijk-moratorium/#more-14266.

8 See Bob Wessels and Stephan Madaus, 'Instrument of the European Law Institute on Rescue of Business in Insolvency Law', 2017, available at: https://ssrn.com/abstract=3032309. Including country overviews since late April 2020 available at OUP, see https://global.oup.com/academic/product/rescue-of-business-in-europe-9780198826521?cc=nl&lang=en&.

consider how to allow for a restructuring of loans: to be provided or guaranteed by public money.

Carefully considered transitional provisions should accompany the return from the apocalyptic shock bringing businesses from the bottom of the market to its top. Transitional law, as a system, is quite complicated. Transitional law concerns the law that relates in particular to the relationship of two successive legislations. It connects three problem areas: the old law, the new law and the typical rules that determine the relationship between the two. The result is applied to the legal statuses existing at the time of the introduction of the new law (or reactivating the adjusted 'toned down' law), current legal relationships, legal consequences of legal acts already performed and accomplished legal facts. Although transitional law is sometimes subject to special exceptions on fundamental, but more often, ancillary points, the main rule in the Netherlands is 'immediate effect', unless existing rights are not respected or legitimate expectations are compromised as a result of that effect.

Predictable framework for corona crooks

One last point I wish to make. He is back again. Father State as the rich uncle. With great flexibility, he is very much welcomed even by opponents of any government interference in business.[9] Businesses have been and are being supported by the provision of an unprecedented amount of money, sometimes unconditionally: wage subsidies, loans and gifts, all urgently needed to maintain (a certain level of) liquidity for (small) companies. As a reminder, this is not governments' money, it is a country's citizens money distributed centrally. As a result many companies will survive, however it will not be enough for some or indeed many businesses. Opening the gate for such immense amounts of money will inevitably attract an entrepreneur, whose moral compass may run wild. Misuse or fraud is lurking. Bad actors, corona crooks or pandemic profiteers will evidently fall under the existing civil sanction law and/or criminal law. One may expect government inspection services and investigative agencies prioritising the detection and arrest of fraudsters. The public prosecution service should apply a fast track, tit for tat policy. A heartless corona fraud requires a focused and decisive approach. Dutch history may again provide an example. After the Second World War (1940-1945) a capital accretion tax ('*vermogensaanwasbelasting*') was levied on the appreciation of assets, regardless of whether they had been sold or given away to third parties. A director's disqualification seems obvious; and for those directors, also holding shares, do extreme times also call for shareholder's disqualification?

To finalise this editorial. The right funding and investment, including a solid organisational structure, should enable us to be better prepared for and able to weather a future emergency crisis. Emergency legislation, as a helpful framework for use by countries, should be created. It should be infused by experiences gained with the myriad of measures taken all over the world, with solid research in, say, three or five years from now. Whether the aftermath of the crisis requires a specific emergency package or additional or different adaptions in the insolvency, discharge and restructuring frameworks, in particular to address the position of public emergency funding claims adequately, is to be discussed. Jurisdictions with excessive public emergency funding would evaluate the legal position of such claims in restructuring and insolvency liquidations. We should not fall back to old customs by creating a privileged position as that would discourage restructuring initiatives, while any subordination of such claims could invite EU state aid scrutiny. What is needed when we deal with the aftermath of COVID-19 is sophisticated solutions. The insolvency community can not sit on its hands. With big-hearted funding an agenda for the future, research should be developed to establish, in relation to restructuring and insolvency matters, predictable frameworks for emergency situations.

Notes

9 A G20 Action Plan with immediate and exceptional measure to be taken, internationally and domestically, against the financial impacts of COVID-19, has in the meanwhile been adopted, see https://g20.org/en/media/Documents/G20_FMCBG_Communiqu%C3%A9_EN%20(2).pdf

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialised enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com