International Corporate Rescue – Special Issue

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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.

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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&.

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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

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Australia's Measures to Address the Economic Impact of COVID-19

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Synopsis

The global economic upheaval caused by COVID-19 has prompted governments to implement a variety of urgent legal and economic measures to adapt to the pandemic and mitigate the economic harm caused by stringent lockdowns imposed to protect public health. Many of those measures are of special interest to restructuring and insolvency professionals. Australia's response has included specific changes to insolvency law, practical measures to facilitate doing business remotely, and economic stimulus and financial relief for those especially affected. We survey these measures and assess the impact of COVID-19 on the practice of restructuring and insolvency law in Australia.

Introduction

Like other jurisdictions around the world, Australia's business and economic life has been severely impacted by the Coronavirus pandemic. In circumstances where the financial impacts of the pandemic will persevere for some time, and the timing and trajectory of the recovery is clouded in uncertainty, the strain on businesses has been and will continue to be significant. We have already seen some notable corporate collapses in severely hit sectors (such as the appointment of administrators to Virgin Australia and Australian Securities Exchange listed Speedcast International Limited filing for Chapter 11 bankruptcy protection in the USA). The outbreak has also made restructuring mandates, the conduct of business-as-usual, as well as all forms of external administration appointment, more challenging. The legislative response to the impacts of the pandemic on the Australian economy has been the announcement of a number of temporary emergency measures. This note briefly outlines the key measures which bear upon the restructuring and insolvency market in Australia.

Corporate insolvency measures

Australia is renowned for its strict insolvent trading regime which makes company directors personally liable for debts incurred when the company is insolvent. One defence to insolvent trading liability is that the director took reasonable steps to prevent the debt being incurred, such as by taking action to appoint an administrator to the company. In an attempt to mitigate the risk of a veritable tsunami of voluntary administration appointments in response to the pandemic (by boards who may otherwise have thought they had no alternative to protect themselves from personal liability), Australia's Federal Parliament enacted the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) ('Economic Response Package'), which, *inter alia*, includes amendments to the Australian *Corporations Act 2001* (Cth) ('Corporations Act') which temporarily suspend directors' personal liability for debts which are incurred in the ordinary course of the company's business, for the period of 6 months between 25 March 2020 and 25 September 2020.

The reforms do not prevent a company's creditors from applying to the Court for the company to be wound up. However, reforms have also been made to Australia's winding up regime to put a pause on the most common method for winding up companies, thereby allowing companies extra breathing space to deal with their debts. The Australian Corporations Act allows a creditor to serve a 'statutory demand' on a company for payment of a debt of AU$ 2,000 or more which is due and payable. If the debtor company does not satisfy the demand within the prescribed statutory period (of 21 days), it is deemed by statute to be insolvent for the purposes of an application to wind up the company (a status which can otherwise be difficult and expensive to prove). The Economic Response Package contains measures extending the time for compliance with a statutory demand from 21 days to 6 months and increasing the monetary threshold for a statutory demand from $ 2,000 to $ 20,000. These changes apply to demands served between 25 March 2020 and 25 September 2020.

A further limb of the reforms is the introduction of a temporary mechanism to give flexibility (and power) to the Federal Treasurer to legislate further reforms to provide regulatory relief to classes of persons who are unable to meet their obligations under the Corporations Act or the Corporations Regulations. The precise scope of this remains to be tested but in principle the Federal Treasurer will have power to grant further

relief if satisfied that (a) it would not be reasonable to expect the persons in the class to comply with the provisions; or (b) the exemption or modification is necessary or appropriate, in circumstances relating to COVID-19, to facilitate continuation of business or to mitigate the economic impact of the coronavirus.

Importantly, the Economic Response Package reforms do not suspend a company's liability to pay its debts and do not suspend enforcement processes generally. In addition, while commentators have pushed for such relief, there are currently no COVID-19-related exemptions to claw-back claims available to company liquidators. Properly advised, directors will be using the period to attempt to develop a rehabilitation plan for the company so as to avoid or manage potential personal liability for insolvent trading when the relief measures cease.

Economic stimulus and relief measures

The Australian Government has also announced a series of economic stimulus and relief measures in response to COVID-19, focusing on business investment, household stimulus and a large wage subsidy package. As a percentage of GDP, these measures are among the largest in the world.

The Federal Government's principal economic measures are:

- wage subsidy programs (the largest of which is an AU$ 130 billion wage subsidy scheme, under which up to 6 million Australians will be paid AU$ 1,500 per fortnight from the government via their employers, if their employer can demonstrate a significant (>30%) reduction in turnover for businesses with an aggregated turnover of AU$ 1bn or less). The program covers employees who are still working, as well as those who have been furloughed as a result of the pandemic;
- tax relief measures to improve cash flow for small and medium sized businesses;
- government-guaranteed loans, and other measures to improve credit, for small and medium sized businesses;
- temporary increases to unemployment benefits, pensions and other government income support;
- direct government investment in securitisation markets used by smaller lenders;
- temporarily allowing individuals affected by COVID-19 to access part of their superannuation (pension) fund; and
- targeted government programs and support in healthcare, aged care, child care, aviation, and COVID-19-affected regions and communities.

Australia's central bank has announced a term funding facility providing banks with access to at least AU$ 90 billion in funding at a fixed interest rate of 0.25%. The facility offers additional low-cost funding to banks if they expand their business lending, with particular incentives applying to new loans to small and medium sized businesses.

State governments have separately introduced local economic stimulus and relief measures, in particular in relation to retail and other commercial tenants.

Relief for tenants

Australia's national cabinet has agreed to a mandatory code of conduct to protect tenants who are unable to meet their commitments due to the impact of COVID-19. It protects commercial tenants with an annual turnover of less than AU$ 50 million and who are eligible for the Federal Government's principal wage subsidy program (which requires that they have suffered a 30% reduction in turnover).

The code requires lessors and lessees to negotiate temporary lease arrangements in good faith. The negotiation is required to apply 14 prescribed principles, including that:

- rent increases are frozen during the COVID-19 pandemic;
- a lessor cannot terminate a lease or draw on the lessee's security on the grounds that the lessee has failed to pay rent, if the lessee is suffering financial hardship as a result of the COVID-19 pandemic;
- lessors must waive or defer rent in an amount proportionate to a commercial tenant's loss of trade due to COVID-19;
- benefits that lessors get for their properties, such as reduced government charges or land tax, or deferred loan payments, should be passed on to the lessee proportionately.

The code is to be implemented through State and Territory legislation. At the time of writing, it has not been adopted uniformly across Australian jurisdictions. In addition to the code, state governents have also legislated other forms of relief for commercial and residential tenants.

Measures relating to execution of documents

It is generally acceptable for contracts (other than deeds) to be in electronic form and executed using electronic signatures in Australia. Section 127 of the Corporations Act permits companies to execute documents by two directors or a director and a company secretary. Australian State and Federal Governments

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have introduced measures to facilitate the execution of documents during the pandemic, including legislation allowing regulations to be issued to modify statutory requirements for signatures, witnessing of signatures, and the attestation of documents.

The New South Wales and Federal Governments have also made regulations pursuant to the new legislation. The Federal regulations temporarily allow a company officer to cause the company to execute a document by signing electronically and by signing on an individual counterpart (i.e. where there is more than one director, in split counterparts), and thereby better facilitates signing remotely. The New South Wales regulations temporarily allow signatures on documents, including wills, powers of attorney, deeds, affidavits and statutory declarations, to be witnessed via audio visual link during the COVID-19 pandemic. At the time of writing, other Australian jurisdictions have yet to issue any regulations under the new legislation.

Australian courts have also introduced measures to make it easier to sign, witness and file court documents (such as affidavits) electronically during the COVID-19 pandemic.

Measures relating to corporate meetings

The *Corporations (Coronavirus Economic Response) Determination (No 1) 2020* (Cth) made on 5 May 2020 was made as a response to the COVID 19 pandemic and applies on a temporary basis until 6 November 2020. It allows companies to convene shareholder meetings entirely online, rather than as physical meetings.

Under the changes:

- notices of meeting can be provided via email and, if the meeting is to be held virtually, must include details as to how to attend and participate in the meeting virtually;
- a quorum can be achieved with shareholders attending online; and
- meetings can be held online.

Shareholders must still be given an opportunity to participate, speak and put questions to board members (via suitable technology) and companies are required to enable shareholders to vote virtually and to participate in the usual manner and in real time. Votes must be taken on a poll (and not a show of hands).

The temporary meeting changes apply to each provision of the Corporations Act, the Corporations Regulations, the Insolvency Practice rules, and the Passport Rules, that:

a) requires or permits a meeting to be held, or regulates giving notice of a meeting or the conduct of a meeting; or
b) gives effect to, or provides a means of enforcing, a provision in the constitution of a company or registered scheme, or in any other arrangement, that requires or permits a meeting to be held, or regulates giving notice of a meeting or the conduct of a meeting.

Accordingly, with effect from 5 May, the provisions apply to corporate meetings in external administration in Australia.

Foreign investment review framework

In response to COVID-19, from 29 March 2020 and for the duration of the COVID-19 crisis, all proposed investments subject to Australia's foreign investment review framework will require approval, regardless of the value of the investment or the nature of the foreign investor. Monetary screening thresholds have therefore been reduced to $ 0. To address the anticipated increase in the volume of transactions to be reviewed, timeframes for reviewing applications have also been extended to up to 6 months. The policy is intended to allow scrutiny of potentially opportunistic or predatory transactions taking advantage of the market dislocations caused by the COVID-19 crisis.

Australia's foreign investment review framework includes an exemption for acquisitions of interests held as security for, or acquired by enforcement of, a money-lending agreement. The reforms therefore should not discourage lending to Australian companies or enforcing against collateral situated in Australia.

The impact of the pandemic on the practice of restructuring & insolvency law

Like elsewhere, the pace of legislative and legal change, and financial and operational challenges facing businesses, are unprecedented and affect all aspects of restructuring and insolvency practice. In addition to the emergency measures outlined above, the Australian Courts have responded to the pandemic in a constructive and innovative fashion. Court hearings are now routinely conducted by telephonic or audio visual means including, in some cases, utilising new technologies such as Zoom audio visual conferencing. Judges have, in the significant external administration cases which have come before them since the commencement of the outbreak, been disposed to entertain applications which seek relief befitting these extraordinary times. For example, the administrators of collapsed fashion retailer, Colette, obtained relief in respect of rent payment obligations of approximately AU$ 650,000, with the Federal Court holding that the 'extraordinary' circumstances of the virus meant paying rent was not in

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the interest of the companies' creditors.[1] Similarly, in a recent application for a range of critical and novel relief made by the administrators of the Virgin Australia group, the Federal Court observed that:

> 'The COVID-19 pandemic is causing great disruption to the whole Australian community and the economy. Nevertheless, existing laws that are made or authorised by Federal or State Parliaments must be adhered to and enforced by the courts. However, the COVID-19 pandemic, and the consequent restrictions on the movement and behaviour of people, is a reason to apply flexibility in the application (and perhaps adaption) of existing laws, and to exercise any discretion residing in a court to ensure that the Australian community and economy are supported during this time of crisis.'[2]

It is unknown how long the pandemic will continue to impede economic activity, nor how long it will take for markets to recover. In the meantime, we wish our colleagues in all jurisdictions good health and best wishes in these difficult times.

Notes

1 *Strawbridge (Administrator), in the matter of CBCH Group Pty Ltd (Administrators Appointed) (No 2)* [2020] FCA 472 at [57].
2 *Strawbridge, in the matter of Virgin Australia Holdings Ltd (admin appt)* [2020] FCA 571 at [5].

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Directors' Duties in a COVID-19 World

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Synopsis

With a global pandemic causing unprecedented uncertainty for businesses, it has never been more difficult for the directors of UK companies fully to discharge their duties – and the risks when they do not do so have never been higher. Government schemes which seek to protect UK businesses may add to the pressure on directors to continue trading through financial difficulty, but it is essential that they appreciate what potential liability they face when doing so. Even if there were legal clarity as to the scope and content of a director's duty in respect of creditors' interests, discharging that duty is incredibly challenging when so much factual uncertainty exists.

Introduction

These are uncertain times. Events which only weeks ago would have been unfathomable to many in the business community have occurred with alarming speed. The effect on business is predicted by some to be worse than each recession since the Great Depression. Few sectors have been untouched by the pandemic. Major economies have ground to a halt. It is impossible to be certain if and when businesses will return to pre-pandemic normality and what 'new normal' might emerge.

It has never been more difficult for UK company directors to discharge the duties which bind them under the Companies Act 2006 ('CA 2006') and at common law. Already dealing with increasingly stringent governance requirements, increased risk of investigation and Parliamentary scrutiny, increased prevalence of shareholder class actions, a growing market in the trading of claims and legal reforms which increase the risk of personal liability (for example, the Pension Schemes Bill), directors are required to make decisions about the best interests of their companies in this uncertain landscape. Their doing so is complicated by the potential availability of untested tools (principally those created on an emergency basis by Government) to deal with the crisis. Never before in living memory have directors had to consider, for example, whether it is in the best interests of a company to furlough employees. For companies taking advantage of Government schemes, there is further uncertainty about what happens when those schemes end. For example, will they be able to afford to pay employees when they come off furlough?

This article (in which the law is stated as at 7 May 2020) focuses on the issues for directors of companies that are at risk of insolvency as a result of the pandemic. Successful directors, particularly of large and previously stable companies, do not often have experience of decision-making in these circumstances. They are being 'thrown in at the deep end' and will need quickly to digest how their duties are affected by insolvency risk. While directors are familiar with their core fiduciary duty to act in the best interests of their companies, the idea that best interests must be assessed by reference to creditors not just shareholders can feel alien.

Duty to promote the success of the company

Section 172(1) CA 2006 provides that directors must act as they consider, in good faith, would be most likely to promote the success of the company for the benefit of shareholders. The statutory wording appears to require directors always to act in shareholders' interests. However, both CA 2006 and the common law provide safeguards.

The section 172(1) factors

Section 172(1) identifies, non-exhaustively, six factors to which directors must have regard when discharging this duty, including the long term consequences of directors' decisions and the fostering of relationships with suppliers and customers. It does not prescribe how these factors must be weighed but is clear that they cannot override the obligation to act for the benefit of the company's shareholders. Though it is unclear what liability will attach to directors who do not have regard to these factors, directors are unlikely to be liable unless their decision was one that no reasonable director, having regard to the correct factors, would have taken.

Creditors' interests

Section 172(3) preserves common law rules requiring 'directors, in certain circumstances, to consider or act in the interests of creditors of the company.' Common law has not precisely identified when this duty arises or what is required of directors when it does.

The Court of Appeal gave the most recent and authoritative statement of the common law in *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112, where David Richards LJ reviewed many earlier authorities. The court was asked to consider when the directors' duty to consider or act in the best interests of creditors, termed 'the creditors' interests duty', arose.

It is trite that directors do not owe any duty directly to creditors save in an exceptional case where directors have assumed responsibility to creditors (for example, by making a fraudulent statement to creditors or a negligent misstatement to creditors where the law imposes a duty of care). Directors continue to owe their duties only to the company. The issue is broadly when, in discharging their duty to promote the success of the company, directors must measure that success by reference to creditors not shareholders.

The claimant in *Sequana* unsuccessfully argued that the creditors' interests duty should arise when a company has a real, not fanciful or remote, risk of insolvency. Instead, the court held that the duty only arises when the directors knew or should have known that their company is, or is more likely than not to become, insolvent. The test as expressed in earlier authorities, using phrases like 'doubtful solvency', 'marginal solvency' and 'serious financial difficulty', was thus clarified.

Arguably, the court set the point at which the creditors' interests duty will arise quite late in a company's gradual decline, though that will provide directors little comfort given the impact of the pandemic has been anything but gradual. Setting the trigger too early could, per David Richards LJ, have a chilling effect on business because it could prevent directors from taking entrepreneurial risks due to a perceived need to preserve capital for creditors.

Though *Sequana* helpfully clarified when the duty arises, important questions remain unanswered:

- The Supreme Court was due to hear an appeal in *Sequana* in March 2020 but this was postponed as a result of the UK lockdown. It is now unrealistic to expect judgment until 2021. The claimant will ask the Supreme Court to hold that the creditors' interests duty arises at some stage before the company is or is more likely than not to become insolvent. It would be imprudent for directors of companies currently in financial difficulty to postpone all consideration of creditors' interests until such companies are or are more likely than not to become insolvent; any Supreme Court restatement about when the duty arises will have retrospective effect so that directors who rely on the Court of Appeal judgment might unwittingly be in breach of duty by failing to take into account creditors' interests when they should have done. While ignorance of the law is not generally a defence, if they act reasonably and honestly, and rely on appropriate legal advice, they may be excused of liability under section 1157 CA 2006.
- When the creditors' interests duty arises, what effect does it have? Are the directors required only to consider the interests of creditors and, if so, how should they be weighed against other stakeholders' interests? Or does the duty require directors to act in creditors' interests so that they prevail over all other stakeholders' interests? Neither *Sequana* nor earlier authorities clearly define the content of the duty – in *Sequana*, David Richards LJ stressed that this issue did not arise. As we explain below, in many cases its effect may not often matter.

Dealing with factual uncertainty

The directors' subjective determination of whether their company is or is more likely than not to become insolvent is relevant following *Sequana*. Companies' fortunes change, sometimes on a daily or hourly basis. A company may be more likely than not to become insolvent, but never actually do so. Companies may swing repeatedly between being likely to become insolvent and being likely to remain solvent. Directors constantly need to monitor whether the creditors' interests duty arises. How should they do so in the current environment?

Insolvency for these purposes is assessed on both a cashflow and balance sheet basis (as under section 123 of the Insolvency Act 1986 ('IA 1986')), by reference to the company's actual solvency position, not potential entry into an insolvency process.

Cashflow insolvency

A company is likely to become cashflow insolvent if it is more likely than not to be unable to meet its debts as they fall due. Put simply, is the company likely to run out of cash?

There are real difficulties with making that assessment currently. Market experience suggests that many companies preparing cashflow forecasts have assumed that they will have much reduced or no turnover for 3 to 12 months. It is unclear whether that is a correct assumption and, even when the current lockdown eases, whether and how quickly turnover will return to pre-pandemic levels. For companies with significant debts falling due in the medium term which they will be unable to meet unless income recovers in the same period, they may even now be more likely than not to become insolvent so that the creditors' interests duty arises.

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As to expenditure, many businesses are reducing discretionary spending and cutting costs. Some outgoings may be met via Government schemes, though it is not certain how long these schemes will last and whether support will remain at current levels. The costs of operating businesses in the current climate and when lockdowns ease may increase, for example as a result of adjustments that must be made to respond to health concerns. It is unclear what adjustments may be required and what impact they may have on profitability, but their cost should not be underestimated. Even businesses which are perceived to be experiencing increased demand during the pandemic may not realise profits as a result. For example, supermarket Sainsbury's recently announced that it expected to suffer a substantial reduction in annual profits partly as a result of adopting safety measures for the benefit of its customers and staff. Online retailer Amazon announced that it might report an annual loss due to expanding its workforce, purchasing protective equipment and disinfecting its warehouses.

Turning to financing obligations, directors may need to re-assess when payments of principal and interest will become due. The pandemic has caused some companies to breach financial covenants with which they were previously unproblematic to comply. Other companies have potentially triggered events of default which are rarely considered in practice, for example in relation to cessation of a substantial part of a borrower's business, material adverse change and non-compliance with an approved business plan. Breaches and defaults will likely permit lenders to accelerate. Directors will be required to take a view on whether lenders are likely to accelerate and, if so, whether the company is likely to be unable to repay in full upon demand. The market has little experience of whether lenders will accelerate debts as a result of these breaches and defaults or whether waivers might be available; there is little precedent to inform directors' views. The likely stance of lenders is more difficult to predict due to their diversity – no longer are lenders exclusively banks – and the complexity of debt capital structures.

Assessing cashflow also requires a view to be taken by directors about their companies' counterparties. In many markets, companies which supply goods and services have not required payment on account. The recipients of those goods and services, anxious to preserve cash, may now seek to withhold or delay payment. Liability under invoices may ultimately be compromised at less than their value. Costly proceedings may be required in order to recover other liabilities. Though directors of these counterparties, at least if they are UK companies, might need to consider whether preserving cash in this way takes appropriate account of the need to foster business relationships with suppliers, being one of the factors listed under section 172(1) CA 2006, the reality for suppliers is that invoices are not being paid as they once were. Directors must consider this when forecasting cashflow.

The best protection for directors is to ensure that their cashflow forecasts use reasonable assumptions, that they genuinely believe them to be reasonable and that the forecasts cover an appropriate period.

Balance sheet insolvency

The balance sheet test is also difficult for directors to apply currently. The current pandemic has made it difficult to value assets and liabilities. For example:

- Where valuation turns upon the availability and robustness of a market, current market stagnation is likely to impact the accuracy and attractiveness of asset valuations.
- Where counterparties are unable or unwilling to pay, the debts due to a company may become more difficult to recover. This is likely to impact the value of the company's receivables (or require bad debt provisioning).

Again, the best protection for directors is to ensure that they are making reasonable assumptions, with appropriate valuation or accounting advice, and that they genuinely believe them to be reasonable.

Content of the creditors' interest duty

When the creditors' interests duty applies, what does it require of directors? There is little guidance in the cases.

When a company is actually insolvent, creditors' interests probably prevail over shareholders' interests because shareholders generally no longer have an economic interest in the company. Though this issue was not determined in *Sequana*, David Richards LJ stated that 'where the directors know or ought to know that the company is presently and actually insolvent, it is hard to see that creditors' interests could be anything but paramount.'

Even this simple proposition begs questions in the current pandemic. The abrupt change to market conditions and the reaction of many companies seeking to preserve cash is likely to lead to a liquidity crisis, especially for companies in the supply chain. It will be risky for their directors to cause these companies to assume additional debt financing in circumstances where the company is uncertain to be able to make repayments. These companies may therefore already be more likely than not to be unable to pay their debts as they fall due so that the creditors' interest duty applies, despite having adequate assets to make whole all creditors were the company wound up with any surplus being paid to shareholders. Is it right that the interests of creditors

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should be paramount even where shareholders retain an economic interest in the surplus and it is only a single debt due to a single creditor which cannot be paid when due? The cases do not provide an answer.

Where the company is more likely than not to become insolvent but is not actually insolvent, it is still more unclear how the interests of shareholders and creditors should be balanced. Some academics and limited pre-*Sequana* judicial guidance suggest tentative support for a spectrum in which the more likely a company is to become insolvent, the more weight must be given to the interests of creditors. Put another way, the extent to which creditors' money is at risk affects the regard which must be had to their interests. *Sequana* confirms that the creditors' interest duty does not apply at all until the point on the spectrum at which the probability of insolvency is more than 50%, but does not address the weight of creditors' interests relative to those of other stakeholders beyond that point.

When this question is finally determined by an appellate court, creditors' interests may be held to prevail when a company is actually insolvent but not where a company is merely more likely than not to become insolvent, in which case creditors' interests must be balanced with other interests. It would then be up to the directors to form judgments as to the weight to be given to creditors' interests. Board members may disagree, potentially hampering decision-making and promoting stalemate, at precisely the time when quick and decisive action is required to give the company the best possible chance of survival.

Does the duty's content matter?

The lack of clarity as to timing and content of the creditors' interests duty, and the potential impact for directors' personal liability, can only add to the sense of concern and uncertainty that many directors will currently be experiencing. However, it is arguable that the creditors' interests duty will only rarely impact directors' decision-making or give rise to personal liability. The interests of shareholders and creditors often align – both wish the company to be successful so that they can be paid – so that it does not matter whose interests the directors actually considered.

Reported cases in relation to the creditors' interests duty tend therefore to arise out of transactions where the interests of shareholders and directors conflict, such that a decision in the interests of shareholders necessarily prejudices the interests of creditors. *Sequana* concerned the payment of a dividend to shareholders when, it was alleged, cash ought to have been preserved to meet the company's liabilities. Earlier cases concerned other shifting of value to shareholders: for example, *West Mercia Safetywear v Dodd* [1988] BCLC 250 concerned payment of money to a holding company and *Kinsela v Russell Kinsela Pty Ltd* (1986) NSWLR 722 concerned a lease granted to directors on favourable terms.

When the courts finally determine the content of the creditors' interests duty, it may be negative not positive – rather than requiring directors to act in or consider the best interests of creditors, it may require only that directors do not prejudice or ignore those interests when a company is actually or more likely than not to become insolvent. That is not a new idea, and was characterised by Professor Sealy as more akin to a duty of care than a fiduciary duty (see (1988) CLJ 175). This negative formulation of the common law duty would be similar to the statutory wrongful trading test, to which we return below. If this is the correct formulation, the duty will require directors to act differently to how they would in a solvent company principally where creditors' interests require assets to be preserved while shareholders continue to have an interest in the company taking entrepreneurial risk.

Why, then, do boards and their professional advisers spend so long considering the interests of creditors? The simple answer is that if creditors' interests are not properly considered, and if the company does enter an insolvency process, an administrator or liquidator may pursue claims against directors in relation to how the directors responded to the company's financial difficulties. Where directors acted to preserve assets which are available for distribution by the administrators or liquidators, they are less likely to be criticised. Favouring a cautious approach so as to minimise the consequences for creditors upon insolvency may also be thought to assist directors responding to post-insolvency investigations (including via the public forum of Parliamentary Select Committees) and disqualification proceedings.

However, too cautious an approach also puts the directors at risk. First, creditors' interests may be best served by continuing to trade, at least if there is real prospect of survival or an opportunity to realise profits with which to minimise losses to creditors in an insolvency process.

Second, if the creditors' interests duty does not require creditors' interests to prevail to the exclusion of other interests, logically the directors must continue to owe a residual duty relating to shareholders' interests. If the company ultimately recovers but does so more slowly due to an overly cautious approach being adopted, shareholder returns may be affected. Unlike creditors, whose only likely remedies against directors are via an insolvency process, shareholders can seek to sue directors in the name of the company via the derivative claims regime under Part 11 of CA 2006. Minority shareholders may also seek other relief in respect of unfair prejudice under section 994 CA 2006 (particularly where the board is largely comprised of majority shareholder appointees). This issue receives little attention but is a potential source of future litigation, especially given the increased prevalence of shareholder class actions and availability of litigation funding. While it may

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be difficult to imagine that directors who have successfully managed their companies through the pandemic, ensuring survival, will subsequently be criticised for taking too cautious an approach, and while courts are generally slow to find breaches of duty arising out of the honest and reasonable business decisions of directors, the possibility of shareholders de-risking litigation via funding and adverse costs insurance policies and shareholders' potential access to meaningful recoveries via a directors and officers' insurance policy could well encourage such claims.

Group companies

One aspect of the duty which is likely to have the most significant effect on day-to-day decision making in large corporate groups is the impact on ratification of directors' breaches of duty.

In a solvent situation, directors tend to identify the interests of group companies on a collective basis, reflecting the interests of the group's ultimate shareholders. This potentially gives rise to numerous breaches of the directors' duty to act so as best to promote the success of an individual company within the group, but such breaches can be ratified (including informally under the *Duomatic* principle) by each group company's shareholders.

When a group is in distress, the potential for different companies within that group to have different interests is increased. Some companies may be best served by taking on new debt. Others will be so reliant on their affiliates that their best hope of survival is to secure the affiliate's survival, perhaps via the granting of security or guarantees. Where the creditors' interests duty applies, *West Mercia* and other authorities confirm that shareholders can no longer ratify the directors' breaches.

Directors must therefore identify the interests of each individual group company and, for those companies that are or are more likely than not to become insolvent, must apply the creditors' interest duty. Failing to do so risks liability.

For groups which operate and are managed via group-wide divisional structures, effectively ignoring the separate legal personality of each entity within the group, it is often challenging accurately to assess the individual position of any single group company, more so if each group company is unable to continue trading without the support, services or personnel of its affiliates. As the Nortel Networks insolvency has shown, the costs ultimately borne by creditors when these divisional structures need to be unwound in insolvency can be very significant, as can be the time required to resolve disputes which arise between companies as to their relative entitlement to the proceeds of transfers of a business previously operated jointly by several entities within a group.

Wrongful trading

It is important to distinguish between the common law creditors' interests duty and wrongful trading liability under sections 214 and 246ZB IA 1986.

While the creditors' interests duty will arise wherever a company is more likely than not to become actually insolvent, wrongful trading focuses on directors' acts when there was no reasonable prospect of avoiding insolvent administration or insolvent liquidation. The statutory regime is therefore triggered when it is almost inevitable that creditors' money is at risk, yet requires directors only to minimise losses to creditors (a negative test). By contrast, the common law duty may arise long before insolvent administration or insolvent liquidation is inevitable, and might impose some form of positive duty on directors.

The differences are well illustrated when directors consider entry into administration to facilitate a company's rescue. In order to obtain an administration order, paragraph 11(1)(a) of schedule B1 IA 1986 requires that 'the company is or is likely to become unable to pay its debts'. This is the same test that triggers the creditors' interests duty at common law. However, if there remains a reasonable prospect of rescue via administration, and avoidance of insolvent administration, directors cannot be liable for wrongful trading. That remains the case even if the rescue subsequently fails and the administration becomes insolvent.

The Government has announced that the wrongful trading regime will be suspended in response to the pandemic, with retrospective effect from 1 March 2020 for three months. Legislation to implement this suspension is awaited. It appears that the Government's objective is to prevent directors prematurely placing companies into an insolvency process so as to minimise losses for creditors for fear that, if they do not, the directors themselves will be personally liable. Government's announcement referred to 'temporarily suspending wrongful trading provisions … for company directors so they can keep their businesses going without the threat of personal liability.'

However, it is not correct that companies in difficulty can continue trading without threat of personal liability for directors. Suspension of the threat of wrongful trading liability will place increased emphasis on the creditors' interests duty. If directors would have been at risk of wrongful trading liability but for its suspension, the common law duty must arise: if there is no reasonable prospect of avoiding insolvent administration or insolvent liquidation, the company must also be more likely than not to become insolvent. If the common law duty is a negative one, it may require directors to minimise losses for creditors just as would the wrongful trading regime. If the duty is a positive one, additional steps may also be required of directors.

What impact will the suspension have? Oddly, it could increase potential liability for directors. Directors are

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seldom criticised by the courts for seeking insolvency protection too soon. Courts tend to be sympathetic to directors who are, in difficult circumstances, doing all that they can to manage a company into an orderly insolvency process which will realise value for creditors. However, the suspension of wrongful trading laws, and the Government's message that directors can continue to trade without risk of personal liability, will increase pressure on directors to continue trading companies which should otherwise seek insolvency protection. The creditors' interests duty may not look kindly on them doing so.

Similar issues arise for other announced reforms. Government debt has been made available and companies are encouraged to use it, but it is still debt which directors should not take on if the company has no means of repaying it. Reforms to introduce a short moratorium during which directors will retain management control have been announced, but when should directors use this and what are their duties during the moratorium period? Ordinarily, companies benefitting from moratoriums are managed by insolvency practitioners who are well used to that role, not by directors who may have little relevant experience. With each scheme or reform announced by Government, directors are being required to answer questions which have never been asked previously.

The continued importance of other duties

Amongst detailed discussion of the creditors' interests duty during the pandemic, directors must not forget their other duties. It is, in truth, relatively easy for an honest director to ensure compliance with the creditors' interests duty because, even though the trigger for the duty incorporates an objective element where the directors should have known that the company was or was likely to become insolvent, the duty itself is subjective. Directors will not be liable if they do what they honestly think best protects creditors' interests. Further, it is relatively rare for the interests of shareholders and creditors to diverge such that directors need choose between them. Even in acute financial difficulty, maximising the value of the company and taking reasonable steps (as opposed to costly gambles) to seek to ensure its survival will often serve both shareholders' and creditors' interests.

If directors should have realised that the company was more likely than not to become insolvent, they will not automatically be liable for breach of duty simply because they did not and failed to take any account of creditors' interests. They may have reached the same decision had creditors' interests been considered or the company's position may have been so dire that, no matter what decision the directors made, the company would have ended up in the same position – in either case, the directors' decision will not have caused loss to the company. Further, if a reasonable director, having taken into account creditors' interests, could have reached the same decision as the directors actually did (absent consideration of creditors' interests), the directors may not be liable: *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch). Even if they are liable, directors' liability can be excused under section 1157 CA 2006 where they acted reasonably and honestly.

It is uncommon for directors to be sued solely for breach of duty where establishing fault turns on the subjective belief of the directors. Breaches of other general duties are more easily proven. Directors will be in breach of duty under section 174 CA 2006 if they fail to exercise the level of skill, care and diligence that a reasonable director having the same knowledge, skill and experience would have exercised. This duty is likely to be broad enough to catch costly gambles made in an attempt to ensure a company's survival. Equally, it can likely catch a director's decision to continue trading when a reasonable director in the same situation would not have done so.

Other duties also create traps for the unwary. Directors cannot take advantage of their company's business opportunity, absent prior authorisation, even if the company is unable to pursue the opportunity due to insolvency: *Davies v Ford* [2020] EWHC 686. Consider a group of companies with common directors, where opportunities are made available to the group and the directors allocate them between companies. Absent prior authorisation, each allocation is *prima facie* a breach of duty – one group company's interests are prioritised over another's. If shareholders cannot ratify the breach because the creditors' interest duty has arisen, a subsequent insolvency officeholder can sue directors for breach and potentially obtain a remedy not only against them but also the group company that took up the opportunity.

And it is not only directors' general duties that must be observed. For example, directors remain required under section 363 CA 2006 to ensure that a company's accounts give a true and fair view. With all of the uncertainty caused by the pandemic and its effect on many aspects of a company's balance sheet, this is not straightforward even with the benefit of skilled advice.

Conclusion

Directors are being asked in this crisis to step up to a role which is alien to many, carrying their companies through distress and continuing to trade even where insolvency is likely. It has never been more important for directors to understand their duties in these circumstances. While the Government is hoping that directors will steer businesses through, where companies do fail, it is unlikely that directors' decisions will avoid critical scrutiny. For directors, the risks have never been higher.

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The Impact of the CARES Act on US Consumers, Small Businesses, Bankruptcy and Insolvency Laws and Procedures

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Summary

COVID-19 is taking an alarming and unfortunate toll on the world's population. In the United States, the number of COVID-19-related deaths will soon approach 75,000. Billions of dollars of economic output will be lost. As a consequence, on 27 March 2020, US lawmakers signed the Coronavirus Aid, Relief, and Economic Security Act (the 'CARES Act') into law. It provides USD 2.2 trillion in economic stimulus to various sectors of the American economy. This article explains three aspects of the CARES Act: a consumer economic stimulus, a small business payment protection program, and the impact of the CARES Act on US bankruptcy laws and procedures in several of the nation's busiest bankruptcy courts.

Additional consumer protections

The CARES Act provides many Americans with a one-time economic stimulus payment. The amount of this payment is based upon an individual's adjusted gross income reported on the individual's 2018 or 2019 (whichever was most-recently filed) Federal income tax return up to a threshold of USD 99,000 for individuals and USD 198,000 for married couples. Section 1113 of the CARES Act also clarifies that, in chapter 7 liquidation filings, these payments are excluded when calculating current monthly income in deciding a debtor's eligibility. In connection with individual debtors' chapter 13 filings, these payments are excluded when calculating a debtor's disposable income.

Section 1113 of the CARES Act also aids chapter 13 debtors operating under a confirmed bankruptcy plan. As of 27 March 2020, a debtor may extend a confirmed plan for up to seven years from the date the first payment is due under the plan. To qualify for this postponement, a debtor must demonstrate a 'material financial hardship' resulting from the COVID-19 pandemic. Courts will decide what constitutes such a hardship based on the facts of each case.

Paycheck Protection Program

One significant facet of the CARES Act impacting small businesses is the Paycheck Protection Program (the 'PPP'), which is administered by the US Small Business Administration (the 'SBA'). It enables most businesses with less than 500 employees to obtain low-interest loans of up to USD 10 million that may ultimately qualify for partial or complete forgiveness to cover costs while they are shuttered by State and/or local COVID-19-related shutdown orders. The SBA will forgive a borrower's PPP loan if at least 75% of the proceeds are spent on eight weeks' worth of eligible business expenses, which include paying current employees (subject to a cap of USD 100,000 on any one employee's salary) or rehiring workers who had been furloughed or laid off between 15 February 2020 and the date of implementation of the PPP program. Any other PPP loan proceeds may be spent on rent, insurance premiums, utility bills, or interest payments. Any PPP loan proceeds that do not qualify for forgiveness must be repaid over a two-year term at a 1% fixed rate.

Since the inception of the PPP program through the passage of the CARES Act, the SBA has issued guidance to shed additional light on the requirements for obtaining loan forgiveness and the ineligibility of certain businesses to obtain PPP loans. Importantly in the bankruptcy context, the SBA issued an interim final rule on 15 April 2020, confirming that companies currently in bankruptcy are not ineligible for the PPP program. Debtors cannot apply for PPP loans, and companies that previously applied for a PPP loan and later filed for bankruptcy before receiving PPP loan proceeds must cancel the PPP application.[2] Notably, Chief Bankruptcy Judge David R. Jones of the United

Notes

1 Mr. Kodish is admitted to practice law in the State of Maryland and The District of Columbia.

2 Business Loan Program Temporary Changes; Paycheck Protection Program – Requirements – Promissory Notes, Authorizations, Affiliation, and Eligibility, 13 CFR 120-121 (2020).

States Bankruptcy Court for the Southern District of Texas and Bankruptcy Judge David Thuma for the United States Bankruptcy Court of the District of New Mexico subsequently made rulings that would either partially or completely invalidate the PPP's bankruptcy exclusion.[3] Conversely, Bankruptcy Judge Brendan L. Shannon of the United States Bankruptcy Court for the District of Delaware declined to reach a similar result.[4] Given that there are at least two similar challenges pending in two other United States Bankruptcy Courts as of the date of this article, it is safe to say that this issue is unsettled and will likely require a more definitive ruling from one of the United States Courts of Appeals or even, potentially, the United States Supreme Court.

Expansion of streamlined bankruptcy process

In August 2019, the Small Business Reorganization Act of 2019 (the 'SBRA') took effect. Its primary benefit is that companies with debts under USD 2,725,625 can file for chapter 11 bankruptcy. Among other protections, debtors benefit from the Bankruptcy Code's automatic stay: actions by creditors to pursue lawsuits, enforce liens, and collect debts against debtors are placed on hold. The SBRA also streamlines and reduces other costly expenses that are often incurred in bankruptcy cases. Importantly, Section 1113 of the CARES Act amends the SBRA to provide eligibility for small businesses with debts up to USD 7,500,000 to file under the SBRA's standards. This new limit will remain in effect for one year, when the threshold will revert to USD 2,725,625. The increased debt limit applies only to cases filed after the effective date of the CARES Act (*i.e.*, 27 March 2020).

Many bankruptcy courts in the United States have adopted special rules and procedures in light of the pandemic and the enactment of the CARES Act. For instance, on 20 April 2020, the United States Bankruptcy Court for the District of Delaware issued an Interim Order which amends Interim Bankruptcy Rule 1020 to comport with the provisions of the CARES Act and provides the benefits and expedited procedures afforded by the SBRA. This Interim Order expands Interim Rule 1020 to include small business debtors with debts up to USD 7,500,000 as otherwise defined by section 1182(1) of the Bankruptcy Code. The amended version of Interim Rule 1020 will remain in effect for one year following the enactment of the CARES Act.[5] On 23 April 2020, the United States Bankruptcy Court for the Southern District of New York issued General Order M-546, which has the same practical effect as the Interim Order signed three days earlier by the Bankruptcy Court for the District of Delaware.[6]

Telephonic and electronic hearings

Most US bankruptcy courts have altered their practices and procedures in other ways to mitigate the spread of COVID-19. For example, the United States Bankruptcy Courts for the Southern District of New York, the Eastern District of New York, the District of Delaware, and the Southern District of Texas have each issued Orders that require most, if not all, hearings to proceed electronically or telephonically. In the Southern District of New York, General Order M-543 provides that hearings and conferences scheduled for the Manhattan, White Plains, and Poughkeepsie Divisions of the Bankruptcy Court will be held telephonically. Parties can also request adjournments of hearings or conferences by filing a motion or request detailing the request and its basis. Effective as of 13 March 2020, all in-person chapter 7, 12, and 13 section 341 meetings[7] scheduled through 10 April 2020 have been continued to a later to be determined date, and section 341 meetings cannot proceed during this period except by telephonic or other alternative means that do not require the personal appearance of debtors.[8]

In the Eastern District of New York, all hearings will be held by phone and recorded by the Court until further notice.[9] Other recordings of those telephonic hearings may not be made. All in-person chapter 7, 12, 13 and section 341 meetings scheduled through 10 April 2020 have been continued to a later to be determined date, and section 341 meetings may not proceed unless

Notes

3 See *Hidalgo County Emergency Service Foundation v Jovita Carranza, In Her Capacity as Administrator for the U.S. Small Business Administration*, Case No. 20-2006 (Bankr., S.D. Tex., 24 April 2020) and *In re Roman Catholic Church of the Archdiocese of Santa Fe*, Case No. 18-13027 (Bankr. D. N.M., 1 May 2020).

4 *Cosi Inc. v Small Business Administration et al.*, Case No. 1:20-ap-50591 (Bankr. D. Del., 30 April 2020).

5 *In Re: Adoption of Cares Act Changes To Interim Bankruptcy Rule 1020*, Bankr. D. Del., 20 April 2020.

6 *In Re: Adoption of Temporary Amendment to Interim Bankruptcy Rule 1020 Corresponding to the Coronavirus Aid, Relief, and Economic Security Act*, Bankr. D. S.D.N.Y., 23 April 2020.

7 A 341 meeting takes place about one month after an individual files for chapter 7 bankruptcy and includes the individual filer (and his/her attorney, if applicable) and the chapter 7 trustee. The meeting is optional for creditors or their attorneys. The purpose of a 341 meeting is to confirm that: (a) all required Court filings and exhibits are in order, (b) the individual filer is not attempting to commit fraud, and (c) which of the filer's non-exempt assets can be sold to repay creditors.

8 General Order M-543, Bankr. S.D.N.Y., 9 April 2020.

9 Home page, Bankr. E.D.N.Y., <https://www.nyeb.uscourts.gov/>, 8 April 2020.

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by telephonic or other means not requiring a personal appearance.[10]

In the District of Delaware, as of 28 April 2020, all visitors to the Bankruptcy Court, including litigants and attorneys, must wear a mask or face covering when in public areas of the Court and when interacting with the Court's staff.[11] Additionally, Court hearings that are not considered time sensitive have been continued to a later, to be determined date; the rescheduled date will be decided by the presiding judge, but in no event can it occur before 18 May 2020. All Court hearings occurring before 18 May 2020 will be held telephonically and/or by video conference unless otherwise ordered by the presiding judge. The method for submitting evidence for telephonic and/or video conference Court hearings held before 18 May 2020 will be determined by the presiding judge on a case-by-case basis.[12]

In the Southern District of Texas, all hearings will be conducted electronically until further notice. Hearings may be held either by the judge assigned to the case, or by any other bankruptcy judge. Notice of chapter 13 panel hearings will take place through a notice posted by the chapter 13 trustees on the trustee's website. Unless otherwise ordered, 'chapter 13 panel hearings will only be heard if there is a statutorily imposed deadline for the conduct of the hearing', and the trustees 'will post a hearing calendar that contains only matters with statutorily imposed deadlines'.[13]

Other adjustments to court rules and procedures

Some Courts have made adjustments that may have a more substantive effect on creditors and debtors alike. For instance, on 9 April 2020, the United States Bankruptcy Court for the Southern District of New York issued General Order M-545, which provides that for individual chapter 7, 11, 12, and 13 cases, an original signature is no longer necessary to electronically file a document bearing that signature, subject to the fulfillment of certain conditions. Additionally, creditors providing temporary suspensions of mortgage payments to debtors are required to file a Notice of Temporary Forbearance, which is attached as an addendum to General Order M-545. Similar creditor-debtor communications regarding forbearance during the forbearance period do not violate the automatic stay. The additional protections afforded by General Order M-545 will remain in effect until 1 July 2020.[14]

Some judges have also approved temporary case management procedures designed to ease administrative burdens and decrease debtor costs. For example, in *In re CraftWorks Parents, LLC, et al.*, Judge Brendan Shannon of the United States Bankruptcy Court for the District of Delaware issued an order that (1) permits the debtors to reject executory contracts and unexpired leases via email, (2) encourages parties who desire a lifting of the automatic stay to first contact the debtors to seek a consensual agreement, (3) delays any hearings on non-urgent lift-stay motions until at least 30 April 2020, (4) encourages all parties-in-interest to address outstanding disputes via stipulation, and (5) requires all hearings to be heard telephonically until further notice.[15] In addition, Judge Kevin Huennekens of the United States Bankruptcy Court for the Eastern District of Virginia in *In Re Pier 1 Imports, Inc.*, agreed to the temporary suspension of all proceedings and deadlines while explicitly authorising the temporary deferment of all rent payments due by a debtor to its creditor landlords.[16]

Conclusion

In light of the tremendous economic upheaval caused by the COVID-19 pandemic, the number of bankruptcy filings in the US will likely continue to rise months ahead. The CARES Act provides interim specific relief to debtors and creates a backdrop by which courts can provide additional flexibility during the bankruptcy process. But it is conceivable that the Federal and State governments will need to take additional measures to assist debtors, creditors, and the Courts in handling the continuing wave of filings directly or proximately resulting from the dramatic effects of COVID-19.

Notes

10 Telephonic 341 meeting of creditors during Covid-19 Emergency: Instructions for Testifying Debtors and Counsel, Office of the United States Trustee, E.D.N.Y., <https://www.nyeb.uscourts.gov/sites/nyeb/files/Covid-19-General-Instructions.pdf>, last visited 8 April 2020.

11 *In Re: Use of Face Mask/Coverings In Public Areas of the District And Bankruptcy Courts*, Standing Order, Bankr. D. Del., 28 April 2020.

12 *In Re: Second Amended Order Governing the Conduct of Hearings Due to Coronavirus Disease 2019 (COVID-19)*, Bankr. D. Del., 20 April 2020.

13 *In Re: Adoption of Contingency Plan to Address Possible Public Health Limitations on Court Operations*, Bankr. S.D. Tex., 9 March 2020.

14 General Order M-543, Bankr. S.D.N.Y., 9 April 2020.

15 Order (I) Establishing Temporary Procedures and (II) Granting Related Relief, *In re CraftWorks Parent, LLC, et al.*, Case No. 20-10475 (Bankr. D. Del., 30 March 2020).

16 Order Granting (I) Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief Motion to Approve, *In re Pier 1 Imports, Inc.*, Case No. 20-30805-KRH (Bankr. D. E Va., 6 April 2020).

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The German COVID-19 Insolvency Suspension Act (COVInsAG)

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Synopsis

The spreading COVID-19 pandemic has placed an almost unimaginable burden on private and economic life worldwide. With a view to reduce the devastating effects of the COVID-19 pandemic, the German federal government has initiated since end of March 2020 a wide range of economic and legal support measures for consumers and businesses. One of these measures is the so called COVID-19 Insolvency Suspension Act. It provides for far-reaching changes in the area of German insolvency law and is the subject of this article.

A. Introduction

The measures taken by the German authorities to reduce the spread of the COVID-19 pandemic, such as curfews, closure of certain businesses, etc. are economically forcing many people and businesses to their knees. The long-term economic consequences cannot be predicted yet.

With a view to reduce these dramatic economic consequences for consumers and businesses, the German federal government *(Bundesregierung)* has initiated various economic and legal support measures. One of these measures is the so-called COVID-19 Insolvency Suspension Act *(COVID-19-Insolvenzaussetzungsgesetz,* hereinafter referred to as 'COVInsAG'*)*, which came into force on 27 March 2020. The COVInsAG is an integral part of a larger package of German laws entitled 'Law on Mitigating the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Proceedings Law' (*Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*) and is regulated in its article 1. It provides for far-reaching changes in the area of German insolvency law and is the subject of this article. For a quick overview of the most relevant changes and practical recommendations, please refer to the summary at the end of this article.

B. Overview of the provisions of the COVInsAG

The COVInsAG consists of four paragraphs ('§'). §§ 1 and 2 COVInsAG contain rules on the requirements for a suspension of the duty of (managing) directors to file for insolvency (sec.15a of the German Insolvency Code (hereinafter referred to as 'InsO')) and the legal consequences of such suspension. § 3 COVInsAG provides for a temporary suspension of the right of creditors to file a petition for the opening of insolvency proceedings over the assets of a debtor (sec. 14 InsO).

§§ 1 to 3 COVInsAG entered into force retroactively as of 1 March 2020 (*cf.* for further details C.IV.). According to § 4 COVInsAG, the term of certain provisions of the COVInsAG may be extended until 31 March 2021, if necessary (*cf.* for further details C.IV.).

C. The individual provisions of the COVInsAG in detail

I. § 1 COVInsAG – Suspension of the duty to file for insolvency

1. § 1 sentence 1 COVInsAG – Comprehensive suspension of the duty to file for insolvency

Under German insolvency law, if a company or a partnership with limited liability is illiquid[2] (*zahlungsunfähig*, sec. 17 InsO) or over-indebted[3] (*überschuldet*,

Notes

1 The author expresses exclusively his opinion in this article.

2 Illiquidity under German insolvency law is defined as the debtor's inability to honour its payment obligations (now) due. This is generally indicated by the fact that the debtor has ceased to make payments. The debtor's illiquidity cannot be presumed if there is only a temporary delay in payments, for example, when the debtor's gap in liquidity can be closed to at least 90% by expected payments, new loans or the liquidation of assets within a short period of time (usually no more than two weeks).

3 The principal prerequisite for over-indebtedness is that the debtor's assets no longer cover its liabilities. This is determined by assessing a pre-insolvency balance sheet and valuing assets at their present liquidation values (*Überschuldungsbilanz*). Even if it turns out that on the basis of the pre-insolvency balance sheet that the assets do no longer cover the liabilities, the company is not over-indebted if, under the given circumstances, a continuation forecast demonstrates that the company's financial strength is sufficient to ensure its economic survival

cf. sec. 19 InsO), the (managing) directors have a duty to file for insolvency without undue delay and within a maximum period of three weeks (sec. 15a InsO). Failure to do so can result in very severe civil and criminal consequences/sanctions for the directors.

§ 1 sentence 1 COVInsAG now provides for a suspension of the duty to file for insolvency for the directors of (European)[4] companies and partnerships with limited liability (hereinafter referred to as 'Company' or 'Companies'; sec. 15a InsO) as well as for the management boards of associations (sec. 42 para 2 of the German Civil Code) until 30 September 2020. In material terms, the provision applies in case of an insolvency of the Company based on illiquidity and/or over-indebtedness.

2. § 1 sentence 2 COVInsAG – Exemptions from the suspension of the duty to file for insolvency

§ 1 sentence 2 COVInsAG provides that the suspension of the duty to file for insolvency pursuant to sentence 1 is excluded in the following two cases: (i) the insolvency (*Insolvenzreife*, i.e. illiquidity and/or over-indebtedness) of the Company is not 'based (*beruhen*) on the effects of the spreading COVID-19 pandemic' or (ii) there are no 'prospects (*Aussichten*) of eliminating an existing illiquidity' of the Company.

aa) Insolvency is based on the COVID-19 pandemic

Regarding the first exception – formulated positively – a suspension of the duty to file for insolvency may only apply if the insolvency of the Company is based on the effects of the spreading COVID-19 pandemic.

Unfortunately, neither the provision itself nor the legislative materials of the COVInsAG explain or define the concept of 'based on the COVID-19 pandemic' more precisely. The legislative materials only indicate that a causality (*Kausalität*) is required.[5] However, according to the main purpose of the COVInsAG – the support and rescue of fundamentally healthy Companies that have fallen into a financial crisis, particularly as a result of the COVID-19 pandemic[6] – the concept must be interpreted narrowly. This means that the direct and/or indirect effects of the COVID-19 pandemic must not only have been partly causal in the occurrence of the insolvency of the Company. Rather, the effects of the COVID-19 pandemic must have been decisive in the sense of a *conditio-sine-qua-non* for the occurrence of the insolvency. Such a strict causal link can often be assumed, for example, in the case of an ordered closure of the Company's business and an associated massive loss of turnover and liquidity (*cf.* C.I.4 for the practical documentation needs of the directors in this context).

bb) Prospects of eliminating an existing illiquidity

Cumulatively to the causal link, a Company must at the same time have prospects of eliminating its existing illiquidity (hereinafter referred to as 'Prospect Test').

First, it is noteworthy that the German legislator is only aiming to eliminate an existing illiquidity[7] within the Prospect Test. The legislator obviously assumes that the COVID-19 pandemic will primarily lead to (short-term) liquidity needs. The fact that the COVID-19 pandemic may also cause Companies to fall into over-indebtedness[8] and that there is no prospect of eliminating such over-indebtedness seems harmless. This is appropriate, as long-term planning and prognoses (such as the 'positive continuation prognosis' (*positive Fortführungsprognose*)[9] test within the scope of the over-indebtedness test pursuant to sec. 19 para 2 sentence 2 InsO) are hardly possible due to current developments.[10]

Unfortunately, neither the provision itself nor the legislative materials of the COVInsAG indicate which criteria are crucial for the assessment of whether there are 'prospects of eliminating an existing illiquidity'. I hold the view that 'prospects' of eliminating an existing illiquidity already exist if such elimination – from the *ex-ante* point of view of a prudent businessman – is not obviously (*offensichtlich*) or evidently (*evident*) hopeless (hereinafter referred to as 'Conclusiveness Test'). A predominant probability (> 50 %), as required, for example, in the context of the 'positive continuation prognosis'[11] is not required. Only such wide understanding of the Conclusiveness Test does justice to the fact that, due to current developments, even short-term planning and forecasts are hardly possible and that the directors of a company should be relieved from any duties and liability risk without too many hurdles (*cf.* C.I.4 for the practical documentation needs of the directors in this context).[12]

Notes

at least for the current and the following business year (*positive Fortführungsprognose*).

4 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 22.
5 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 22.
6 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 17.
7 *Cf.* footnote 2 for a definition of illiquidity (*Zahlungsunfähigkeit*) under German insolvency law.
8 *Cf.* footnote 3 for a definition of over-indebtedness (*Überschuldung*) under German insolvency law.
9 *Cf.* footnote 3 for further details in this regard.
10 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 2, 17 and 22.
11 *Cf.* footnote 3 for further details in this regard.
12 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 2, 17 and 22.

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3. § 1 sentence 3 COVInsAG – Presumption

The legislator of the COVInsAG has included a statutory presumption provision in § 1 sentence 3 COVInsAG to the benefit of the directors of a Company. According to this provision, if a Company was not illiquid (i.e. solvent) as at 31 December 2019, it is rebuttably presumed (*widerleglich vermutet*) that (i) a (subsequent) insolvency (i.e. illiquidity and/or over-indebtedness) of the Company is based on the COVID-19 pandemic and (ii) there are prospects of eliminating an existing illiquidity of the Company. With the statutory presumption, the legislator wishes to effectively relieve the directors of a Company from any proof and prognosis difficulties. Consequently, while the directors – in the event of a (judicial) dispute – will still have to proof that the Company was not illiquid as of 31 December 2019 (*cf.* C.I.4 for the practical documentation needs of the directors in this context), a rebuttal of the statutory presumption is – according to the declared will of the legislator – only possible if it is obvious (*offensichtlich*) or evident (*evident*) that the COVID-19 pandemic was not the reason for the Company's insolvency and/or that the elimination of an existing illiquidity of the Company cannot be achieved. In this regard, extremely high demands must be made on a rebuttal.[13] As a result, the rebuttable presumption thus comes close to an irrefutable presumption.

Finally, also the following aspect should be pointed out. According to its mere wording, the statutory presumption also applies if a Company was not illiquid, but already (under German insolvency law) over-indebted as of 31 December 2019. I hold the view that such understanding was not intended by the legislator of the COVInsAG, since this would allow Companies that have been (long since) insolvent to continue to operate under the guise/wings of the COVInsAG. According to the declared purpose of the COVInsAG – the support and rescue of fundamentally healthy Companies that have fallen into a financial crisis, particularly as a result of the COVID-19 pandemic[14] – the statutory presumption is to be considered as rebutted in such cases, since the insolvency (i.e. over-indebtedness) is obviously not based on the effects of the COVID-19 pandemic, but had already occurred and existed prior to it.

4. Need for documentation

The statutory presumption in § 1 sentence 3 COVInsAG requires that the directors are able to prove – based on the historical books and records – that the Company was not illiquid (i.e. solvent) as at 31 December 2019.

However, even if the statutory presumption is applicable, the directors of a Company should carefully document as early as possible and in writing on what factual basis (facts) and with what justification they assumed *(business judgment rule)* that the insolvency (including over-indebtedness) of the Company is 'based on the effects of the COVID-19 pandemic' (*cf.* C.I.2.aa)). This is a 'static' test that will probably only have to be carried out once. The necessary data/documents should be well prepared and be available any time

Further, there is a corresponding need for documentation when examining the 'prospects of eliminating an existing illiquidity' (*cf.* C.I.2.bb)). However, this is a 'dynamic' test which must be continuously reviewed and updated by the directors. The examination and documentation should – as far as possible – be underpinned by reliable, provisional liquidity and income forecasts. In complex cases the directors should involve professional legal and/or business support in order to reduce any existing risks.

II. § 2 COVInsAG – Consequences associated with a suspension of the duty to file for insolvency

Further consequences, which are triggered and associated with a suspension of the duty to file for insolvency are regulated in § 2 para 1 no. 1 to 4 COVInsAG.

1. § 2 para. 1 no. 1 COVInsAG – Protected payments

In principle, the directors of a Company are required to reimburse the Company for any payments which they make to third parties out of the Company's assets after the Company has become illiquid and/or over-indebted, unless such payments would also have been made by a prudent businessman in similar circumstances. (*cf.* sec. 64 sentence 1 of the German Act on Limited Liability Companies and sec. 92 para. 2 sentence 1 of the German Stock Corporation Act).

The legislator of the COVInsAG has recognised this considerable personal liability risk for the directors and has regulated in § 2 para. 1 no. 1 COVInsAG that such payments under certain circumstances do no longer give rise to a personal liability of the directors. However, this is only the case if (i) the duty to file for insolvency pursuant to § 1 COVInsAG is suspended, (ii) the payment in question is made during the suspension period and (iii) is further made in the ordinary course of business (*im ordnungsgemäßen Geschäftsgang erfolgen*) and useful (*dienlich*) to the business. If these conditions are met, the payments are privileged and treated as being compatible and in line with the due care of a prudent businessman (*als mit der Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters vereinbar*).

Notes

13 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 22.
14 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 17.

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The application of the payment privilege will in each individual case decisively depend on whether the respective payment was (i) made in the ordinary course of business of the Company and (ii) was useful to it. Regarding the first criteria, i.e. the connection to the ordinary course of business, the provision provides the user with three codified examples: (i) maintenance and (ii) resumption of the business operations or (iii) implementation of a restructuring concept. As the wording of the provision and the use of the term 'in particular' (*insbesondere*) suggests, the codified examples are not exhaustive. Therefore, payments made, for example, in the context of a restructuring-related change of the Company's business operations[15] and/or in the context of a restructuring-related, 'solvent' liquidation of the legal entity are also covered.

It remains somewhat unclear how the second criteria of 'usefulness' is to be understood. Neither the wording of the provision nor the legislative materials of the COVInsAG give any help in this regard. I hold the view that a very broad understanding of this term is required that goes beyond the exceptions developed so far by the German case law regarding payments made by a prudent businessman (see 64 sentence 2 of the German Act on Limited Liability Companies). Especially the purpose of the provision speaks in favour of such broad interpretation. The goal of the provision is to ensure that the directors are not threatened by a potential personal liability when continuing the Company's business in the current exceptional situation.[16] Rather, the directors should be motivated to continue the Company's business without having to fear the sword of Damocles of a possible personal liability.[17] Against this background, all payments are to be considered as 'useful', which – from the *ex-ante* point of view of a prudent businessman – are not obviously (*offensichtlich*) or evidently (*evident*) useless for the maintenance, resumption, or restructuring etc. of the Company. Such interpretation is also in line with the requirements for directors when examining the prospects of eliminating an existing illiquidity (*cf.* C.I.2.bb)).

Finally, in order to avoid/reduce any personal liability risks, it is advisable that the directors document in writing on what factual basis (facts) and with what justification *(business judgment rule)* they assumed that payments made or to be made (i) belong to the ordinary course of the Company's business and (ii) are useful to it. In the case of ongoing payments (e.g. rental payments), the corresponding review and documentation should be carried out by the directors at regular intervals ('dynamic' review).

2. § 2 para. 1 no. 2 COVInsAG – Claw-back risks regarding new loans

Under German insolvency law, transactions (e.g. the repayment of a loan), entered by a Company prior or after the filing for the opening of insolvency proceedings may be subject to insolvency claw-back (*Insolvenzanfechtung*) within certain hardening periods. This especially applies to transactions between the Company and its shareholders, which are under German law – roughly speaking – challengeable under very low conditions. In case of a successful claw-back (action), the Company's assets of which the estate has be deprived have to be returned to the estate.

§ 2 para. 1 no. 2 sentence 1 COVInsAG contains an insolvency claw-back privilege with respect to new loans (*neue Kredite*) and their collateralisation, which are granted during the period of a suspension of the duty to file for insolvency. A repayment of such loans, which is made until 30 September2023 (including appropriate interest payments)[18] is considered not to be detrimental to creditors of the Company (*nicht gläubigerbenachteiligend*) (legal fiction). However, according to German insolvency law, such detriment to the creditors (*Gläubigerbenachteiligung*) is a necessary requirement for every claw-back (action).

The legislative materials of the COVInsAG indicate that the term 'loan' must be interpreted broadly. It also covers trade credits and other forms of payment on credit terms.[19] According to the wording of the provision, only 'new' loans are not privileged. Thus, in the case of a mere novation or prolongation and economically comparable circumstances (e.g. a standstill), which only results in a back and forth payment, the claw-back privilege does not apply.[20] This can be explained with the purpose of the provision, which is to motivate banks and other lenders to provide 'fresh' money/liquidity to a Company in a crisis.[21]

Sentence 2 of the provision extends the claw-back privilege also to new shareholder loans and payments on claims arising from legal acts which are economically equivalent to such shareholder loans (e.g. deferred shareholder claims which arose during the suspension period). This is intended to motivate the shareholders of a Company to provide 'fresh' money/liquidity to the

Notes

15 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 19.
16 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.
17 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.
18 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.
19 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.
20 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23
21 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.

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Company.[22] However, the collateralisation of shareholder loans or equivalent claims is explicitly not privileged according to sentence 2 of the provision.

Sentence 3 of the provision finally states that shareholder loans, which meet the requirements of sentence 1 and 2 of the provision, are not subject to equitable subordination (*Nachrang*), insofar as insolvency proceedings are opened over the Company's assets until 30 September 2023.

In summary, (shareholder) lenders should ensure that the timing of new financings and their collateralisation is documented in writing as precisely as possible. Moreover, before granting a new loan, (shareholder) lenders should especially obtain a written confirmation from the Company's directors that the conditions for a suspension of the duty to file for insolvency in their favor are met.

3. § 2 para. 1 no. 3 COVInsAG – Lender liability

Under German law, when lending to a Company in crisis, lenders may face the risk that they will be later confronted with a personal liability claim by other creditors or the insolvency administrator if the Company eventually ends up in insolvency. In this context, the German Federal Court of Justice (*BGH*) speaks of a 'prolongation of the Company's death struggle'[23] (*Verlängerung des Todeskampf der Gesellschaft*) by the lender as opposed to a sustainable restructuring. In order to avoid such liability risks the lender will usually have to carefully examine the chances of a sustainable restructuring of the Company. A plausible restructuring plan (*Sanierungskonzept*) together with a neutral restructuring opinion (*Sanierungsgutachten*) will be necessary to demonstrate that the Company is able to survive in the medium and long-term if the envisaged restructuring measures are met. However, this is regularly a very time and cost consuming task.

§ 2 para. 1 no 3 COVInsAG now widely excludes these personal liability risks for lenders. Thus, loans and their collateralisation which are granted to the Company during the period of a suspension of the duty to file for insolvency, are not considered as a contribution to/prolongation of the Company's death struggle.

Unlike § 2 para.1 no. 2 COVInsAG this lender privilege does not only apply to 'new' loans. According to the legislative materials novations and prolongations are also privileged within the scope of the provision.[24]

The lender privilege does further not distinguish between loans from third parties or from shareholders. Consequently, the privilege also protects loans granted by a shareholder.

Finally, it should also be noted with regard to this provision that the (shareholder) lenders should, where possible, ensure a detailed documentation of all circumstances in writing (*cf.* C.II.2).

4. § 2 para. 1 no. 4 COVInsAG – Claw-back risks regarding other transactions

Under German insolvency law, transactions (e.g. the payment of a purchase price, the provision of collateral) entered into by the Company prior or after the filing for the opening of insolvency proceedings may be subject to insolvency claw-back (*Insolvenzanfechtung*) within certain hardening periods. In case of a successful claw back (action), the Company's assets of which the estate has be deprived have to be returned to the estate.

The legislator of the COVInsAG has recognised that in the current COVID-19 pandemic situation there is a strong need for the protection of transactions from claw-back risks, which do not constitute loans (*cf.* with respect to loans and their collateralisation above under C.II.2)[25] This applies especially, for example, to contractual partners of the Company with a continuing business relationship, such as landlords or lessors, but also suppliers.[26] These contractual partners should not be burdened with the risk of a (subsequent) claw-back (action), if they continue their contractual relationships with a Company which may be economically distressed as a result of the COVID-19 pandemic. Otherwise, they would be inclined to terminate their contractual relationships as quickly as possible, which would regularly thwart all rescue/restructuring efforts.

§ 2 para. 1 no. 4 sentence 1, sub-sentence 1 COVInsAG stipulates that so-called 'congruent' (*kongruente*) transactions which take place during the period of a suspension of the duty to file for insolvency are generally exempted from claw-back risks. Under German insolvency law, congruent transactions are defined as transactions (e.g. payments or the provision of collateral) that the creditor had a right to receive at that time and in that form from the debtor.

However, pursuant to § 2 para. 1 no. 4 sentence 1, sub-sentence 2 COVInsAG a claw-back (action) shall still be possible, if the other party is aware that the Company's restructuring and financing efforts are not suitable to eliminate an existing illiquidity.[27] However, only positive knowledge (*positive Kenntnis*) is detrimental. According to the legislative materials of

Notes

22 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 23.
23 *BGH*, Urt. v. 30.01.2006 – II ZR 357/03.
24 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
25 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
26 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
27 *Cf.* footnote 2 for a definition of illiquidity (*Zahlungsunfähigkeit*) under German insolvency law.

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the COVInsAG, the other party does in particular not have to convince itself that the Company is making suitable restructuring and financing efforts; only a proven positive knowledge of a lack of restructuring and financing efforts and/or of the obvious (*offensichtliche*) or evident (*evidente*) unsuitability of the restructuring and financing efforts are able to destroy the claw-back privilege.[28]

According to the legislative materials of the COVInsAG the burden of proof of positive knowledge lies entirely with the party who wishes to invoke the claw-back contestability of the particular transaction, i.e. usually a later insolvency administrator.[29] Nevertheless, in order to avoid/reduce any claw-back risks, the contractual partners of a distressed Company should document in writing and have it confirmed by the directors of the Company that necessary and appropriate restructuring measures (e.g. application for state aid etc.) have already been taken or will be taken in the near future and that these measure are not obviously/evidently useless to sustainably restructure the Company.

Finally, § 2 para. 1 no. 4 sentence 2 COVInsAG also privileges certain 'incongruent' (*incongruent*) transaction – this means transactions which are either not yet due or due in another form – from claw-back risks: payments in lieu of performance, payments by a third party, granting of a different collateral, shortening of due dates, deferred payment plan. However, it should be noted that the list in 2 para. 1 no. 4 sentence 2 is exclusive. (Incongruent) Transactions other than those mentioned there are still subject to (significant) claw-back risks, even if they occur during the period of a suspension of the duty to file for insolvency.

5. § 2 para. 2 COVInsAG – Companies in a crisis

The suspension of the duty to file for insolvency regulated in § 1 COVInsAG, to which the legal consequences in § 2 COVInsAG are linked, shall in a first step only apply to directors of Companies which are in principle subject to a duty to file for insolvency due to their legal form and which are already insolvent (i.e. illiquid and/or over-indebted) as a result of the effects of the COVID-19 pandemic.

§ 2 para. 2 COVInsAG extends the legal consequences regulated in § 2 para 1. no. 2, 3 and 4 COVInsAG, which are all generally linked to a suspension of the duty to file for insolvency, also to entities which are not subject to the duty to file for insolvency (such as retail traders and limited partnerships with a natural person as general partner). This is appropriate since the effects of the COVID-19 pandemic ultimately affect all kind of entities regardless of their legal form.[30]

Moreover, there are or will also be many debtors who will get into serious economic difficulties as a result of the COVID-19 pandemic without being/becoming insolvent. In order to make additional financings available to these debtors before they become insolvent, to ensure that their (contractual) business partners continue to contract with them and to avoid further uncertainties, the legal consequences in § 2 para. 1 no. 2, 3 and 4 COVInsAG shall – according to the legislative materials of the COVInsAG – also apply to these debtors.[31] Summarised, the legal consequences regulated in § 2 para. 1 no. 2, 3 and 4 COVInsAG apply to all companies, regardless of whether they are in an economic crisis or not.

III. § 3 COVInsAG – Creditor filings for insolvency

§ 3 COVInsAG suspends the right of creditors to file a petition for the opening of insolvency proceedings over the assets of a Company until 28 June 2020. The provision aims to protect Companies in a crisis, which should be enabled to restructure by means of (state) aid measures or other financing measures without having to fear a creditor filing for insolvency all the time.[32]

IV. § 4 COVInsAG – Entry into force/Prolongation

Pursuant to Art. 6 para. 1 of the 'Law on Mitigating the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Proceedings Law' (*cf.* A) §§ 1 to 3 COVInsAG shall enter into force retroactively as of 1 March 2020.

The suspension of the duty to file for insolvency in § 1 COVInsAG as well as the associated legal consequences regulated in § 2 COVInsAG initially apply until 30 September 2020. The suspension of the creditors' right to file a petition for the opening of insolvency proceedings over the assets of a Company pursuant to § 3 COVInsAG is initially limited until 28 June 2020. However, based on § 4 COVInsAG, the German authorities have the right to extend the validity of §§ 1 to 3 COVInsAG until 31 March 2021.

Notes

28 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
29 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
30 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
31 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 24.
32 Legislative material of the German parliament (*Bundestag*), BT-Drucks. 19/18110, p. 25.

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D. Summary, recommendations for action and outlook

With the COVInsAG the German legislator suspends the duty of the (managing) directors of a Company to file for insolvency until 30 September 2020 (§ 1 sentence 1 COVInsAG). However, this suspension only applies if (i) the insolvency (i.e. illiquidity and/or over-indebtedness)[33] of the Company is 'based' (*beruhen*) on the effects of the Covid-19 pandemic and (ii) the elimination of an existing illiquidity of the Company is not obviously (*offensichtlich*) /evidently (*evident*) hopeless (§ 1 sentence 2 COVInsAG). If a Company was not illiquid (i.e. solvent) on 31 December 2019, it is by law rebuttably presumed that the conditions (i) and (ii) are fulfilled (§ 1 sentence 3 COVInsAG). This considerably relieves the directors of a Company of any difficulties in proofing that the requirements for a suspension of the duty to file for insolvency are given. However, the statutory presumption does not apply if the Company was already over-indebted as of 31 December 2019. Despite the generous statutory presumption, in order to avoid/reduce any personal liability risks, the directors should (continuously) document in writing on what factual basis (facts) and with what justification they assume *(business judgment rule)* that the conditions for a suspension of the duty to file a petition are met (*cf.* for further details C.I.4).

The temporary suspension of the duty of the directors to file for insolvency is flanked by § 3 COVInsAG. The provision suspends the right of creditors to file for the opening of insolvency proceedings over the assets of a Company until 28 June 2020. § 3 COVInsAG aims to avoid that fundamentally healthy Companies that have fallen into a financial crisis, particularly as a result of the COVID-19 pandemic are 'pushed' into insolvency proceedings.

Finally, § 2 para. 1 no. 1 to 4 COVInsAG regulates further legal consequences which are associated with a suspension of the duty to file for insolvency. These include the protection of certain payments by the directors of a Company as well as far-reaching claw-back and lender-liability privileges regarding (new) loans and other transactions/acts between the Company and third parties (such as payments to suppliers/customers etc.). In this context, too, a precise documentation by all parties involved will often be important in the future (*cf.* C.II.2 and C.II.3).

Summarised, it should be noted that in the light of the numerous comments on the COVInsAG, most of which could not be taken into consideration due to the speed and brevity of the legislative process, it cannot be excluded that the legislator will soon make (further) adjustments to the COVInsAG. In view of the current exceptional situation, however, the COVInsAG seems as a good first reaction to reduce and mitigate the consequences of the COVID-19 pandemic in Germany.[34]

Notes

33 *Cf.* footnote 2 and 3 for a definition of illiquidity (*Zahlungsunfähigkeit*) and over-indebtedness (*Überschuldung*) under German insolvency law.

34 This article is (partially) based on Lütcke/Holzmann/Swierczok, 'Das COVID-19-Insolvenz-Aussetzungsgesetz (COVInsAG)' [2020] 17 BB, 898 and printed with the explicit consent of the Betriebs-Berater (BB) journal.

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France: A Country at War against the Coronavirus Pandemic

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Synopsis

On 16 March, the French President held a speech to the nation in which he made a call to his fellow citizens for solidarity and responsibility. 'The country is at war,' he said, 'against an invisible, elusive and progressing enemy.' Accordingly, by the end of March, containment measures to prevent the spreading of the coronavirus[1] pandemic had been implemented and renewed. A law, instituting the state of emergency[2] and authorising the Government to take immediate measures by ordinance, had also been enacted.[3] Companies and businesses of all sorts were temporarily shut down, forcing their employees and workers to stay home and/or working remotely, causing the country to review its growth forecasts. Approximately nine million employees have since been furloughed and, as in many other countries, the stock markets fell brutally.

The author briefly presents some of the main measures[4] of the rescue package implemented to support companies and businesses and enable them to survive a crisis of this magnitude.

1. Amendments to existing rules

1.1 Amendments to insolvency legislation

The Government specified by ordinance[5] that the section of the insolvency legislation dedicated to the state of insolvency (*l'état de cessation des paiements*) should temporarily be construed to provide that, until the expiry of a three months period following the end of the state of emergency, the state of cessation of payments would be assessed having regard to the debtor's situation as of 12 March 2020.

Accordingly, and as specified in an explanatory report[6] to the ordinance:

– Companies in financial trouble before 12 March, but not insolvent (i.e unable to pay their outstanding debt with their available assets) by then, are eligible to apply for preventative measures[7] or safeguard proceedings within the extended time period (three months following the end of the state of emergency) even if they become insolvent during that period;

– For ongoing confidential preventative measures and particularly *conciliatio*n *proceedings*, the section of the code, providing that a conciliation cannot last more than five months in a row and cannot be resumed until the expiry of a three months period, is not applicable. This means that a new conciliation can be implemented immediately to enable the debtor to continue its negotiations and reach an agreement with its key creditors;

– By assessing the state of the debtor's cessation of payments by reference to 12 March, until the expiry of the time period set by the ordinance (see above), the management is temporarily protected from personal sanctions for mismanagement linked to their failure to timely file for insolvency, i.e within 45 days from the date of cessation of payments.

The ordinance also provides that further to an application by the plan implementation commissioner (*commissaire à l'exécution du plan*) or the public prosecutor, the presiding judge of the court[8] having adopted a safeguard or a continuation plan, or the court,[9] may extend the latter's duration either by three months

Notes

1 Commonly called Covid 19 in France.
2 For two months as from the publication of the Law, i.e until 24 May 2020.
3 Loi No. 2020-290 du 23 mars 2020 d'urgence pour faire face à l'épidémie de covid-19 (1).
4 26 Ordinances were published on 26 March 2020 and many others thereafter – this article is however only up to date as of 15 April.
5 Ordonnance No. 2020-341 du 27 mars 2020.
6 Rapport au Président de la République relatif à l'ordonnance No. 2020-341 du 27 mars 2020 portant adaptation des règles relatives aux difficultés des entreprises et des exploitations agricoles à l'urgence sanitaire et modifiant certaines dispositions de procédure pénale.
7 As per Article L 611-4 of the Code of Commerce, the commencement of a conciliation is subject to the debtor not being insolvent for more than 45 days. Article L 620-1 of the Code provides that the commencement of a safeguard is subject to the debtor not being insolvent.
8 When the application is filed before the expiry of the three months' time period after the end of the state of emergency.
9 When the application is filed after the above three months' time period but within the next six following months.

beyond the end of the state of emergency or by a maximum of one year.

A faster handling of the payment by the AGS,[10] on behalf of insolvent employers, of unpaid wages, notice periods and redundancy costs is also implemented until the end of the three-month period following the end of the state of emergency.

1.2 Amendments to corporate related rules

Two ordinances published on 26 March[11] followed by a decree dated 10 April,[12] extended the time period for accomplishing several key corporate steps linked to the preparation and approval of companies' annual accounts.

Ordinance No. 2020-318 extended the time period for:

- The board to present its report, the annual and consolidated accounts to the supervisory board, by three months;
- The board, supervisory board and managing director to prepare the documents specifically required[13] for companies employing more than 300 employees and with a turnover in excess of EUR 18 million, by two months;[14]
- Liquidators to prepare the annual accounts of the companies in liquidation for which they are appointed, by two months beyond the three months period starting from the end of the relevant financial year;
- The management to convene the annual shareholders' meeting, by three months, provided that the statutory auditors of these companies had not issued their report in relation to the accounts by 12 March 2020, in which case the extension granted by the ordinance does not apply.

Ordinance No. 2020-321 provides inter alia that:

- Board and management meetings can validly be held, even when not provided for in the articles of incorporation or internal management procedures, by conference call and video conference provided that the attendees can be identified, and their effective attendance is guaranteed;
- Decisions by the board and management are also valid, when made in writing by their members provided that the collegiality of the deliberation is guaranteed, even when not provided for in the articles of incorporation or internal management procedures;
- Shareholders' meetings, when the gathering of shareholders is prohibited because of the sanitary measures linked to the coronavirus, can be validly convened by the relevant corporate bodies and held without the shareholders being physically present and participating by conference call or video conference;
- The convening of the meetings can be made by any means, enabling the shareholders or any person entitled to participate to be provided with effective information regarding the date and time of the meeting and the conditions under which they can exercise their rights;
- The shareholders attending by video or conference call are deemed to be present for the calculation of the quorum and the required majority for the vote of the resolutions. The other persons allowed to attend are entitled to participate by the same means. The ordinance adds that the technical means enabling the remote attendance must at least transmit the voice of the participants and allow the continuous and simultaneous retransmission of the deliberations.

1.3 Amendments to the labor code and collective agreements and to the duration of the working week

By ordinance dated 25 March[15] the Government authorised employers, subject to the prior signature of a company-wide or an industry-wide collective agreement, to instruct their employees to take up to six days of paid holidays (*congés payés*), either sequentially or non-sequentially, when convenient for the employer, or to unilaterally modify the dates of their leave period without these amendments to their holiday dates requiring the employees' consent. The ordinance, however, limits the employer's faculty to impose holidays on employees, including before the start of the period during which they are normally intended to be taken, to leave periods ending 31 December 2020.

As of today, many employers have already implemented these measures, particularly in the banking and insurance sectors.

Notes

10 Association pour la Gestion du régime d'assurance des créances de Salaires.

11 Ordonnances No. 2020-318 et 321 portant adaptation des règles relatives à l'établissement, l'arrêté, l'audit, la revue, l'approbation des comptes et autres documents … et des règles de réunion et de délibération des assemblées et organes dirigeants des personnes morales … en raison de l'épidémie de covid-19.

12 Decree No. 2020-418 published on 11 April 2020.

13 A report on the available and realisable assets and outstanding debts, a cash flow statement and a forecasted financing plan.

14 Provided that they relate to the financial years closing between 30 November 2019 and a month after the end of the state of emergency.

15 Ordonnance No. 2020-323 du 25 mars 2020 portant mesures d'urgence en matière de congés payés, de durée du travail et de jours de repos.

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The ordinance also authorises employers, when justified by the financial difficulties linked to the pandemic, to (i) set the rest day dates (*jours de repos*) to which employees are entitled under specific agreements or the collective bargaining agreements, at pre-determined and agreed dates, and (ii) unilaterally modify these dates.[16] This option remains limited to a maximum of 10 rest days.

Finally, the ordinance amends the daily and weekly maximum working hours to extend them to 12 hours per day and 60 hours per week for companies belonging to an industry sector necessary for the nation's security or the continuation of its economic and social activities.[17]

Several other ordinances were also implemented in early April. These were essentially addressed to professional training (*formation professionnelle*) issues, the postponement of the election of staff representatives (*représentants du personnel*) for a period ending three months after the expiry of the state of emergency and the prorogation of their ongoing functions and statutory protection until the holding of these elections.

1.4 Amendments to tax rules and payment deadlines

Further to decisions by the French Government, the payment of direct taxes (i.e corporate income tax, payroll tax and corporate local taxes) due in March was deferred. For instance, the 15 March corporate income tax instalment was deferred to 15 June, with no need for the companies proceeding with the deferral to justify it, provided however that a specific form is filed with the tax authorities. For those who had paid it ahead of the deferral announcement, it was indicated that a refund would be made upon request.

Likewise, for the payment of local taxes (*Cotisation Foncière des Entreprises* and *Taxe Foncière*), a temporary deferral until year end was authorised for companies paying them on a monthly term, with no need to justify the deferral, provided however that a specific form is filed with the tax authorities

The tax authorities also announced that they were agreeable to speeding up the refunding of outstanding receivables including VAT credits and R&D tax credit.

VAT or other indirect taxes have so far remained outside of the scope of the deferral measures.

Similar measures were taken for the payment of social security contributions.

2. Other measures taken by the French Government or institutions

2.1 Loans

The Government, via Bpifrance Financement[18] ('BPI') has implemented a very supportive rescue package,[19] modelled on the German package, consisting in the guaranteeing of unsecured new loans granted by banks as well as direct lending, which can be obtained by companies and businesses if they meet the required criteria.

2.1.1 State guaranteed loans (*'Prêts Garantis par l'Etat', hereafter 'PGE'*)

The PGE is a global EUR 300 billion[20] State guarantee scheme granted by BPI for unsecured loans, syndicated or not, made by banks from 16 March 2020 to 31 December 2020, at a rate close to nil,[21] to meet the cash flow needs of companies and businesses impacted by the coronavirus outbreak. Even though not expressly excluded from the rescue package, it is doubtful that all cash flow needs will fall under the scope of the PGE, such as the funding of redundancy plans for example, even when caused by the pandemic.

The PGE is intended for companies and businesses involved in all economic activities except for:

(i) Credit institutions, finance companies (*sociétés de financement*) and real estate companies (*société civiles immobilières*);

(ii) Companies subject to insolvency proceedings (safeguard, administration or liquidation): This seems to imply that companies, subject to insolvency proceedings earlier in the year, but which exited these proceedings via reorganisation plans adopted by court before 24 March (i.e the date of publication of the law and decree instituting the PGE), but possibly also companies which may exit these proceedings thereafter and which are not undergoing any proceedings when applying for a PGE, may be eligible. Likewise, companies or businesses

Notes

16 Article 2 of the Ordinance.
17 Subsequently determined by decree.
18 BPI stands for *Banque Publique d'Investissement.*
19 Arrêté du 23 mars 2020 accordant la garantie de l'Etat aux établissements de crédit et sociétés de financement en application de l'article 4 de la loi de finances rectificative pour 2020.
20 This total amount represents approximately 13% of France's 2019 GDP.
21 At 'resource' rate.

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undergoing preventative measures (*mandat ad hoc and conciliation*) are also eligible;

(iii) Undertakings 'in difficulty' on 31 December 2019, as defined by the EU Commission Regulation dated 17 June 2014[22] to which the Commission specifically refers in its 19 March 2020 Communication[23] under 'aids in the form of guarantees on loans'. Assessing whether a company applying for a PGE qualifies as an undertaking in 'difficulty' may not, in some instances, be straightforward until its 2019 accounts are certified and approved. The Government has therefore recommended that steps to be taken to assess whether a borrower's situation remain proportionate and that sworn statements would not be required.[24]

Amount covered by the guarantee:

In principle, the coverage of the PGE may not exceed 25% of the 2019 / latest FY turnover (excluding VAT), with the following derogations:

– For newly created or innovative companies, the coverage is capped at two years of payroll;
– For companies with less than 5,000 employees and a turnover below EUR 1.5 billion,[25] the guarantee will cover 90% of the outstanding principal amount, interest and incidental charges under the loan; and
– If an event of default occurs within the first two months of the granting of the loan, the PGE will not apply, leaving the bank which granted the loan without any collateral at all.

Loan term and amortisation:

The PGE is a one-year bullet cash loan. Its maturity cannot be shorter than 12 months and at the end of the initially agreed maturity, the borrower may decide to amortise the loan over a further one, two or more years with a maximum of five years. As a result, a PGE may have a maximum 6-year maturity with a grace period over the first 12 months.

No other security than the PGE, except for loans granted to large companies and new money privilege:

The PGE may not be secured by any liens or collateral over the borrower's assets to the benefit of the bank and the guarantee issued by BPI to secure the PGE loans is not collateralised either, except for large companies, i.e those employing more than 5,000 employees and generating a turnover in excess of EUR 1.5 billion. For PGEs granted to large companies, only the portion of the loan not covered by BPI will be eligible to coverage by collateral.

Interestingly, in a Q&A session between professionals, BPI and the French Banking Federation (FBF) advertised by the Government,[26] the latter has taken the view that a lender granting 'new money' in a court approved conciliation,[27] and benefiting from the statutory 'new money' privilege may also benefit from the PGE, thereby granting said lender a double guarantee. This opinion position has recently given rise to the commencement of conciliation procedures solely to obtain that the new money granted under that framework also benefit from that specific privilege, beyond the BPI guarantee.

Applying for a PGE:

A PGE is applied for directly with the company's bank with a view to obtaining the bank's pre-approval. Further to an agreement reached with the FBF it must be granted at no cost, i.e a resource rate.

Once the bank's pre-approval is issued, the borrower then applies for the BPI guarantee. For small and medium sized companies, BPI does not conduct a second review beyond the review carried out by the bank and the latter is in principle granted if the required criteria are met. A question, however, remains: will the BPI accept to guarantee a loan to a borrower who is notoriously not complying with statutory payment terms to its suppliers?

Companies employing more than 5,000 employees and with a turnover in excess of EUR 1.5 billion must make application for a PGE directly to the French government.

Many applications have been turned down so far. In that event, the ousted applicant can reach out to the *médiateur du crédit* at the Banque de France, who will check whether the applicant meets the required criteria and contact the bank to discuss the reasons for the rejection of the loan request.

Notes

22 Article 2 (18) of the Commission Regulation (EU) No. 652/2014 of 17 June 2014, declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty. According to Article 2 (18): companies (i) which have received rescue aid and not yet reimbursed the latter or received restructuring aid and are still subject to a restructuring plan, or (ii) that are not SMEs and where their book debt to equity ratio has been greater than 7.5 and their EBITDA interest coverage ratio has been below 1.0 for the past two years, are considered as 'undertakings in difficulty'. Likewise, limited liability companies which are not SMEs and which have lost more than half of their share capital as a result of accumulated losses also qualify as 'undertakings in difficulty'.

23 Regarding the Temporary Framework for State aid measures to support the economy in the current Covid-19 outbreak.

24 Foire aux Questions – Prêt Garanti par l'Etat, 31 mars 2020, page 3.

25 Above these ceilings, the coverage decreases to (i) 80% of the loan for companies with a turnover below EUR 5 billion but with more than 5,000 employees, and (ii) 70% for companies with a turnover in excess of EUR 5 billion.

26 Foire aux Questions – Prêt Garanti par l'Etat, 31 mars 2020.

27 'Une conciliation ayant donné lieu à un accord homologué' as per Article L 611-11 of the Code of Commerce.

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There is, however, no duty for a bank to grant a loan eligible for BPI's guarantee. Credit institutions remain entitled to exercise their discretionary right to grant, or not to grant, a loan depending on the applicant's financial situation and rating and provided that the purpose of the loan is to remedy a liquidity shortage caused by the coronavirus outbreak. So far, according to the press, banks have shown limited enthusiasm in granting such loans, particularly to small companies, because of the (i) risk of some borrowers filing for insolvency before the expiry of the two months grace period until the BPI guarantee becomes effective, and (ii) lack of remuneration for such loans and the banks' exposure over the portion of the loan which remains uncovered by the PGE in case of default.

The Government therefore announced on 15 April that it would make a EUR 500 million loan package available to companies eligible for a PGE, but whose applications have been turned down by their banks.

2.1.2 Loans granted by the BPI

As part of the rescue package, the BPI also offers direct liquidity support loans. These loans are unsecured, with no collateral over the assets of the borrower. They are dedicated to very small companies (VSEs), small and medium sized companies (SMEs) or middle sized companies (MSEs) which are facing financial difficulties linked to the pandemic.

Two types of loans can be made available:

– the *Prêt Rebond (literally meaning rebound loan)*, from EUR 10,000 up to EUR 300,000, granted over a period of seven years with a two-year grace period; and
– the *Prêt Atout (literally meaning advantage loan*), up to EUR 5 million for SMEs, EUR 30 million for MSEs, granted over a period of three up to five years with a deferred amortisation.

The Prêt Rebond

This loan is intended for SMEs, provided that the they have been in business for at least one year.

All industries are eligible, except for certain marginal exclusions (real estate companies, financial intermediation companies, etc.).

The loan is designed to finance:

– cash requirements linked to the economic situation;
– an increase in working capital requirements;
– intangible investments; and
– tangible investments with low pledge value (equipment designed/built by the company for its own needs, computer equipment…)

The Prêt Atout

This loan is intended for VSEs, SMEs and MSEs provided that the borrower has been in business for at least one year. All industries are eligible, except for some marginal exclusions (real estate companies, financial intermediation firms, etc.). It is designed to finance:

– a one-off cash requirement; and/or
– an exceptional increase in working capital requirement, caused by the pandemic.

It produces interest at a fixed or variable rate and has a term of three to five years, with a grace period of up to 12 months.

2.2 Creation of a solidarity fund for small businesses, SMEs and self-employed entrepreneurs (artisans, travailleurs indépendants, artistes-auteurs) *particularly affected by the coronavirus*

According to an ordinance published on 26 March and a decree published on 31 March[28] the fund's purpose, created for three months, is to provide financial assistance (*aide financière*) in the form of a lump sum aid of EUR 1,500, which may be increased by another EUR 5,000.[29]

Eligible for such assistance are individuals and SMEs, which are French tax residents and operating an economic activity (hereafter 'Businesses'):

– having not filed for insolvency by 1 March 2020;
– employing ten or fewer employees;
– having generated a turnover below EUR 1 million during the last financial year;
– having generated a taxable profit of less than EUR 60,000 during that financial year;
– not controlled by a commercial company as per the definition of the code of commerce;
– subject to an administrative ban of the reception of public (*interdiction d'accueil du public*) or having suffered a loss of at least 50%[30] of their turnover between 1 and 31 March 2020 compared to the same period during their previous financial year;

Notes

28 Ordonnance No. 2020-317 du 25 mars 2020 portant création d'un fonds de solidarité à destination des entreprises particulièrement touchées par les conséquences économiques, financières et sociales de la prorogation de l'épidémie de covid-19 et décret No. 2020-371 du 30 mars 2020 relatif au fonds de solidarité.

29 Initially, this amount was EUR 2,000.

30 In the initial decree, which was amended in early April, this amount was 70% of the turnover.

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– whose manager does not benefit from a full-time working agreement or old age pension, nor from a daily social security allowance exceeding EUR 800;
– which were not in financial trouble on 31 December 2019, as per Article 2 of the EU Regulation[31] declaring certain aids compatible with the interior market.

The application must be filed digitally with an estimation of the lost turnover and a sworn statement that the Business meets the required conditions.

2.3 Deferral of the duty to pay rent, electricity, gas and water bills owed by Businesses impacted by the coronavirus and eligible for the solidarity fund

According to an ordinance published on 26 March,[32] complemented by a decree, such deferral must be granted upon request[33] for rent and rental charges, electricity, gas and water bills due between 12 march and the end of the state of emergency, including for Businesses undergoing safeguard, administration and liquidation proceedings.

At the end of the state of emergency, the deferred bills for electricity, gas and water will be payable in equal installments over a period of no less than six months. Rent and related charges payments are deferred until the expiry of a further two months period beyond the end of the state of emergency. Thereafter, the tenant will benefit from a similar period of at least six months to settle the deferred rent and charges. During the deferral period, the eligible Businesses will be protected against any termination and financial damages provisions or the activation of guarantees by their landlords linked to the failure to pay their rent and charges in relation to their professional premises.

2.4 Proceedings before the Paris Commercial Court and more generally in France

The presiding judges of the chambers of the Paris Commercial Court dealing with insolvency and pre-insolvency scenarios issued a note[34] providing that since the beginning of the containment measures:[35]

– Pre-insolvency applications for *mandat ad hoc* and *conciliation* proceedings must be made electronically at the following address: prevention@greffe-tc-paris.fr and all the corresponding hearings held via conference calls every Tuesday and Thursday;
– Other applications, including for example the extension of the scope, the duration and the end of these proceedings are also handled digitally; and
– As of 5 April, 18 *mandats ad hoc* and 23 *conciliation proceedings* had been commenced in relation to debtors with a combined annual turnover in excess of EUR 2 billion, employing more than 12,000 employees and with debts in excess of EUR 1.2 billion.

According to a recent report posted by Deloitte’s head of restructuring in France,[36] the number of insolvency filings in the country dropped substantially between mid-March and mid-April compared to the same period in 2019. This is essentially, according to him, because of (i) the temporary amendments in relation to the assessment of the cessation of payments concept (see above), which validly enable a number of companies in distress to defer their filings, and (ii) the reduced capabilities of courts to handle all the matters during the containment period. In his opinion, by the end of the state of emergency, the restructuring professionals will be faced with a considerable number of cases, including the deferred filings and those linked to future defaults.

2.5 Payment of dividends and eligibility to the rescue package

Bruno Le Maire, the Minister of Finance, stated on 27 March that companies paying dividends to their shareholders would not be entitled to benefit from the rescue package and other measures implemented by the Government.

So far, his statement has not translated into a regulatory measure but various large companies,[37] i.e essentially those targeted by the Minister’s statement, announced that they would either defer the payment of dividends, reduce them or propose not to pay any dividends at all[38] at their next shareholders’ meeting.

Notes

31 EU Regulation No. 651/2014 dated 17 June 2014.
32 Ordonnance No. 2020-316 du 25 mars 2020 relative au paiement des loyers, des factures d’eau, de gaz et d’électricité afférents aux locaux professionnels des entreprises dont l’activité est affectée par la prorogation de l’épidémie de covid 19.
33 Including inter alia a sworn statement confirming that the applicant meets the required criteria, i.e being (i) a Business, and (ii) impacted by the coronavirus.
34 Communiqué du 5 avril 2020 des Délégations Générales de la Présidence du tribunal de commerce de Paris à la Prévention et au Traitement des Difficultés des Entreprises.
35 As from 17-March 2020.
36 Jean Pascal Beauchamp, partner, Deloitte Finance.
37 Employing more than 5,000 employees or generating a turnover in excess of EUR 1.5 billion.
38 JC Decaux, Airbus, Tarkett, Autogrill, Auchan Holdings, Elior and others.

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Conclusion

As in every war, there will be winners and losers. To be among the winners and exit the crisis in a better position than competition, acquire a target or settle a litigation at optimised conditions, professional advice and strategy will matter more than ever.

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Measures to Support the Dutch Economy

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Synopsis

The COVID-19 pandemic has led to a semi lockdown in the Netherlands. Schools, restaurants and hairdressers have been closed for a considerable amount of time, sports have been suspended and many events have been cancelled. People however were not prevented from leaving their homes, provided they observed the guidelines on social distancing. Obviously the economic activity has been hard hit by the measures and the government has taken several measures to help business to survive the slowdown. They can be divided into three categories: (i) subsidies, (ii) loans and (iii) tax facilities. The subsidies can be granted quickly. The loans may require somewhat longer.

Subsidies

The most important facility is probably the Temporary Emergency Bridging Measure to Sustain Employment ('NOW'). Companies that expect to suffer a loss of revenue of 20% or more can apply for a subsidy to pay the wages for a period of up to three months. The subsidy depends on the expected loss of revenue and can run up to 90% of the costs of the employees. During the period for which the subsidy applies, the company is not allowed to lay off employees for economic reasons. If it nevertheless starts proceedings for such dismissals the relevant part of the subsidy will be reclaimed, with a 50% penalty. The exact amount of the subsidy will be calculated later on the basis of the actual loss of turnover and this may result in the government reclaiming part of the subsidy.

There is furthermore a general facility for entrepreneurs (the Temporary Bridging Measure for Independent Entrepreneurs ('TOZO')) which provides support for individuals having a business and which helps them meeting their cost of living. Somewhat larger amounts are available for small enterprises in hard hit sectors such as restaurants, hairdressers, dancing schools, cinemas, enterprises in the cultural sector, travel agencies, bowling alleys and so on. These subsidies are rather small, but the total cost adds up as there are numerous small enterprises in these sectors.

In the agricultural sectors there are rather extensive subsidy facilities in place, such as the Supplemental Measure for Growers of Flowers and Market Gardening and the Supplemental Measure for Growers of Potatoes Used for French Fries.

Loan facilities

The government provides guarantees for loans that are provided by the banks to medium and large enterprises that encounter liquidity issues as a result of the COVID-19 crisis. Those state guarantees can amount to 90% of the loan. The available budget amounts to EUR 10 billion.

The existing guarantee facility for SMEs has been expanded. The premium that the enterprise has to pay has been halved, the coverage has been increased from 50% to 75% and the budget has been increased from EUR 765 million to EUR 1.5 billion.

Finally, a facility has been created for start-ups, scale-ups and innovative SMEs.

Tax facilities

The government also has put important tax facilities in place. For example it is possible to obtain a postponement of three months for VAT, wage taxes, company tax and many other taxes. Further postponements can also be obtained. Interest over tax debts is decreased to .01% p.a. and it is possible to get a lower preliminary assessment for personal income or company tax, which lowers the prepayments to be made and thus creates more liquidity.

Apart from these general facilities, the government also provides aid, to the extent allowed under European legislation, to some larger companies. Presently negotiations with KLM are ongoing. The government also has substantially supported IHC, a shipbuilder, although that rescue operation is not COVID-19 related.

The courts have implemented policies of restraint in relation to bankruptcy requests.

The Dutch scheme

Presently a bill is pending in the Dutch parliament in order to create a framework for out-of-court

restructurings (*Wet Homologatie Onderhands Akkoord*). The bill has been fast tracked because of the Corona crisis and the expectation is that these out-of-court restructurings will be needed soon. Under the envisaged framework a debtor will have the possibility to offer a reorganisation plan to his creditors and shareholders or to some of them. The bill is to some extent structured like an US Chapter 11 plan, in the sense that creditors are placed in classes which vote on the plan independently of each other. Secured creditors and creditors with priority rights can be included in the plan just like ordinary creditors. The plan is accepted if a required majority of two thirds in amount is obtained in each class which will subsequently have to be confirmed by the court. The court can also confirm a plan if one or more classes of affected creditors reject the plan. Thus the court can cram-down the rejecting class or classes. In general, confirmation requires that the plan meets the best interests tests, i.e. each creditor should receive at least what he would receive in case of liquidation, and the execution of the plan should be feasible and sufficiently ascertained. Cram-down of a dissenting class requires that the so-called absolute priority rule is observed. Thus no creditor or shareholder with a lower ranking than the creditors of the dissenting class should receive anything under the plan or should retain any stake in the company.

However the bill allows for an escape if the court deems such escape to be just. Furthermore cramming down of a dissenting class requires that the dissenting class has the option to receive a distribution in cash which should at least equal what those creditors would get in case of liquidation. The bill differs from the US Chapter 11 provisions in that no formal bankruptcy proceedings are opened and that the court involvement prior to the confirmation hearing can be minimal. Court involvement however is necessary inter alia if the debtor seeks a stay of creditors' enforcement actions. In case the debtor refuses to offer a plan, creditors, shareholders or the work council may ask the court to appoint a restructuring expert who may assist with the negotiation of a reorganisation plan or may offer one itself. Such a plan offered by the restructuring expert, when confirmed, binds the company and the creditors and shareholders that are affected just like a plan offered by the debtor itself. The ambition of the government is to have the law enter into force on 1 July 2020 which would be in time to deal with the expected need for reorganisation plans.

Final remarks

It is questionable whether the abovementioned instruments will suffice to deal with the economic consequences of the COVID-19 pandemic. Therefore discussions are ongoing about such additional instruments as a general moratorium for a number of months or more specific holidays for hard hit branches. Such measures have been implemented earlier during the 1672 war with England, France and part of today's Germany, after the Lisbon earthquake of 1750, during World War I and after the inundation of a large part of the country in 1953. In particular a debate is ongoing with respect to real estate. Many commercial tenants cannot pay rent, and many landlords need the revenues.

In the private sector the major Dutch banks have adopted a policy under which they allow postponement of up to six months for instalments of principal under credit agreements not exceeding EUR 2.5 million. This measure should give some additional breathing space to small enterprises.

So far the increase in the unemployment rate seems to be limited. Probably this is in large part due to the NOW facility mentioned above. The government has decided to start loosening the lockdown, which may help the economy, but it remains to be seen whether it will be possible to avoid a serious recession. Not only is it not possible to continue the abovementioned facilities for a long time, but the Dutch economy is very dependent on developments with its main trading partners. Of course a substantial second COVID-19 wave might strangle any favourable prospects.

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Return of the MAC: The English Courts' Approach to Material Adverse Change Clauses

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Synopsis

In light of the significant business downturn occasioned by the COVID-19 pandemic, we anticipate that the meaning and effect of 'Material Adverse Change' or 'MAC' clauses will be of critical potential importance to all businesses reliant on debt financing, and the professionals who advise them.

MAC clauses are commonplace in loan facility agreements and are provided for in substantially all loan facilities on the Loan Market Association standard forms (save for certain investment grade debt). MAC clauses are also found in business acquisition agreements (most typically, in the UK at least, in public acquisitions) and other more general contracts (such as long-term supply agreements in the commodities context). In the interests of brevity we only consider in this article the paradigmatic case of MAC clauses in loan facility agreements. However, the principles applicable to the consideration of MAC clauses in loan facility agreements will have general application to MAC clauses in other business contexts.

Where are MAC clauses typically found?

While their meaning and effect obviously turn on their precise terms, MAC clauses are often found in the following instances:

– as 'event of default' clauses that provide that in the event of a generally unforeseeable event that materially effects the borrower, the lender will have the option to accelerate the debt due or to place a stop on drawdowns;

– as part of a borrower's representations and warranties to the lender either between the signing of the loan facility and first drawdown, or before each drawdown e.g. there has been no material adverse change in the financial condition of the borrower since the most recent borrower's audited financial accounts provided to the lender; and

– as an important qualifier to certain covenants, representations or warranties provided by the borrower to the lender (e.g. the borrower is not in breach of any covenants where such breach would give rise to a Material Adverse change in the borrower's business).

Guidance from the Court

The leading English case on the interpretation of MAC clauses is *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 (Comm).

The case concerned the financing of a hotel in London by a Spanish fund that invested in hotels (Carey). Grupo Hotelero Urvasco (GHU) was involved in developing the hotel and had entered into a loan agreement with Carey in 2007. The agreement contained a 'plain vanilla' MAC clause pursuant to which GHU represented that there had been 'no material adverse change in its financial condition'. The representation was made and repeated at specified times. Carey ceased lending in 2008 after it become concerned about GHU's financial position given the decline in the Spanish economy due to the collapse of the Spanish property bubble. Work on the hotel development stopped and GHU claimed damages for breach of contract. Carey argued that it was entitled to refuse drawdown because a MAC to GHU's financial position had taken place.

Though the interpretation of the MAC clause turned on the specific wording of the clause in question Blair J's judgment in *Carey* provides some helpful guidance as to the approach a Court is likely to take (see [334-364] of the Judgment). In particular:

1. If the MAC clause requires a change in the 'financial condition' of the borrowing company that condition will be assessed *primarily* by reference to the company's financial information (interim financial reports and/or management accounts), though other information relevant to the company's financial condition can be taken into account (such as missed debt payments in *Carey*). If the clause in question refers to the '*business* and financial condition' it is likely that a wider range of matters can be considered.
2. Evidence of 'external economic or market changes' (e.g. the collapse of the Spanish property bubble in *Carey*) will not generally be sufficient to trigger a

MAC clause. This is because the individual borrower may perform better or worse than the sector in question. However it is worth noting that evidence of external economic or market changes may be more relevant and persuasive in the context of the COVID-19 pandemic than it was in the context of the collapse of the Spanish property bubble. This is because the strict lockdowns imposed across the world have meant that certain sectors have simply been unable to trade at all such that questions about a company's ability to perform better or worse than others in the same sector do not arise in the same way.

3. There must be a change. Therefore a lender cannot rely on circumstances that it was aware of when the agreement was entered into unless 'conditions worsen in a way that makes them materially different in nature'. This is most relevant to contracts entered into after the pandemic was under way.
4. The change must be 'material'. It must affect 'the borrower's ability to perform its obligations, in particular its ability to repay the loan'. Further it must 'significantly' affect that ability because otherwise 'a lender may be in a position to suspend lending and/or call a default at a time when the borrower's financial condition does not fully justify it, thereby propelling it towards insolvency' and the impact must not be temporary (even if the event causing the impact is).
5. The burden of proof is on the lender (or party seeking to rely on the MAC clause). The importance of the quality of evidence required was emphasised in *Decura IM Investments LLP v UBS AG London Branch* [2015] EWHC 171 (Comm).

Key considerations when interpreting/drafting a MAC clause

Given the above, the key considerations when interpreting an existing MAC clause or drafting a new one include:

1. Scope of the clause: What needs to have changed? Is it only a change in a company's *financial* condition that will suffice or are other matters taken into account? There is a wide range of possible wording from clauses that allow a range of generally defined matters to be taken into account (finances, business, prospects and property for example) to clauses which are triggered on the occurrence of a specific narrowly defined event (a particular change in the company's accounts or a downgrading of its credit rating for example).
2. Timing: Does the clause require the material change to have occurred or is it enough to point to an event that has occurred and a change that is likely to (or may) occur. If the latter, what is the standard that is to be reached?
3. Whose assessment: Is the lender's subjective assessment enough or is the position to be determined by some objective criteria, and if so, what? On appeal from a decision of the British Virgin Islands Court of Appeal, the Privy Council in *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2016] A.C. 293 considered a MAC clause in a facility agreement that provided 'Any event or circumstance which in the opinion of [the lender] has had or is reasonably likely to have a material adverse effect on the financial condition, assets or business of [the borrower].' It was common ground between the parties that the MAC clause only required the lender to believe that the MAC clause engaged and that such belief had to be both honest and rational. The Privy Council considered that the lender would have to convince the Court by admissible evidence that it had in fact formed the requisite opinion and that such opinion was honest and rational. See also *Torre Asset Funding Ltd v Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) where the MAC clause was conditioned on 'the reasonable opinion of the [agent for certain lenders]' with the effect that the MAC clause was not triggered even though another event of default relating to the borrower's finances was.

Wider clauses are usually considered 'lender friendly' (and outside of the lending context friendly to the party entitled to trigger the clause if the relevant change occurs in its counterparty's finances). However it is worth bearing in mind that the interpretation and application of a clause drafted in wide and general (sometimes even intentionally vague) terms is inherently more unpredictable than a clause referring to a specific, narrowly defined event or events. Some lenders may prefer certainty especially given the risk of becoming liable to the borrower for a repudiatory breach of contract if a MAC clause is triggered when no material change has occurred. This could prove costly especially if the financing in question is central to the borrower's business (such that without it the borrower would become insolvent) or a particularly lucrative business venture.

In addition to the above matters, when drafting a MAC clause it is also important to consider practical matters such as what documents are likely to be required in assessing whether a MAC has taken place. As set out above the burden of proving a MAC is on the lender but the borrower will likely hold the most relevant information about its finances (and, if relevant, business prospects, property etc.). A lender may therefore wish to include express contractual obligations on the borrower to e.g. hand over relevant information periodically or when prompted to do so.

When drafting a clause it is also crucial to consider what the MAC clause is intended to achieve. Some MAC

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clauses can simply be relied on to trigger an event of default. Others allow for a wider range of outcomes and can be relied on to trigger an obligation to provide further security for example. There is a range of possibilities. It should not be assumed that a lender will always wish to call an event of default. In the current unusual circumstances where entire sectors of the economy are under threat a lender may reasonably take the view that it would be better to allow a borrower to try and (eventually) 'trade out' of a dire financial situation with the hope of keeping that company (or sector) as a client in the future. But such a lender may still wish to rely on the MAC clause to trigger further security or other similar protection in the event of a material change in the borrower's finances or business.

Conclusion

The meaning of each MAC clause will obviously turn on its wording. While perhaps the conventional reading of *Carey* is that a downturn in general or sectoral market conditions would not *generally* be sufficient to trigger a MAC clause, it may be arguable that the effects of the COVID-19 pandemic raise such widespread and novel circumstances that the English Courts will take a more expansive approach.

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COVID-19: Developments in Austrian Restructuring Law

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Synopsis

In March and April 2020, Austria passed several COVID-19 laws aiming at avoiding the opening of insolvency proceedings over the assets of Austrian companies that were financially stable prior to the COVID-19 pandemic. This article provides a summary of the relief measures taken in the area of Austrian restructuring law, while also providing a comprehensive overview on Austrian insolvency proceedings, crisis financing, and associated management liability.

While the newly introduced measures undoubtedly are a first step in the right direction, it remains to be seen whether they will be sufficient to prevent a significant rise in insolvency proceedings over the summer. Although further restructuring measures are not yet currently in political discussion, we believe additional measures similar to the ones implemented in other European jurisdictions could be adopted in the upcoming weeks, because of economic and political pressure.

1. Introduction

The COVID-19 pandemic, and the measures taken to contain its negative impact on the Austrian health care system, present companies with far-reaching financial challenges. The Austrian government implemented a nationwide lockdown in mid-March, including the mandatory closure of most stores for four weeks. Larger stores were even closed for seven weeks. Ongoing fixed costs and payment obligations vis-à-vis suppliers can easily lead to a financial crisis, if pandemic-related sales losses occur, and the implementation of state aid measures takes time, and only covers a part of the realised shortfall in profits and cash-inflows. To prevent the COVID-19 pandemic from causing a wave of insolvencies in Austria (private individuals as well as companies), new laws have been introduced to provide remedial action in some areas.

2. Material insolvency

Under Austrian law, a debtor is regarded as materially insolvent if at least one of the following conditions is fulfilled:

(a) *Cashflow test – illiquidity*: based on the lack of readily available means of payment, the debtor is unable to pay its due and payable debts, and presumably cannot obtain the required means of payment shortly, provided that this situation constitutes not only a mere delay of payment:[1]

- (i) 'readily available means of payment' means in particular cash, deposit money, available facilities, assets that are typically accepted as payment by creditors (e.g. cheques issued by third parties and bills of exchange accepted by third parties or otherwise executed), and other easily realisable assets;
- (ii) 'unable' means that the debtor is objectively incapable of paying (and not just unwilling to pay) its debts because of the lack of readily available means of payment;
- (iii) 'due and payable debts' means that only obligations due and payable at a certain point of time are taken into consideration when assessing the status of illiquidity – however, if liquid funds will be available in the near future to cover all obligations then due and payable, this only constitutes a mere delay of payment, and not yet illiquidity (see below); and
- (iv) a 'mere delay of payment' relates to cases where the debtor will be able to organise liquid funds shortly (e.g., claims due to the debtor are not paid on time, the debtor has to make a large payment unexpectedly, or the expected increase of a facility is delayed). Austrian courts tend to grant the debtor a reasonable grace period to overcome its payment difficulties. The duration of such grace period varies between the courts and the circumstance, and typically lasts not

Notes

1 Pursuant to Austrian Supreme Court 19.01.2011, 3 Ob 99/10w a mere delay of payment is present if the shortfall amounts to only 5% of the due and payable claims, or the debtor is able to obtain the required funds within three months (in particular cases even five months).

more than three months (only where it is almost certain the delay of payment is only temporary, it may last up to five months).

(b) *Balance sheet test – over-indebtedness*: insolvency relevant over-indebtedness requires both (i) a negative status of the entire assets and liabilities based on liquidation values[2] and (ii) the lack of a positive going concern forecast. The going concern forecast usually contains:

(i) an analysis of the reasons for the financial losses;

(ii) a financial plan; and

(iii) the future prospects of the company.

The going concern forecast assesses the probability of future illiquidity, taking into consideration intended restructuring measures. Over-indebtedness shall only apply to cases where the viability of the company as a going concern – even in the light of intended restructuring measures – is not secured sufficiently, and the short balance cannot be compensated by future positive developments. The *going concern forecast* must be based on a realistic estimate of the company's future income and expenses. For a positive forecast, the liquidity and viability of the company as a going concern must be predominantly probable. In practice, a going concern forecast contains a primary forecast regarding the liquidity of the company during the following 12 months, and a secondary forecast regarding the sustainable mid-term positive developments and/or turn-around (typically a period of 2–3 years).[3]

The management must monitor the financial situation of the company and check whether the above conditions are fulfilled on an ongoing basis. The obligation to apply for the opening of insolvency proceedings based on the fulfilment of one of the above conditions constitutes a non-dischargeable management duty.[4]

Furthermore, restructuring proceedings with or without self-administration can already be initiated if the debtor's illiquidity is imminent.

3. Insolvency proceedings

The Austrian Insolvency Code 2010 (Insolvency Code) provides for the following insolvency proceedings:

(a) *restructuring proceedings with self-administration* – designed as a special form of restructuring proceedings, for which a restructuring administrator is appointed to supervise the debtor's management of the business (the debtor-in-possession concept), requiring a restructuring plan offer with at least **30%** quota;

(b) *restructuring proceedings without self-administration* – designed as a special form of restructuring proceedings, for which a bankruptcy administrator is appointed, and in which only a few provisions differ from those for bankruptcy proceedings, requiring a restructuring plan offer with at least *20%* quota; and

(c) *bankruptcy proceedings* – for which a bankruptcy administrator is appointed, and which aims at the debtor's liquidation (the sale of the whole insolvency estate and distribution of sales proceeds).

The insolvency proceedings are summarised in Figure 1.

The main advantage of restructuring proceedings with self-administration lies in the fact that the management of the debtor would generally stay in control of the administration of the business; however, a restructuring administrator will be appointed, having a right to veto certain transactions out of the ordinary course of business.

It should be noted that (i) if restructuring proceedings with self-administration are initiated, the debtor can request to change the proceedings into restructuring proceedings without self-administration or bankruptcy proceedings, and (ii) if restructuring proceedings without self-administration are initiated, the debtor can request to change the proceedings into bankruptcy proceedings. However, it is generally not possible to 'better the deal' and go the other direction (e.g., once bankruptcy proceedings are initiated, this cannot be changed).

It should be also noted that, if insolvency proceedings are initiated as bankruptcy proceedings, the debtor still has the right to present a restructuring plan, with the effect of a stay of liquidation of the insolvency estate (i.e., similar to a restructuring proceeding without self-administration, the debtor continues trading under the control of an appointed bankruptcy receiver). However, it is not possible to change to restructuring proceedings.

4. Filing for the opening of insolvency proceedings

The debtor's management is obliged to apply for the opening of insolvency proceedings, 'without culpable

Notes

2 Equity replacing claims shall not be taken into consideration pursuant to section 67 para. 3 of the Insolvency Code.

3 See for example *Karollus/Kodek/Kvasnicka* Leitfaden Fortbestehensprognose, 10. ReTurn Jahrestagung, 15.04.2016; *Lichtkoppler/Reisch* Handbuch Unternehmenssanierung2 marginal notes 1.137ff.

4 Austrian Supreme Court 23.9.1987 1 Ob 608/87; Austrian Supreme Court 5.4.1989 1 Ob 526/89.

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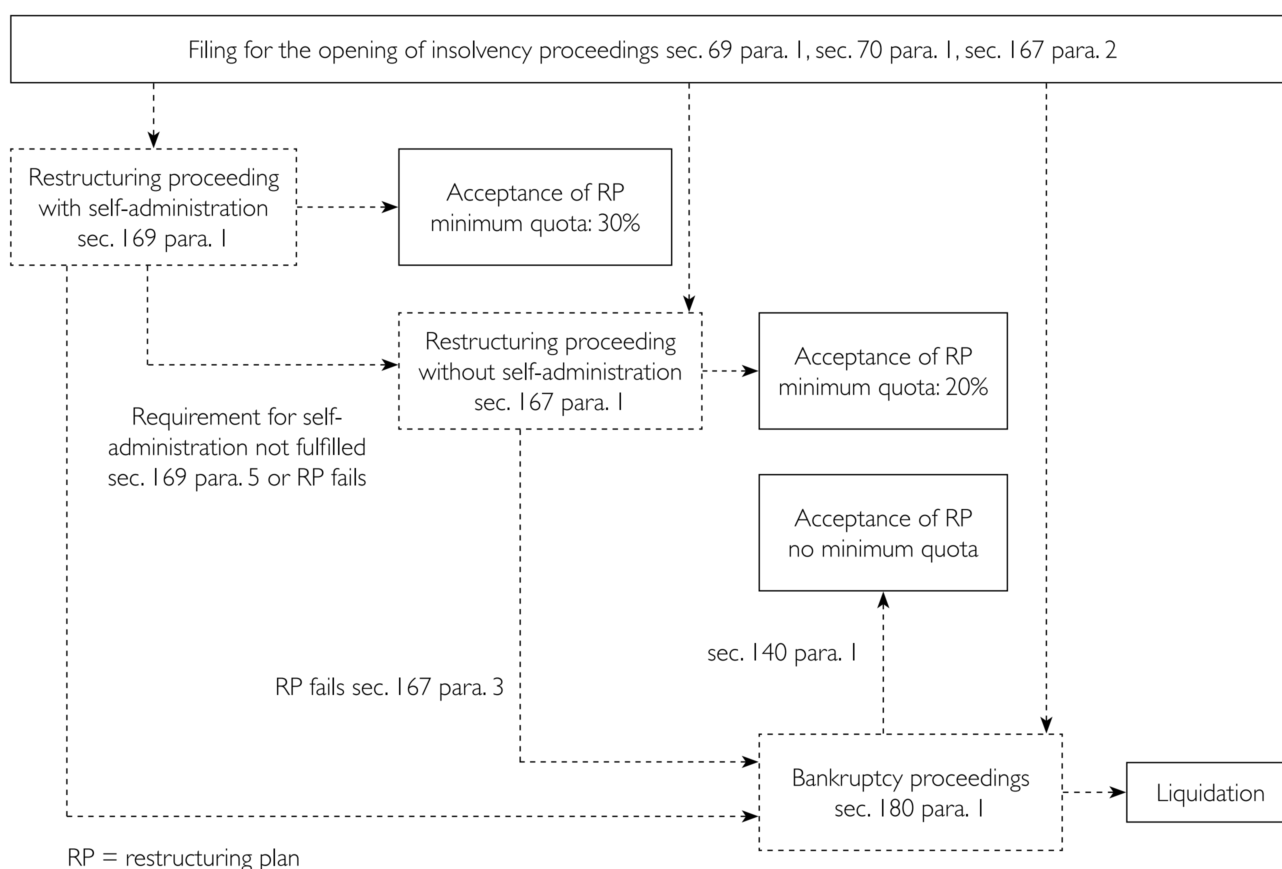
Figure 1



delay', but in any event no later than *60 days* after the insolvency effective date of material insolvency. During this 60-day period, the managing directors may make reasonable efforts to prepare for a filing of restructuring proceedings, or agree with the creditors on an out-of-court settlement. If the material insolvency is caused by a natural disaster (e.g. epidemics and pandemics such as COVID-19), this deadline is extended to *120 days*. The natural disaster need not be the sole cause of the material insolvency, but it is a necessary condition (without the natural disaster, insolvency would not have occurred). Typically, the insolvency proceedings are opened immediately upon application by the debtor (i.e., next Austrian business day).[5] Further, in the case of imminent illiquidity, the debtor has the right to apply for the opening of restructuring proceedings, but is not obliged to.

A creditor may also file for the opening of insolvency proceedings over the assets of a debtor. As a general rule, such creditor shall prove that it has a title for enforcement (e.g., final and binding court ruling or a valid settlement contract) or an acknowledged claim (e.g., a writing by the debtor confirming the due and payable claim).

Under the COVID-19 legislation, a debtor is not required to file an insolvency petition for over-indebtedness occurring between 1 March 2020 and 30 June 2020. As long as the debtor is solely over-indebted, but not also illiquid, insolvency proceedings are not to be opened during this period, even at the request of a creditor. Given the current uncertainties in the valuation of company assets, and the impossibility of making a well-founded going concern forecast in the current market situation, companies that are essentially viable as a going concern should be protected from being crushed in insolvency.

If the debtor is over-indebted after 30 June 2020, they must petition for insolvency 'without undue delay', by the later of (i) 60 days after 30 June 2020, or (ii) 120 days from when the over-indebtedness started.

In sum, as of today we expect to see a rise in insolvency proceedings starting from mid-July 2020 (when the 120-day-period for insolvency filings due to illiquidity caused by COVID-19 lapses), and over the summer, when the above periods for insolvency filings based on over-indebtedness lapse. However, there could be additional relief measures. In particular, the obligation to file based on illiquidity may be suspended, similar to the

Notes

5 There are no 'pre-insolvency proceedings' under Austrian Law.

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system already implemented in comparable jurisdictions like Germany.

5. General procedural aspects

The following types of claims must be distinguished in an insolvency proceeding, and in the following order of priority:

(a) *Secured Claims* – claims of a creditor against the debtor for which an in rem security (by contract or operation of law) granting preferred right of satisfaction into the underlying collateral has been provided; these claims are not affected by the opening of insolvency proceedings.

(b) *Preferred Claims* – claims that are generally arising in the course of insolvency proceedings, and that have to be paid in full. Such claims can include:

 (i) employee claims for current wages during insolvency proceedings;

 (ii) claims for fulfilment of bilateral agreements assumed by the insolvency administrator;

 (iii) claims based on any legal acts of the administrator; and

 (iv) claims based on an unjust enrichment of the insolvency estate.

(a) *Insolvency Claims* – claims that will be cut down to a quota. Such claims include:

 (i) any claim of a creditor against the debtor, that has come into existence before the opening of insolvency proceedings, and that is not a Secured Claim; and

 (ii) certain claims from termination of an employment contract, even if they arise after the opening of insolvency proceedings.

(d) *Subordinated Claims* – claims under equity replacing loans.

In the current COVID-19 situation, until 31 December 2020, insolvency courts may reasonably extend procedural deadlines in insolvency proceedings by official means or upon request, for a maximum of additional 90 days (the COVID-19 Deadline Extension). This is of particular importance for complex cases, where the general period of 90 days for adoption of the restructuring plan is too short.

6. Adopting a restructuring plan

The restructuring plan is subject to the vote of the unsecured insolvency creditors in the common hearing on the restructuring plan, at the latest 90 days after the opening of the proceedings (subject to the COVID-19 Deadline Extension). Holders of Secured Claims are only entitled to vote (i) if they request to vote; and (ii) in the amount of their expected loss (i.e., the amount of their claim that is not covered by the security interest). Particular voting restrictions apply for shareholders of the debtor. The estate may only be realised by the insolvency receiver if the restructuring plan has not been approved within these 90 days (subject to the COVID-19 Deadline Extension).

In the creditors' meeting, the restructuring plan requires the approval of more than 50% of the aggregate claims of those creditors who are present at the creditors' meeting (value count), *and* the simple majority of the creditors present (head count), as well as the insolvency court's confirmation. Claims of shareholders are only considered if they are not subordinated or equity replacing.[6]

In order to effect the *cramdown*, the restructuring plan presented in the course of restructuring proceedings with self-administration must offer satisfaction of all Preferred Claims, and at least 30% of the Insolvency Claims. If a restructuring plan is to be adopted in the course of restructuring proceedings without self-administration, the minimum threshold is lowered to at least 20%.

The entire quota offered by the plan must be paid to the creditors within a period of not more than 2 years following the approval of the restructuring plan. In our experience, most professional creditor representatives will not approve the plan unless a certain percentage of the quota is deposited up-front with the court, together with the costs of insolvency proceedings.

In general, strict rules apply to the fulfilment of a restructuring plan adopted in insolvency proceedings. If the debtor defaults on fulfilment of its debt vis-à-vis individual creditors, the cramdown and the benefits of the restructuring plan lapse vis-à-vis these creditors in the pro rata share of the unpaid restructuring plan quota payments ('revival of the claim').[7] In general, such a default presupposes that the debtor has not paid a due debt, despite a written reminder for payment sent to it by the creditor, granting a grace period of at least 14 days. However, in order to protect debtors from defaulting on restructuring plan quota payments because of the COVID-19 crisis, the described consequences of

Notes

6 Equity replacing claims shall not be taken into consideration pursuant to section 67 para. 3 of the Insolvency Code.

7 Example: if the creditor's insolvency claim amounts to EUR 10,000 and the quota offered under the restructuring plan is 20%, the debtor would have to make restructuring plan quota payments in an aggregate amount of EUR 2,000. After having paid restructuring plan quota payments in an aggregate amount of EUR 1,000, the debtor defaults on the further payments. Since the debtor has fulfilled 50% of its quota payments, the insolvency claim revives in the amount of EUR 5,000 (= 50% of 10,000).

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default in the restructuring plan will not occur in relation to a debt falling due at or after 22 March 2020, if the creditor's written reminder for payment is sent between 22 March 2020 and 30 April 2020.

The quota is also applied to claims of creditors that were not part of the proceeding. Omitting to file a claim in the proceeding does not invalidate the claim, but, in any event, a cram-down is effected. However, if the debtor is at fault for creditor claims not being able to be filed, the full amount can still be claimed. This is particularly relevant for tax and insurance claims that the authorities could not have filed because of incorrect or missing applications.

7. Avoidance rules – right of contestation

In the event of insolvency proceedings, the bankruptcy administrator (or, for restructuring proceedings with self-administration, the restructuring administrator) can contest legal actions and transactions which have taken place within certain time periods prior to the opening of insolvency proceedings over the assets of the debtor (referred to as hardening periods), and which relate to the assets of the insolvent debtor, provided that those acts have reduced the funds of the insolvency estate, or have otherwise caused a direct disadvantage to the creditors of the debtor, or an indirect disadvantage, if it was objectively foreseeable.

Some of the circumstances for contestation under the Insolvency Code include:

(a) *Intent to cause disadvantage to insolvency creditors* (section 28 items 1-3 of the Insolvency Code). Legal acts may be contested if:

   (i) they have disadvantaged the creditors of the debtor;

   (ii) the counterparty should have known of the debtor's intention to disadvantage (even slight negligence of the counterparty is sufficient); and

   (iii) the legal acts occurred during a hardening period of two years prior to the opening of insolvency proceedings.

   If the counterpart had actual knowledge of the intention to disadvantage, the hardening period is extended to ten years.

   If the debtor and the counterpart are members of the same affiliated group, the insolvency administrator's burden of proof is reduced. The counterpart must prove that it did not know and should not have known of the debtor's intention to disadvantage its creditors.

   The intention to disadvantage is fulfilled, not only if the satisfaction of another creditor is prevented, but also when it is delayed or aggravated.

(b) *Fraudulent conveyance* (section 28 item 4 of the Insolvency Code). Purchase, barter, and delivery agreements may be contested if:

   (i) they have disadvantaged the creditors of the debtor;

   (ii) the counterpart realised or must have realised that the transaction constitutes a fraudulent conveyance causing disadvantage to the creditors of the debtor (e.g., selling goods for an unusual and unjustified low price); and

   (iii) the agreements were executed during a hardening period of one year prior to the opening of insolvency proceedings.

(c) *Transactions free of charge* (section 29 item 1 of the Insolvency Code). Transactions free of charge may be contested, if they occurred during a hardening period of two years prior to the opening of insolvency proceedings.

(d) *Preferential treatment* (section 30 of the Insolvency Code). The following acts that occurred (1) after the debtor became materially insolvent, or (2) after the application for the opening of insolvency proceedings over the debtor's assets had been filed, or (3) within a period of 60 days prior to these points in time can be contested if:

   (i) a creditor has obtained a security interest, or the satisfaction of a claim, that the creditor was not entitled to receive in this way, or at this time, unless the creditor has not been treated preferentially, compared to other creditors of the debtor; or

   (ii) the debtor has provided a creditor with a security interest, or satisfied a claim, with the intention to treat this creditor preferentially, and the creditor knew, or should have known, of the debtor's intent to treat it preferentially; and

   (iii) the acts occurred during a hardening period of one year prior to the opening of insolvency proceedings.

(e) *Knowledge of insolvency of the debtor* (section 31 of the Insolvency Code). The following legal acts that occurred after the debtor had become materially insolvent or after the application for the opening of insolvency proceedings had been filed can be contested if:

   (i) they involved providing a security interest or satisfying a claim *vis-à-vis* an insolvency creditor, or any legal transaction entered into by the debtor with any third party to the direct detriment of its other creditors, and the third party counterpart knew, or should have known, of

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the debtor's material insolvency, or the application for the opening of insolvency proceedings; or

(ii) they were legal transactions entered into by the debtor with any third party to the indirect detriment of its other creditors, and the third party counterpart knew, or should have known, of the debtor's material insolvency, or the application for the opening of insolvency proceedings, and the occurrence of such detriment to the insolvency estate was objectively foreseeable. According to the Insolvency Code, an indirect detriment to other creditors is in particular foreseeable if the restructuring concept is obviously unfit; and

(iii) they occurred during a hardening period of six months prior to the opening of insolvency proceedings.

(f) *COVID-19 Bridge Loan Protection* (see section 10, 2. COVID-19 Judicial Accompanying Act). Since the short-time work subsidy from the Austrian Labor Market Services is only paid out retrospectively, companies have to finance their employees' salaries temporarily, and they often use bridge loans. Such loans, granted between 1 March 2020 and 30 June 2020, in the amount of the subsidy, and their immediate repayment upon receipt of the subsidy, are not subject to challenge under section 31 of the Insolvency Code, provided that (i) no collateral was provided by the borrower, and (ii) the lender was not aware of the borrower's illiquidity at the time the loan was granted.

8. Crisis financing in Austria

Austrian law does not provide a super senior ranking for a new third party lender providing bridge financing to overcome a company's liquidity shortfall. A super senior ranking would have to be agreed upon by all other creditors of the company.

Because of the Austrian avoidance rules outlined above, bridge financing in a financial crisis is typically granted as a term loan, and not as a revolving loan. In a revolving facility, each drawdown and repayment is regarded as a separate legal act, that is subject to contestation by the insolvency administrator. Collateral to be provided by the borrower should be granted and perfected as a condition precedent for disbursement under the loan, in order to strengthen the argument that the borrower and lender are performing concurrently, and to avoid an avoidance argument based on preferential treatment of the lender.

Finally, equity replacement rules play an important role in crisis financing in Austria. Essentially, if a shareholder extends a loan to its subsidiary in a financial crisis, the loan is equity replacing, and must not be repaid until the subsidiary has overcome its financial crisis. Under the Austrian COVID-19 laws, a new exemption has been introduced for cash loans that are granted and disbursed, for no more than 120 days, between 5 April and 30 June 2020, where the borrowing company has not provided a pledge or comparable security from its assets.

Equity replacement rules also apply to shareholder security for loans granted by third party lenders, when the subsidiary's crisis was known or evident to the third party lenders. The third party lender may only demand repayment from the subsidiary in crisis, to the extent enforcing the shareholder security would not provide for full recovery of the loan amount.

9. Management liability

If the management fails to file for the opening of insolvency proceedings in a timely manner, each managing director may become personally liable to its company for damages caused to the company. However, as a relief measure under the new Austrian COVID-19 laws, for a period starting on 1 March 2020 and ending on 30 June 2020, the management liability for payments made after the occurrence of over-indebtedness does not apply. This is only for over-indebtedness, and not for illiquidity!

A managing director failing to file for the opening of insolvency proceedings in a timely manner may also become personally liable to the creditors of its company. For existing creditors, they can be liable for reducing a quota (cut-off date is the effective date). For new creditors, they can be liable for the damage suffered because the creditor trusted in the company not being insolvent. Again, this liability does not apply if debtors become over-indebted, and management does not petition for insolvency, during a period starting on 1 March 2020 and ending on 30 June 2020. Management liability for a delayed filing based on illiquidity is not affected!

Under the Austrian Business Reorganisation Act 1997, the members of the management board are jointly and severally liable for the company's debts that are not covered by the insolvency estate, up to a maximum amount of EUR 100,000 per managing director. This applies if, during the two years prior to the filing for the opening of insolvency proceedings, they (i) received an auditor's report showing the equity ratio to be less than 8%, with a hypothetical period of over 15 years needed to repay the debt, and they did not initiate or continue a voluntary business reorganisation proceeding without undue delay; or (ii) have not prepared annual accounts, or have not engaged the auditor to audit the annual accounts, in a timely manner.

Members of a supervisory board may become liable for not properly fulfilling their supervisory duties, especially in a crisis. If a company becomes materially

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insolvent, the supervisory board must make sure that the management board files for insolvency in a timely manner. While the supervisory board is not entitled to file for insolvency on behalf of the company, it must take adequate steps towards a timely filing by the management (e.g. discussions regarding insolvency filing by the management, threatening the replacement of management board members).

The managing directors may also become liable for unpaid taxes, or pursuant to social security laws, if taxes or social security contributions were not paid because of their negligence, or not retained pro rata when making payments to employees of the company. In the latter case, the managing directors may even be subject to criminal liability under the social security laws.

Under certain circumstances, the managing directors of a company may become subject to criminal charges as follows:

(a) fraudulently causing an insolvency, pursuant to section 156 of the Act on Crimes;

(b) preferential treatment of a creditor, pursuant to section 158 of the Act on Crimes; or

(c) grossly negligent impairment of creditor interests, pursuant to section 159 of the Act on Crimes.

10. COVID-19 civil law relief measures

For consumers and small businesses (with less than 10 employees, and annual turnover or budget not exceeding EUR 2 million), the Austrian COVID-19 laws have introduced a statutory standstill for payments under credit agreements, during a period starting on 1 April 2020 and ending on 30 June 2020, if circumstances arising from the COVID 19 pandemic render the borrower unable to pay.

Additional relief measures have been introduced in the area of general contract law.

(a) If a payment due in the period starting on 1 April 2020 and ending on 30 June 2020 is not made on time, because of the debtor's impaired economic capacity as a result of the COVID-19 pandemic, default interest is limited to the statutory default interest rate of 4% per annum.

(b) If a contractual party is in default on its obligation because of their impaired economic capacity, or restrictions in their ability to carry on their business, as a result of the COVID-19 pandemic, that party is not obliged to pay agreed contractual penalties, including no-fault penalties.

11. Future outlook

It remains to be seen whether these selective measures taken under the new Austrian COVID-19 legislation will be sufficient to avoid a surge of insolvencies following the pandemic. During the past seven weeks, we have mostly seen insolvency proceedings being opened over companies that were already experiencing financial difficulty before the COVID-19 crisis hit Austria. However, continued revenue losses due to protection measures (e.g., maximum number of customers per store), and the restrictions and complex details of state aid measures, do not create a very optimistic outlook. The ongoing restrictions on international travel strongly affect hotel and leisure businesses, and the food service industry. Some businesses have found new ways to operate during the lock-down; we have seen a boom in digitalisation, online shops, and delivery services. While the current crisis provides opportunities for certain sectors, we believe that we will see the need for restructuring in sectors that have already experienced a massive hit by the COVID-19 crisis, such as the automotive industry, hotel and leisure business, and the food service industry, in the upcoming months.

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Outline of Anti-COVID-19 Crisis Measures in Poland[1]

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Synopsis

This article discusses selected elements of the most important anti-crisis measures introduced by the Polish Government, in the view of the author, in response to the COVID-19 epidemic relating to the protection of jobs and maintaining of financial liquidity of Polish firms. Moreover, the article provides information on new regulations concerning court restructuring and bankruptcy aimed at granting priority to these procedures in the Polish justice system during the epidemiological crisis, as well as on relief of debtors insolvent due to COVID-19 or their representatives from liability for late filing or non-filing of bankruptcy applications during a state of epidemiological threat or COVID-19 epidemic. At the same time the author points out that Polish anti-crisis legislation provides considerably more instruments of assistance than those cited in the article and that legislative work continues on further measures. The parameters of the article nevertheless restrict their discussion.

Lockdown in Poland

The first diagnosed COVID-19 case was on 4 March 2020. Since that date the number of cases has systematically increased. As a consequence, a state of epidemiological threat in Poland was declared ten days later followed by a state of epidemic as of 20 March 2020. In order to forestall the speed of the outbreak, the Government introduced a range of limitations on public and economic activities. On 12 March 2020, the educational system was temporarily suspended. Starting on 14 March 2020 large shopping centres were closed (with the exception of groceries stores, pharmacies and laundries, where a range of restrictions was introduced). Restaurants, coffee shops and bars could only provide takeout or delivery services. Gyms, swimming pools, dance clubs, fitness clubs, museums, libraries and cinemas were closed. Remote work whenever possible was recommended by the Government. From 15 March 2020 the Poland's borders were closed to foreigners and a mandatory 14-day home quarantine was introduced for all persons returning to Poland (in both cases with some exceptions). International air and rail passenger connections were suspended. On 24 March 2020, limitations on movement were introduced (with the exception of travel to work or essential every day needs). The final step in imposed restrictions included the closure on 1 April 2020 of hotels, parks, boulevards and beaches to visitors, as well as beauty, hair and tattoo salons. In the meantime many other firms have also been affected by the COVID-19 epidemic, in particular by disruptions in global supply chains or limitations on consumers' movement.

In connection with the introduction of unprecedented limitations on consumers and businesses, the Government decided to allocate, as to its own estimate, more than PLN 312 billion within the framework of the so-called Anti-Crisis Shield and Financial Shield to protect the Polish state and its citizens from the crisis caused by the COVID-19 pandemic. UniCredit assesses the package of financial and other measures announced by the Government to be the equivalent of 20 percent of annual GDP, thus being the most generous of packages introduced in the Central and Eastern Europe region.[2] The package is based on five pillars: (i) protection of jobs and employees safety, (ii) financing of entrepreneurs, (iii) protection of health, (iv) strengthening of the financial system and (v) public investments. In this article the author focuses on selected aspects of the first two pillars considered to be most important for businesses. The author also points out, however, that Polish anti-crisis legislation provides considerably more instruments of assistance and that legislative work continues on further measures. Parameters of the article nevertheless do not allow their discussion.

In light of the promising effects of actions limiting the spread of the epidemic one month after the lockdown, the Government initiated a process of resumed public and economic activity. On 20 April 2020, some limitations on movement were eased. On 4 May 2020, large shopping centres and hotels reopened and from 18 May 2020 visits to restaurants, cafés, bars, beauty

Notes

1 As of 14 May 2020.
2 PAP, Premier skomentował opinię UniCredit, Puls Biznesu, <www.pb.pl/premier-skomentowal-opinie-unicredit-988811>, 10 May 2020.

and hair salons will be feasible against (with numerous sanitary restrictions). According to estimates of the Federation of Polish Entrepreneurs and Lewiatan Confederation, direct losses to the Polish economy caused by COVID-19 restrictions from 16 March 2020 to 15 May 2020 exceeded PLN 122 billion.[3] As it appears, these losses will continue to grow with each day and week. The date when all restrictions imposed on the Polish economy are lifted is difficult to predict. Fortunately, the Polish economy is perceived as the most resilient to the pandemic crisis in the European Union, Bloomberg agency reported.[4]

Anti-crisis shield

The Anti-Crisis Shield presently constitutes more than 400 pages of new legislations introduced from approx. mid-March 2020 to mid-May 2020. Two packages of regulations entered into force, the so-called Anti-Crisis Shield 1.0 and Anti-Crisis Shield 2.0. Advanced stage work continues in Parliament on a third package of changes, the so-called Anti-Crisis Shield 3.0 will enter into force in coming days. More such packages may be expected in upcoming weeks and months.[5]

The Anti-Crisis Shield essentially does not apply toward entrepreneurs against whom court restructuring proceedings have commenced or who have been declared bankrupt. In the case of entrepreneurs against which petitions have been filed to initiate such proceedings support procedure is suspended. These instruments are generally for firms that decide to fight for survival outside court procedures.

The Anti-Crisis Shield allows micro and small firms to obtain an exemption from March to May 2020 from premiums for social and health insurance, the Labour Fund, the Solidarity Fund, the Employee Guaranteed Benefit Fund and the Retirement Bridge Fund. Self-employed individuals whose revenue did not exceed PLN 15,681 and micro firms employing up to nine employees can count on a 100% exemption. In turn, small firms employing up to 49 employees are exempt at 50%. In mid-May 2020 the Parliament expanded these rights from April to May 2020 for the self-employed whose revenue is equal to or higher than PLN 15,681 if their income did not exceed PLN 7,000.

Persons conducting business can also seek a so-called 'standby benefit' from PLN 1,300 to PLN 2,080 monthly for a period of up to three months. Conditions include continued business activity and a decrease in revenues of at least 15% in comparison to the month preceding that when an application was filed.

Firms experiencing a certain decrease in turnover due to COVID-19 can seek co-financing for three months' payroll and premiums for employees who are subject to 'economic standstill' or 'reduced work time'. Payroll during an economic standstill is co-financed with funds from the Employee Guaranteed Benefit Fund at up to 50% of the statutory minimum wage, namely PLN 1,300. In turn, employee remuneration for reduced work time may be co-financed at up to 50% of the amount, but no more than up to 40% of the average wage for the preceding quarter announced by the Chairman of the Central Statistical Office binding on the date of submitted application for co-financing (presently 40% is PLN 2 079.43) with consideration of work time. This assistance is not provided to employees earning more than 300% of the average wage for the preceding quarter as announced by the Chairman of the Central Statistical Office binding on the date of submitted application (PLN 15,595.74 for the fourth quarter of 2019). An entrepreneur is also entitled to financing of social insurance premiums for the above employees borne by an employer.

Moreover micro, small and medium-sized firms experiencing a certain decrease in turnover due to COVID-19 can also seek co-financing from the Labour Fund for three months' payroll and premiums for other employees. Firms may apply for funds, depending on the drop in turnover: (i) by at least 30%: up to 50% of the statutory minimum wage per employee (namely PLN 1,300) increased by related social security contributions; (ii) by at least 50%: up to 70% of the statutory minimum wage per employee (namely PLN 1,820) increased by related social security contributions; and (iii) by at least 80%: up to 90% of the statutory minimum wage per employee (namely PLN 2,340) increased by related social security contributions. This program is also available for the self-employed persons for co-financing of ongoing business costs for up to three months.

A key element in the Anti-Crisis Shield is a low interest loan from the Labour Fund for micro firms (also for the self-employed) of up to PLN 5,000 to cover ongoing business costs. Repayment of this loan can be fully waived if a firm continues its activity for three months from the date of its granting and applies for its waiver by a set deadline.

Firms and self-employed persons cannot receive co-financing for the same costs of payroll, premiums and other that have been already or will be co-financed from public funds.

As of 13 May 2020, according to data provided by the Government, more than 3.74 million applications

Notes

3 Straty-Covid.pl, <straty-covid.pl>, 10 May 2020.

4 Bloomberg o danych KE: Polska gospodarka najbardziej odporna na kryzys w Unii Europejskiej, <www.businessinsider.com.pl/finanse/makroekonomia/bloomberg-pozytywnie-o-polskiej-gospodarce/82rxdz8>, 15 May 2020.

5 The Anti-Crisis Shield, Gov.pl, <www.gov.pl/web/tarczaantykryzysowa>, 10 May 2020.

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were filed for benefits under the Anti-Crisis Shield. The largest number concerned an exemption from social and health insurance premiums, loans for micro firms and standby benefits. Over PLN 8.27 billion has already been transferred to entrepreneurs under the Anti-Crisis Shield.[6]

Moreover, the Industrial Development Agency S.A. (ARP), owned by the State Treasury, offers small and medium-sized firms affected by COVID-19 operational loans at preferential rates to finance deficits in working capital or payroll. A loan to finance a deficit in working capital can range from PLN 800,000 to PLN 5 million for a period up to six years and can be repaid on a one-time basis or in instalments. A moratorium on principal repayment can last up to 15 months. In turn, a loan financing payroll can be granted for a period of up to two years in the net amount required to finance a payroll deficit. It can also be repaid on a one-time basis or in instalments. A moratorium on principal repayment can last up to 12 months. As well, the ARP also provided operational leasing for the transport sector in an amount up to PLN 5 million net for a period up to six years (including a moratorium) to refinance currently leased transport means not older than three years and exceeding 3.5 tons. A moratorium on repayment of leasing fees lasts up to 12 months.[7]

The Anti-Crisis Shield also introduced changes to functioning of the *de minimis* guarantee offered by Bank Gospodarstwa Krajowego, a state development bank (BGK) (in particular, increased scope of guarantee – maximum of PLN 3.5 million, extension of the guarantee period and no commission on the first guarantee year). Guarantees are available for micro, small and medium-sized firms to secure commercial credits. Moreover, an additional Liquidity Guarantee Fund has been established at BGK that is dedicated to medium and large scale firms affected by COVID-19 seeking new or renewable liquidity financing at commercial banks (guarantee amount from PLN 3.5 million to PLN 200 million). BGK also finances interest free liquidity loans from the Intelligent Development Program for micro, small and medium-sized firms affected by COVID-19 in amounts up to PLN 15 million with repayment periods of up to six years (repayment moratorium up to six months). Activation of a system of co-payments from BGK toward interest on operational commercial credit for small, medium and large firms affected by COVID-19 is also planned.[8]

The Anti-Crisis Shield does not include a moratorium suspending payments, also to financial institutions. Commercial banks, under the auspices of the Polish Bank Association, have nevertheless introduced a simplified procedure for reviewing applications for so-called 'credit holidays' (up to three months), primarily with micro, small and medium-sized firms in mind. The same applies to leasing and factoring firms in bank capital groups.[9] Moreover, on the basis of the Anti-Crisis Shield, banks are entitled, in cooperation with debtors, to modify terms of credit on the basis of credit worthiness in the last quarter of 2019 or the first quarter of 2020.

A ban on retail sales was introduced from 14 March 2020 to 4 May 2020 at shopping centres with a sales area exceeding 2,000 m^2 (with the exception of groceries stores, pharmacies and laundries). Also introduced within the scope of the Anti-Crisis Shield are regulations providing for statutory expiry of mutual obligations of parties to a lease, tenancy or other similar contract during the period of prohibited activity at shopping centres. A party entitled to use retail space should submit an unconditional and binding offer to the providing party of its will to extend a contract by the period equals to prohibition period plus six months on existing terms. The offer should be submitted within three months from the date of lifted ban. Expiry of the parties' mutual obligations ceases to bind the providing party after the ineffective expiry of offer submission deadline.

Financial shield

The Financial Shield, in turn, is an additional program of strictly monetary support for micro (employing at least one person), small, medium and large scale firms experiencing a decrease in revenues due to COVID-19. The program has a total value of PLN 100 billion. Its purpose is to protect the labour market and provide financial liquidity to firms during the period of severe disruption to the economy resulting from the COVID-19 epidemic. The program is directed toward approximately 670,000 Polish entrepreneurs and is executed by the Polish Development Fund S.A., owned by the State Treasury (PFR).[10] Funds are paid out through commercial and cooperative banks working with the PFR. Program financing is through the emission of bonds

Notes

6 Już ponad 8,27 mld zł trafiło do przedsiębiorców dzięki tarczy antykryzysowej, Gov.pl, <www.gov.pl/web/tarczaantykryzysowa/juz-ponad-827-mld-zl-trafilo-do-przedsiebiorcow-dzieki-tarczy-antykryzysowej>, 15 May 2020.

7 Industrial Development Agency S.A., <www.arp-tarcza.pl>, 10 May 2020.

8 Bank Gospodarstwa Krajowego, Pakiet pomocy dla firm dotkniętych skutkami pandemii COVID-19, <www.bgk.pl/pakietpomocy>, 10 May 2020.

9 Komunikat ZBP w sprawie działań pomocowych podejmowanych przez banki w związku z pandemią koronawirusa COVID 19, The Polish Bank Association, <www.zbp.pl/Aktualnosci/Wydarzenia/Komunikat-ZBP-w-sprawie-dzialan-pomocowych-podejmowanych-przez-banki>, 10 May 2020.

10 Polish Development Fund S.A., <www.pfr.pl>, 10 May 2020.

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by the PFR with maturity rates from two to ten years and a State Treasury guarantee. The National Bank of Poland will also be able to subsequently re-purchase these bonds.

Micro, small and medium-sized firms can seek interest-free subsidies if they experienced a decrease in revenues of at least 25% due to COVID-19. The maximum level of subsidies for micro firms is PLN 324,000 for a period up to three years and up to PLN 3.5 million for the same period for small and medium-sized firms. The moratorium on subsidy repayment is 12 months. If certain conditions are met (including continued activity and employment), it will also be possible to waive up to 75% of the subsidy repayment amount.

Support for large firms has an individual character and will include the ability to seek a preferential loan for ongoing operations and restructuring up to PLN 750 million for a period up to three years with an extension option up to one year. If certain conditions are met, it will be possible to reduce the loan face value amount up to 75%. Large firms will also be able to seek liquidity financing for ongoing operational activity up to PLN 1 billion on market terms in the form of loans, acquisition of receivables, bonds and guarantees. Investment financing through instruments such as shares, warranty subscriptions, bonds or convertible loans for shares will also be made available.

Support from the program can be sought by firms which, among others, conducted business and had no tax or contribution arrears on 31 December 2019 or on the date of application (payment in instalments or its postponement is not considered an arrear), have not commenced liquidation and are not subject to court restructuring or bankruptcy proceedings, have tax residence in the European Economic Area, are registered in Poland and whose main beneficiary owner has no tax residence in a so-called 'tax havens'. An exemption to this rule is only possible through an obligation of a firm and/or its main beneficiary owner to transfer tax residence to the European Economic Area within nine months from the date of support granted through the program.

On 27 April 2020, the Financial Shield program for micro, small and medium-sized firms obtained an appropriate notification from the European Commission. As of 29 April 2020, it began to accept applications for support. As of 13 May 2020, 95,188 firms have benefited from the Financial Shield program in an amount of approximately PLN 19.96 billion. A program for large scale firms awaits a European Commission notification.

Commercial court proceedings, including restructuring and bankruptcy

Court and litigation deadlines, as well as dates for holding trials and open sessions, were suspended in most commercial court cases during the state of epidemiological threat or epidemic declared due to COVID-19. The Anti-Crisis Shield applied an exemption to this rule in the case of so-called 'urgent matters'. Such matters include, among others, review of a restructuring application by a Restructuring Court. In mid-May 2020 it was enacted by the Parliament to lift suspension of court and litigation deadlines as well as to hold trials and open court sessions by video-conference. Moreover the Parliament expanded the list of so-called 'urgent matters' to include court restructuring proceeding itself (i.e. for the procedure following commencement of court restructuring).

Court restructuring procedures are available to insolvent debtors as well as to debtors threatened with insolvency. They are conducted by Restructuring Courts. The main objective of restructuring proceedings is to save debtors from having to declare bankruptcy by allowing them to restructure under an arrangement with creditors. In Poland, restructuring processes are given precedence. If a restructuring and bankruptcy applications are submitted at the same time, the court, in general, will first examine the former.

The Anti-Crisis Shield does not provide an explicit moratorium for declaration of debtor bankruptcy by Bankruptcy Courts. Creditors continue to have the right to submit petitions to declare bankruptcy of insolvent debtors. Debtors themselves or their representatives also remain entitled to the submission of a petition to declare debtors' own bankruptcy if they have become insolvent.

Late submission of a motion to declare bankruptcy or absence thereof may result in liability of an insolvent debtor or its representatives. The deadline for mandatory submission of a motion to declare bankruptcy in Poland is 30 days from the date when a debtor became insolvent. The Anti-Crisis Shield nevertheless modifies this deadline if a debtor became insolvent due to COVID-19. If the basis to declare debtor bankruptcy arose during a state of epidemiological threat or epidemic declared on account of COVID-19 (i.e. after 14 March 2020) and a state of insolvency arose due to COVID-19, the deadline to file a motion to declare bankruptcy does not commence and that which has commenced is interrupted. If a debtor became insolvent after 14 March 2020, it is presumed that this was caused by COVID-19 (a presumption that can nevertheless be abolished). After the end of a state of epidemiological threat or epidemic, the deadline to submit a motion to declare bankruptcy commences anew.

Moreover, in mid-May 2020 the Parliament expanded the range of so-called 'urgent matters' in the Anti-Crisis Shield, including the proceedings aimed at declaration of bankruptcy and bankruptcy proceeding itself.

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The Position of UK Directors during the COVID-19 Pandemic

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Synopsis

In the current pandemic and consequent lockdown UK company directors face many challenges and risks. The government has recently announced that wrongful trading liability under Section 214 of the Insolvency Act 1986 will be suspended for an initial period of 3 months in order to alleviate directors' concerns about personal liability when deciding whether or not to continue trading. However, other duties and routes to personal liability remain in place and directors are by no means 'off the hook'. This article examines the impact of the suspension of wrongful trading liability and gives some advice on best practice for directors seeking to minimise the risk of liability should the company later enter an insolvency proceeding.

Introduction

The COVID-19 pandemic has changed everyday life immeasurably in a short space of time, and presented businesses with a range of serious challenges, both in the short-term and for the future. Many businesses are facing their toughest trading environment in living memory and some have been forced by lockdown measures to stop trading altogether. With no certainty as to how and when the current lockdown will end, many company directors face the difficult task of deciding whether to enter an insolvency procedure, or to try and trade out of a position of cash-flow or even balance-sheet insolvency.

As company directors try to meet the immediate challenges to their business on a daily basis, they may well be mindful of the potential risk that they will be held personally liable for their current actions. Although, as set out below, the UK Government is trying to reduce directors' anxieties in this regard by suspending wrongful trading liability under Section 214 of the Insolvency Act 1986, English law imposes a number of other specific duties on directors that must be complied with even in these extraordinary times.

Directors' duties and liabilities – the factual position

Directors' duties under English law derive from a variety of sources, principally common law, the Companies Act 2006 and other statutes, for example health and safety, employment and environmental legislation. The 2006 Act codified long-standing (and perhaps common-sense) duties, as a reminder:

- to act within their powers according to the company's constitution and only exercise powers for the purposes for which they are conferred (section 171);
- to act in a way that they consider in good faith will promote the success of the company for the benefit of its members as a whole (section 172);
- to exercise independent judgment when fulfilling their duties (section 173);
- to exercise reasonable care, skill and diligence (section 174);
- to avoid actual or potential conflicts between the director's interest and the interests of the company, and not to exploit or profit from their position within the company (section 175);
- not to accept benefits from third parties conferred by reason of being a director or doing (or not doing) anything as a director (section 176);
- to declare any interest in proposed or existing transactions or arrangements with the company to the board (sections 177–182).

These general duties, owed to the company, are cumulative (section 179) and, in the event of wrongdoing, it is not uncommon for a director to be held in breach of more than one of them.

The general duties are focussed on the director's duties to promote the company's success in the interests of its shareholders. However, when the company is insolvent or likely to become so, the directors are then required to act primarily in the best interests of the company's creditors as a whole, maximising (or at least preserving) the value of the company's assets.

As is well-known, a company can be insolvent in cash-flow terms if unable to pay its debts as they fall

due, and/or in balance sheet terms, where its liabilities are more than its assets at a given time (see section 123 of the Insolvency Act 1986). At present, with large sectors of the economy shut down and many businesses unable to generate revenue but still liable to meet fixed costs, it is anticipated that a large proportion of otherwise viable companies could find themselves technically insolvent.

In an insolvency context other potential claims against directors also arise. Apart from wrongful trading (which will be dealt with below) the 1986 Act provides a range of remedies against directors and ex-directors of companies in liquidation. For instance, pursuant to section 212 any director who has misapplied or retained, or become accountable for, any company money or other property or who has been guilty of any misfeasance or breach of duty can be ordered to repay, restore or account for that property (plus interest) or to pay such compensation to the company as the court thinks just. Breaches of duty in this context include negligence and breaches of the general 2006 Act duties set out above. Section 213 of the 1986 Act provides that directors who are guilty of carrying on company business with intent to defraud creditors can be ordered to make contributions to the company's assets.

Furthermore, certain transactions can be set aside or clawed-back in the event of liquidation or administration. The most common examples are transactions at an undervalue (section 238) and transactions amounting to unlawful preferences of particular creditors, sureties or guarantors (section 239).

It should also be noted that where a company has become insolvent a director may be disqualified from acting as a director pursuant to the Company Directors' Disqualification Act 1986 if his conduct makes him unfit to be concerned in the management of a company. There are also numerous criminal offences under the Insolvency Act 1986 relating to fraudulent conduct e.g. in relation to falsification of company books or false representations to creditors (see Sections 206–211).

Wrongful trading liability

By way of summary, wrongful trading pursuant to section 214 of the Insolvency Act 1986 is the continuation of trading by a company at a time when the company is unable to pay its debts as they fall due.

The Section applies if, at some time before the commencement of winding up, the director 'knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or entering insolvent administration' (Section 214(2)(b)), but nonetheless allowed the company to keep on trading. The director is held to the standard of a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions; and (b) the director's actual general knowledge, skill and experience (Section 214(4)). The standard therefore contains an objective element.

However, pursuant to Section 214(3) the Court should not require a director to make a contribution if, after the time when the director first knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation 'that person took every step with a view to minimising the potential loss to the company's creditors as [assuming him to have known that there was no reasonable prospect that the company would avoid going into liquidation] he ought to have taken'.

This defence is construed strictly and requires a director to demonstrate not only that continued trading was intended to reduce the company's net deficit, but also that it was designed so as to minimise the risks of loss to individual creditors, including new creditors incurred during the wrongful trading period (see *In re Ralls Builders Ltd* [2016] Bus LR 555 (Snowden, J.) at para. 245).

Directors are therefore potentially subject to unlimited personal liability for their conduct prior to commencement of the winding-up. The case-law suggests that any contribution is based on the loss suffered by the company caused by the wrongful continuation of trading. The starting point for assessment is the increase in the net deficiency of the company's assets as regards unsecured creditors during the wrongful trading period, but only to the extent that that increase was caused by the wrongful trading (see *Ralls Builders* (cited above) at paras 241–242). Losses that would have been incurred in any event due to the company's insolvency or entering a formal insolvency procedure are not included. It is possible, as in *Ralls Builders* itself, that a period of wrongful trading may actually improve the company's net deficiency by allowing for enhanced collection of contract debts compared to an earlier cession of trading.

However, liability for wrongful trading is relatively rare and the mere fact that a company is insolvent (whether on a balance-sheet or cash-flow basis) and carries on trading is insufficient. It is common for companies to experience cashflow difficulties or balance sheet deficits from time to time. The requirement is not that the company was insolvent, but that there was no reasonable prospect of avoiding liquidation as a result, and the courts are mindful that it is unhelpful to rely too much on hindsight (see *In re Hawkes Hill Publishing Co* [2007] BCC 937 per Lewison J. at paras 28 and 47). The typical case is one where a director closes his or her eyes to obvious reality and has no rational basis for believing that an event which would save the company will come about.

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Suspension of the application of Section 214 – the government announcement

Given the obvious risks of insolvency during the current pandemic, directors who carry on trading, incurring credit and/or paying salaries and suppliers, could be exposed to liability for wrongful trading under section 214 if their companies enter liquidation. At present it is very difficult for directors to make the sort of assessment required by section 214, in that the chance of avoiding insolvent liquidation will depend on when and how the current lockdown is lifted and what financial support, if any, companies receive from the State.

On 28 March 2020 the Business Secretary Alok Sharma announced that wrongful trading liability will be suspended retrospectively from 1 March 2020 for an initial period of three months. The relevant press release stated as follows:

> 'The government will also temporarily suspend the wrongful trading provisions to give company directors greater confidence to use their best endeavours to continue to trade during this pandemic emergency, without the threat of personal liability should the company ultimately fall into insolvency. Existing laws for fraudulent trading and the threat of director disqualification will continue to act as an effective deterrent against director misconduct'.[1]

The suspension is intended to give directors some breathing space, and to prevent a rush of insolvent liquidations as directors opt for winding-up rather than face potential personal liability. As of 11 May 2020 there is only a short Commons Briefing Paper (number 8877) regarding the suspension of wrongful trading and the government have not presented any draft legislation on this subject. The precise way in which the suspension will operate and its scope are therefore unknown. Given the uncertainty it would be a brave company director who relied solely on the announcement when making key business decisions at the moment.

Implications of government announcement

While the government's announcement gives something of a boost to directors trying to 'keep calm and carry on', it also raises a number of practical issues. Most obviously, while liability for wrongful trading is suspended, directors may still be liable for breaching their other duties, including the duty to consider the interests of the company's creditors as a whole in times of doubtful solvency.

Furthermore, other avenues to personal liability remain, such as fraudulent trading, misfeasance, breach of the Companies Act 2006 duties, as well as the threat of disqualification. While the practical effect of the suspension may be that certain expenditure or borrowing during the suspension period does not amount to wrongful trading, a director incurring further credit at a time when they know that the company will be unable to pay it back when due may face liability (e.g. under section 213 of the Insolvency Act 1986). Any future administrator or liquidator of the company is likely to review directors' conduct and explore any avenues for recovery against them.

Given the urgency of the situation, it is perhaps regrettable that the government has not yet produced draft legislation or provided any real detail of how the suspension will operate. For instance, it is unclear whether section 10 of the Company Directors' Disqualification Act 1986 (which allows a court to make a disqualification order against a director found guilty of wrongful trading under section 214 Insolvency Act 1986) will also be suspended. If a director would (bar the suspension) have been found liable under section 214 then it is unclear whether this is a ground for disqualification under section 10 of the 1986 Act.

Another obvious problem is that the suspension is merely temporary and, unless extended in due course, only for three months – to the end of May 2020. There may be cases where wrongful trading predated 1 March and continued into the suspension period or, conversely, began within the suspension period and then continued after the suspension was lifted. It is unclear how such cases will be dealt with from a liability standpoint but further difficulties arise regarding quantum. As set out above, a director's contribution under section 214 is usually calculated by reference to the amount that the net deficiency increases as a result of the wrongful trading after the date that the court finds the directors should have put the company into an insolvency proceeding. The added complexity of applying this approach in a case where a director has been wrongfully trading both within and outside the suspension period is obvious.

Advice for directors

The situation faced by any company director is of necessity fact-specific. Any concrete steps or business decisions will depend on the particular business and the factual scenario that the company finds itself in. However, some general advice on best practice can be given:

Notes

1 Press release dated 28 March 2020 <https://www.gov.uk/government/news/regulations-temporarily-suspended-to-fast-track-supplies-of-ppe-to-nhs-staff-and-protect-companies-hit-by-covid-19> accessed on 5 May 2020.

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- Seek professional advice on key legal and financial issues and, potentially, from an insolvency practitioner or 'turnaround specialist'.
- Explore the various measures announced by the government to ease cash-flow and assist with the financial impact of the pandemic e.g. loan schemes, employee furlough schemes and business rates holidays.
- Consider and act in the best interests of the company's creditors as a whole, especially when deciding whether or not to continue trading. In a rapidly evolving situation such as the current pandemic, the course of action in the creditors' best interests may change, and therefore this needs to be reviewed very regularly. Taking and recording advice from an insolvency practitioner or lawyer may provide some assistance in the event of subsequent enquiry by a liquidator or administrator.
- Remember that, given the likely difficulty of finding a buyer willing to pay a business' fair value at the present time, it is not inevitable that a company's creditors would be in a better position if the company immediately entered an insolvency procedure. However, no assumptions should be made in this regard and the question must be considered on a regular basis.
- Document all business decisions and the reasoning behind them. This is crucial in order to evidence that directors took creditors' interests into account when making decisions. As well as board minutes, directors should consider producing and/or reviewing revised versions of documents such as management accounts, trading and cash flow projections and a plan of how the company will operate during the pandemic and its aftermath. These documents should also be re-considered and adapted as necessary to keep up with changing circumstances.
- Keep communicating with key creditors and stakeholders such as banks and suppliers.
- Once the suspension of wrongful trading liability ends, reconsider the requirements of section 214 and ensure that directors are not wrongfully trading or at risk of doing so. In particular, a director should assess whether there is a reasonable prospect of avoiding insolvent administration or liquidation and, if not, take every step to minimise losses to creditors.

Things to avoid:

- Incurring new liabilities (whether from government schemes or other sources) when the director knows that there is no prospect of repayment or no credible plan for meeting such liabilities when they fall due.
- Repaying liabilities where directors have given personal guarantees in preference to other liabilities or otherwise preferring certain creditors over others, other than in the normal course of trading. The obligation is to consider the interests of creditors as a whole, not just particular creditors or classes of creditor.
- Transferring assets to connected persons or companies other than in the usual course of business.
- Paying out dividends or bonuses where the company is on the brink of failure.

Conclusion

The above analysis is not meant to strike fear into the heart of company directors, but to encourage a conscientious and responsible approach. The suspension of wrongful trading liability is intended to ensure that directors acting in good faith in difficult circumstances are not unduly penalised. Some comfort may also be taken from section 1157 of the Companies Act 2006, where the Court is empowered, in any proceedings against a director for (inter alia) negligence, breach of duty or breach of trust, to relieve the director either wholly or partly from liability if they have acted honestly and reasonably and ought, in the circumstances, fairly to be excused. The need for further Government guidance and, preferably, draft legislation, is pressing. It should not fall to the courts to have to determine (in an information vacuum) what is fairly to be excused. However, directors can take some comfort from the pragmatism and common-sense of the commercial and chancery judges upon whom the burden of filling the information void may, ultimately, fall.

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Re Debenhams Retail Limited [2020] EWCA Civ 600

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Synopsis

In *Re Debenhams Retail Limited*, the Court of Appeal has held that by accessing the UK Government's Coronavirus Job Retention Scheme (the 'JRS') and paying employees that had been placed on furlough, administrators will have clearly adopted the relevant contracts of employment for the purposes of paragraph 99 of schedule B1 to the Insolvency Act 1986.

The decision upholds the judgment of Trower J in the High Court ([2020] EWHC 921 (Ch)), which also followed the decision of Snowden J in *Re Carluccio's Limited* [2020] EWHC 886 (Ch).

The Court ruled that an administrator's intentions (even objectively determined) are not relevant to the question of 'adoption'. The question is whether the administrator has taken active steps to continue the employment of the relevant employee. Accessing the JRS and paying furloughed employees is sufficient for the contracts of employment to be adopted by the administrators, even if no other actions are taken by the administrators in relation to the furloughed employees.

The Court of Appeal's decision provides important clarity on this area of the law and will be of clear relevance to administrators appointed while the JRS is in operation.

The Court accepted that there may be good reasons of policy for excluding action restricted to implementation of the JRS from the scope of 'adoption', however, such exclusion cannot be accommodated under the law as it stands.

Facts

Debenhams Retail Limited (the 'Company') is part of a group which operates retail department stores in various countries across the world. The Company has approximately 15,500 employees in the UK.

Following the introduction of lockdown measures by the UK Government to combat the spread of Covid-19 in late March 2020, the Company closed all of its stores and wrote to approximately 13,000 employees informing them that they were being placed on furlough under the JRS. By the time of the appeal, express consent to these furlough arrangements had been received from all but 14 employees.

An employee placed on furlough temporarily ceases all work for their employer without terminating their employment contract. The essential feature of the JRS is that the UK Government will pay employers 80% (up to £2,500 per month) of the wages of furloughed employees. The basic aim of the JRS is to prevent redundancies as a direct result of the lockdown and the it is expressly stated to be accessible by companies in administration where there is a reasonable prospect of rehiring the furloughed employees.

Shortly after the closure of its store estate and the furloughing of approximately 13,000 employees, on 9 April 2020 the Company appointed joint administrators (the 'Joint Administrators').

The purpose of the administration is to seek to rescue the Company as a going concern and the Joint Administrators are pursuing a so-called 'light touch' administration. As part of this, the Joint Administrators have consented to the Company's management continuing to exercise their day-to-day functions, with a view to being in a position to resume trading from as many of the Company's stores as possible once the lockdown measures are lifted. The Joint Administrators decided to keep the relevant employees on furlough under the JRS, paying them 80% of their wages (up to £2,500), so they could be returned to service once store trading resumed.

The question that arose was whether the contracts of employees who had been furloughed under the JRS would be adopted by the administrators if the employees remained on furlough and the Joint Administrators took no further action in relation to these employees except to pay to them the amounts to be reimbursed to the Company under the JRS and to issue certain communications to these employees.

'Adoption' of employment contracts

The effect of an administrator adopting an employment contract is set out in paragraph 99 of schedule B1 to the Insolvency Act 1986. This provides that wages and certain other liabilities relating to adopted employment contracts enjoy 'super priority' status in the administration, i.e. they rank ahead of other liabilities, including floating charges and the administrator's own remuneration and expenses.

The administrator is given an initial 14 day period following appointment to decide on the action, if any, to be taken in relation to employees. Any action taken within that period does not amount or contribute to the adoption of an employment contract. Following this, any conduct which amounts to an election to treat the employee liabilities as an expense will constitute adoption of the relevant employment contract, elevating these liabilities to 'super priority' status.

The leading case on the meaning of 'adoption' for these purposes is the House of Lords' decision in *Powdrill v Watson, Re Paramount Airways Ltd* [1995] 2 AC 394 ('Paramount').

In Paramount, the relevant employees had performed services for their employers after the expiry of 14 days from the appointment of the officeholders, for which they had been paid. The issue that arose was whether letters that had been sent from the officeholders to the employees stating that the officeholders were not adopting the contracts of employment, had the intended effect that the employment contracts had not been adopted.

It was held by the House of Lords that 'adoption' required 'some conduct by the administrator or receiver which amounts to an election to treat the continued contract of employment as giving rise' to a super priority liability (see Paramount at p.449A-B per Lord Browne-Wilkinson). The decision in Paramount has been applied on a number of occasions since (see, for example, *Re Antal International Ltd* [2003] EWHC 1339 (Ch), cited with approval by the Court of Appeal in this case (at [54])).

The High Court

At first instance in this case, Trower J applied the decision in Paramount and held that, by participating in the JRS and paying remuneration to furloughed employees, the Joint Administrators have adopted the relevant employment contracts. Trower J held that all that was needed for 'adoption' was conduct on the part of the Joint Administrators which could be said to amount to treating the contracts as continuing to give rise to liabilities to which the Company is subject in its administration, which was present on the facts ([2020] EWHC 921 (Ch) at [64]).

Trower J followed the decision handed down a few days previously by Snowden J in Re Carluccio's Limited [2020] EWHC 886 (Ch), which also concerned the operation of the JRS in the context of an administration.

In that case, Snowden J had also applied Paramount and also held that when administrators make an application under the JRS or make payments to furloughed employees, the relevant employment contracts are adopted by the administrators. Snowden J found that the administrators 'would be doing an act which could only be explicable on the basis that they were electing to treat the varied contract as giving rise to liabilities which qualify for super-priority' (at [91]).

The Court of Appeal

It was argued before the Court of Appeal (Sir Geoffrey Vos, David Richards LJ, Bean LJ) that Trower J had applied the wrong test as to 'adoption' at first instance, while Snowden J had identified the relevant test in Re Carulccio's Limited, but had misapplied that test.

It was argued that the Joint Administrators had not adopted the contracts of the Company's furloughed employees because:

a) the employees are not providing any services to the Company;

b) the employees' remuneration is strictly limited to that which is covered by the JRS and therefore, as a matter of economic substance, the Company is a conduit for the JRS funds; and

c) any decision whether to terminate the contract of any furloughed employee will be made only once the JRS has ended.

In dismissing the appeal, the Court of Appeal held that, while it is a relevant factor that the employees are providing no services to the Company, by accessing the JRS and paying employees on a furloughed basis, the Joint Administrators have clearly adopted the contracts of furloughed employees.

The Court ruled that the Joint Administrators' intentions are not a relevant factor, even if objectively determined. The question is one of conduct - has the administrator taken active steps to continue the employment, such that the administrator must have to accept that the relevant amounts falling due under the employment contract enjoy super-priority (at [53]). The Court did not accept that the judgments of Trower J and Snowden J displayed any significant difference in approach (see [49]-[52]).

The Court held that, by paying furloughed employees, the Joint Administrators have taken active steps to continue the employment, because:

a) the Joint Administrators will continue to pay the wages of the furloughed employees pursuant to their employment contracts, up to the limits provided by the JRS. The employees' entitlement to those payments is derived exclusively from their employment contracts;

b) all furloughed employees will remain bound by their contracts of employment, subject to the requirement not to provide services to the Company while on furlough. They will remain available, and will be obliged, to provide their services to the Company when the furlough period ends; and

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c) by continuing to pay the furloughed employees, the Joint Administrators must be acting with the objective of rescuing the Company as a going concern and in the interests of the Company's creditors as a whole (at [57]-[59]).

The Court noted that if the Joint Administrators simply did nothing, then this would involve no continuation by the Joint Administrators of the employment and the relevant contracts would not be adopted. However, the Court held that this was clearly not the case where payments are being made to furloughed employees in accordance with the JRS.

The Court added that it could see that there may be good reasons of policy for excluding action restricted to implementation of the JRS from the scope of 'adoption', but that such exclusion cannot be accommodated under the law as it stands.

Commentary

This decision provides important clarity on this area of the law and will be of clear relevance to administrators appointed while the JRS is in operation.

One of the key implications of the Court's decision is that, unless employees have consented to waive their entitlement to it, any portion of wages which is not covered by the JRS will be a super-priority claim against the company in administration. Certain other liabilities e.g. accrued holiday pay and employers' national insurance contributions on that holiday pay are also not currently covered by the JRS and cannot be contracted out of, so will have to be paid with super-priority.

Newly-appointed administrators will therefore need to decide quickly (within the 14 day window) what their exposure will be in relation to furloughed employees and whether this should be mitigated through either contract variations or redundancies.

If implementation of the JRS (without more) did not amount to 'adoption', then it might be the case that some administrators would in a position to defer decisions relating to employees beyond the 14 days immediately following their appointment, without potential exposure to super-priority claims from furloughed employees. In some cases, this might have the effect that certain employees are retained on a furloughed basis who later return to service, and who might otherwise have been made redundant. This result might be more in keeping with the purposes of the JRS and the rescue culture more generally.

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Developments in the UK as a Result of COVID-19

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Synopsis

At the time of writing, the long-awaited Corporate Insolvency and Governance Bill (the 'Insolvency Bill') is yet to be published but a number of recent announcements by the UK Government have indicated what we can expect the legislation to include.

There have also been some interesting case developments and announcements which we cover in this article.

Proposed reform of insolvency law

In reaction to COVID-19 and in an attempt to provide 'extra time and space' for companies to 'weather the storm', on 28 March 2020, Alok Sharma, the Secretary of State for The Department for Business, Energy and Industrial Strategy announced certain proposals for change to UK insolvency law.[1] Three of the four points below reflect the proposals made by the UK Government in 2016 on which a consultation was carried out in 2018. These proposals may be amended to address the COVID-19 pandemic however the precise scope of the proposed changes will only become clearer once the draft legislation is published.

– *Temporary suspension of the wrongful trading provisions in the Insolvency Act 1986* ('IA') which will mitigate the risk of personal liability for directors who are trading after the point at which they knew or ought to have concluded that there was no reasonable prospect that the company could avoid going into an insolvency process. This temporary suspension will have retrospective effect from 1 March 2020 and is said to relieve the pressure on directors to put a company through an insolvency process prematurely in the current economic climate. This confidence to continue to trade will have to be balanced by the fact that directors' duties prescribed by the Companies Act 2006 and the fraudulent trading provisions in the IA remain in force. Given the potential uncertainty this brings, we consider that directors will continue to require detailed legal advice when considering the options for companies steering their way through this crisis.

– *Legal moratorium* for companies to relieve them from creditor pressure while they consider options for rescuing or restructuring companies. The eligibility criteria for this remain unclear but the company is likely to be assigned an independent 'moratorium monitor'. Whether the role of monitor can only be undertaken by a licensed insolvency practitioner has yet to be clarified.[2]

– *Prohibition on enforcement of termination on insolvency clauses* in contracts. This is to ensure that companies contemplating a restructure can continue to receive goods, supplies and services, which may not necessarily be essential, but are required for the continuation and rescue of the business. The 2016 proposals would suggest that this prohibition may only apply while the moratorium referred to above is in place. It is expected that 'supplies' will include intellectual property and software licences. However the detail will not be known until the draft legislation is published.

– *New formal restructuring plan* which will bind all creditors of a company. The proposal is for this to be a flexible restructuring plan to sit alongside the existing company voluntary arrangement and scheme of arrangement frameworks. Despite the views of many of the respondents in the 2018 consultation, the UK Government remained firmly of the view that this proposal was necessary to support company rescue and fill a gap. The proposed restructuring plan is expected to allow cross-class cram-down of creditors, which will be a significant step.

On 23 April 2020 the UK Government added further measures to be implemented in the Insolvency Bill to

Notes

1 https://www.gov.uk/government/news/regulations-temporarily-suspended-to-fast-track-supplies-of-ppe-to-nhs-staff-and-protect-companies-hit-by-covid-19 .

2 https://www.gov.uk/government/consultations/insolvency-and-corporate-governance.

'protect the UK high street from aggressive rent collection and closure'. A temporary ban is imposed on the use by landlords of statutory demands between 1 March 2020 and 30 June 2020 and on presentation of winding up petitions from 27 April 2020, through to 30 June 2020. These bans will only be implemented where a company cannot pay its debts due to COVID-19. The UK Government also provided tenants with more breathing space to pay rent by preventing landlords from using Commercial Rent Arrears Recovery unless they are owed 90 days of unpaid rent.[3] There already appear to be examples of these measures having an effect in practice. Two landlords have now withdrawn their winding up petitions presented against a casual dining company which were presented ahead of the measures taking effect. On 29 April, an injunction is said to have been granted against a landlord (in a case in which the parties cannot be identified due to a privacy order) who had threatened to wind up its tenant. The court blocked the petition after assessing the UK Government measures.

Emergency measures

Certain emergency measures have been introduced by the UK Government to 'ensure businesses are kept afloat so that they can continue to provide the jobs our economy needs beyond the coronavirus pandemic'.[4] The intention is to provide companies with the best possible chance to emerge intact on the other side of the pandemic. These include:

– Coronavirus Business Interruption Loan Scheme ('CBILS') – available to UK-based trading businesses with an annual group turnover of no more than £45m who have been adversely affected by COVID-19. The lender is provided with a government-backed, partial guarantee against the outstanding balance of finance to encourage more lending. Loans have a maximum value of £5m, available on repayment terms of up to six years. The UK Government makes a payment to cover the first 12 months of interest payments. Personal guarantees cannot be required for facilities under £250k.
– Coronavirus Large Business Interruption Loan Scheme ('CLBILS') – similar to the CBILS but available to businesses with an annual group turnover of more than £45m. A government-backed guarantee of 80% to banks to enable them to make loans of up to £25m to businesses with a turnover of between £45m and £250m and loans of up to £50m to businesses whose turnover is over £250m, available on repayment terms of up to three years.
– Bank of England's COVID Corporate Financing Facility ('CCFF') – a facility administered by the Bank of England on behalf of the UK Government to purchase commercial paper to bridge cash flow issues as a result of COVID-19. Those eligible are companies who make a material contribution to economic activity in the UK and were of sound financial health prior to the pandemic. Evidence of this criteria will be through a short term credit rating of at least A3 or a long term credit rating of at least BBB-/Baa3. The minimum issuance is £1m.
– Future Fund – convertible unsecured bridge finance of between £125k and £5m for a term of up to three years. The funding must be matched by private investment of at least 50-50. This scheme is available to unlisted UK registered companies that have raised at least £250k from private investors in the last five years.
– Bounce Back Loan – the most recent of the measures – a new 100% government backed loan scheme for small businesses where they will be able to borrow between £2k and £50k and access the cash within days. Loans will be interest free for the first 12 months and businesses can apply online through a short and simple form.
– Coronavirus Job Retention Scheme ('JRS') – from 20 April 2020, employers in the UK were able to access the HMRC online portal to apply for a grant to cover 80% of the wages (up to a total of £2,500 per month) of employees who are not working but who are 'furloughed' and kept on payroll, as opposed to being dismissed/made redundant. The claims will be backdated to 1 March 2020. The aim is for these claims to be approved and paid within a period of 6 working days.

Developments in court procedure and case law

Since the introduction of the JRS, the courts of England and Wales have already heard two urgent cases dealing with the application of the JRS and insolvency law.

In the matter of Carluccio's Limited (in administration)[5]

The company entered into administration on 30 March 2020 and the administrators sought urgent directions

Notes

3 https://www.gov.uk/government/news/new-measures-to-protect-uk-high-street-from-aggressive-rent-collection-and-closure.
4 https://www.gov.uk/government/news/new-measures-to-protect-uk-high-street-from-aggressive-rent-collection-and-closure.
5 [2020] EWHC 886 (Ch).

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from the court over their ability lawfully to use the JRS while they continued in their attempts to sell the business as a going concern. The administrators had written to each of the employees asking if they wished to take part in the JRS. The majority agreed, others declined, while the rest did not respond. The administrators also sought clarity on whether they would be able to avoid incurring the liabilities associated with the adoption of employment contracts for those employees who had not responded, without having to make them redundant within 14 days of the date of administration.

Mr Justice Snowden held that the administrators could use the JRS if there was a reasonable likelihood that those employees would be returning to work. Further, it was only as and when the administrators made an application under the JRS in respect of employees or made a payment to the employees under their contracts, that this would amount to an adoption of the contracts of employment. This would enable super-priority payments to be made to those employees under paragraph 99(5) of Schedule B1 of IA.

In the matter of Debenhams Retail Ltd (in administration)[6]

In the same week, Mr Justice Trower was asked to consider and apply the decision of Mr Justice Snowden. The question was whether the employment contracts for those employees who had already been furloughed prior to the appointment of the administrators would be considered to have been adopted by the administrators if those employees remained furloughed and the administrators took no further action except to pay them the amounts provided by the government under the JRS.

The administrators sought further clarity that if those contracts were deemed as adopted, the amount payable would be capped at the amount claimed under the JRS scheme i.e. 80% of wages for the furloughed period up to a cap of £2,500 a month.

Mr Justice Trower followed Mr Justice Snowden's decision and held that it was likely that the acts of participation in the JRS and payment of the furloughed employees, would be considered an adoption of those employment contracts by the administrators. The Administrators appealed but the appeal was dismissed.

These are just two examples of how the Insolvency & Companies Court had to grapple with issues arising out of the COVID-19 pandemic. All insolvency hearings are now being conducted remotely unless this is determined by the judge as inappropriate, for whatever reason. The decision in the recent case of *In the Matter of One Blackfriars Ltd*[7] has shown the courts' reluctance to conclude that a remote hearing is inappropriate; the parties were ordered to continue to prepare for trial and explore the technological options available to facilitate a remote trial.

There are also logistical and practical issues for the courts. On 6 April 2010, the temporary Insolvency Practice Direction ('TIPD') was introduced to supplement the Insolvency Practice Direction and provide workable solutions to the need for courts to operate with limited staff and resources after the UK Government introduced social distancing rules in March 2020. The TIPD will remain in force until 1 October 2020 and includes much needed guidance on:

– E-filing appointment documents in an administration:
  - Notices of intention to appoint an administrator by either a company or its directors and notices of appointment by a qualifying floating chargeholder ('QFCH'), company or its directors shall all be treated as delivered to the court at the date and time recorded in the Filing Submission Email received by those filing. However, this is only if e-filed on days the court is open for business and between the hours of 10am and 4pm.
  - Any notice e-filed outside of this time period shall be treated as delivered to the court at 10am on the day that the courts are next open for business.
  - A notice of appointment by a QFCH can be filed outside of normal court opening hours however the out of hours procedure set out in Rules 3.20 to 3.22 of the Insolvency Rules 2016 must be followed.
– Making and administering statutory declarations in insolvency proceedings – where Schedule B1 of the IA requires a person to provide a sworn statutory declaration (e.g. when swearing a notice of intention to appoint an administrator), this is now possible even without this being conducted in the physical presence of the person authorised to administer the oath if:
  - The person making the statutory declaration does so by way of video conference with the person authorised to administer the oath;
  - The person authorised to administer the oath attests that the statutory declaration was made in this manner; and

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6 [2020] EWHC 921 (Ch).
7 [2020] EWHC 845 (Ch).

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- The statutory declaration states that it was made in the manner referred to above.

The UK Government is constantly adapting measures in an attempt to balance liberty and necessity to maximise the survival of businesses. It will be interesting to see whether the detail in the Insolvency Bill achieves this balance.

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Relief for US Businesses in Response to COVID-19: The Coronavirus Aid, Relief, and Economic Security Act 2020

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Introduction

The Coronavirus Aid, Relief, and Economic Security Act (the 'CARES Act' or the 'Act') was signed into law in the United States on 27 March 2020. It provided unprecedented financial assistance, totalling more than $2 trillion, to businesses and individuals impacted by the novel coronavirus COVID-19.[2]

While the CARES Act has provided important relief to US businesses, implementation has been problematic. A centrepiece of the Act, Paycheck Protection Program loans ('PPP Loans'), was intended to provide emergency funding to small businesses (*i.e.*, those with not more than 500 employees at a single location).[3] As discussed in greater detail below, the Act failed to provide applicants with clear guidance concerning important aspects of the PPP Loans, including the terms of potential loan forgiveness. Roll out of PPP Loans was uneven, as many of the banks through which loan applications were processed were not properly equipped to do so when the program took effect, and other banks prioritised applications from their own customers.[4] Much of the PPP Loan funding was diverted from intended recipients – smaller businesses -- to large corporations that did not need assistance but were nonetheless eligible. In response, the US Treasury Secretary indicated there would be a 'full review' of all PPP Loans over $2 million,[5] but for many small businesses, it may be too late.[6]

Congress is currently working to address many of the problems associated with this comprehensive assistance program, including authorising additional funding, with the goal of limiting the damage resulting from the COVID-19 pandemic.[7]

Background

In December 2019, a pneumonia outbreak of unknown origin occurred in Wuhan, China. The World Health Organisation ('WHO') was notified on 31 December 2019, and health officials in various countries began steps to track and contain the virus, which was identified as a coronavirus similar to SARS in mid-January 2020, and named 2019-nCoV by WHO.[8] The virus, renamed COVID-19, spread rapidly across the globe. The origin of the disease subsequently was linked to the Huanan Seafood Wholesale Market in Wuhan, which featured the sale of live, exotic animals such as civets,

Notes

1 The views expressed in this article are those of the author and not necessarily those of his firm.

2 According to the US Department of Treasury website, 'The CARES Act provides fast and direct economic assistance for American workers and families, small businesses, and preserves jobs for American industries.' https://home.treasury.gov/policy-issues/cares (this and other websites cited herein last visited 6 May 2020). Notably, the CARES Act provides 'economic impact payments' to $1,200 to each eligible individual, as well as $600 per week in Federal Pandemic Unemployment Compensation for up to 39 weeks for eligible individuals who lost their jobs as a result of the COVID-19 pandemic.

3 CARES Act, § 1102.

4 Blake, Brock, *Paycheck Protection Program Loans—The Good, The Bad, And The Ugly*, 19 April 2020 (https://www.forbes.com/sites/brockblake/2020/04/19/ppp-loans-good-bad-ugly/#499d5ae07189).

5 Rapier, Graham, *The US Government Will Do a 'Full Review' of Any Company Taking a Small Business Loan Over $2 Million After Massive Corporations Took Advantage of the Program*, 28 April 2020 (https://www.businessinsider.com/government-review-new-small-business-loans-over-2-million-abuse-2020-4).

6 *See* Reese, Lexi, *How to Fix the Failed Small Business Loan Program*, 25 April 2020 (asserting that the PPP 'has left behind the businesses it set out to save') (https://www.businessinsider.com/how-congress-can-fix-coronavirus-ppp-small-business-loan-program-2020-4 ; *see also* Blake, *supra* note 2 (noting that although approximately 1.6 million small business owners obtained PPP Loans, that figure represents only '6% of America's small businesses').

7 *See* Warmbrodt, Zachary, *Next Round of Small Business Relief May Come with Fewer Strings Attached*, 5 May 2020 (stating that 'lawmakers are preparing to fix the glitches in the next round') (https://www.politico.com/news/2020/05/05/small-business-relief-238995).

8 *See* Hui DS, I Azhar E, Madani TA, Ntoumi F, Kock R, Dar O, et al. (February 2020). *The Continuing 2019-nCoV Epidemic Threat of Novel Coronaviruses to Global Health – The Latest 2019 Novel Coronavirus Outbreak in Wuhan, China*, Int J Infect Dis. 91: 264–66 (https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7128332/).

from which the disease is believed to have jumped to humans.[9]

On 30 January 2020, the WHO declared COVID-19 a Public Health Emergency of International Concern,[10] and on 11 March 2020, declared it a pandemic.[11] After initially downplaying the significance of the spreading virus,[12] on 13 March 2020, the president of the United States declared a national emergency. Within a few days thereafter, states began imposing 'stay at home orders,' directing their citizens to remain at home, other than for certain 'essential' activities such as acquiring food and seeking medical attention.[13] Recognising the tremendous economic harm that would result from closing down the US economy, Congress responded by passing the CARES Act.

US response to COVID-19 pandemic

The CARES Act is comprehensive legislation intended to address the devastating economic harm caused by the COVID-19 pandemic. In addition to providing assistance directly to individuals and state governments, the CARES Act was designed to provide significant relief for both large and small businesses. For small businesses, these measures include (i) emergency grants of up to $10,000 per employer (from an initial pool of $10 billion) to assist small businesses in meeting immediate operating costs (Emergency Injury Disaster loans or 'EID Loans'), (ii) loans of up to $10 million per business (from an initial pool of $349 billion) to maintain payroll and to pay rent or service mortgage indebtedness (Paycheck Protection Program loans or 'PPP Loans'), and (iii) a pool of $17 billion for small businesses already utilising SBA loans to cover six months of payments.[14] On 24 April 2020, supplemental legislation increased the amount available for EID Loans to $20 billion, and the amount available for PPP Loans by $310 billion.[15]

For large businesses, the CARES Act established a pool of $500 billion for loans and loan guarantees, with up to $25 billion set aside for passenger air carriers, $4 billion earmarked for air cargo carriers, and $17 billion allocated for businesses critical to national security.[16] The Act appropriates $150 billion for assistance to states, US territories and tribal governments. It also contains significant changes to the treatment and availability of tax attributes such as net operating losses ('NOLs'), as it permits NOLs arising in 2018, 2019 and 2020 to be carried back for five years and carried forward indefinitely to offset income.[17] The Act also establishes a deferral period for payment of certain quarterly and payroll taxes, and provides for the suspension of certain aviation excise taxes.[18]

Implementation of the CARES Act

Implementation of the CARES Act has encountered numerous problems. Unfortunately, the CARES Act failed to provide applicants with clear guidance concerning important aspects of the PPP Loans, such as how to calculate eligible payroll expenses, and how and where to submit loan applications. The Act was also opaque concerning potential terms of loan forgiveness.

Many banks were not equipped to process PPP Loan applications, leaving many businesses unable to apply for loans through existing banking relationships. Moreover, the eligibility requirements for PPP Loans also were not carefully crafted. As a result, many large businesses – including publicly traded corporations – applied for and received millions of dollars in PPP Loans, resulting in exhaustion of the initial loan pool before many small businesses ever had a chance to apply. Although several notorious recipients have agreed to return PPP Loans,[19] and Congress has authorised

Notes

9 *Id.*
10 *See Statement on the Second Meeting of the International Health Regulations (2005) Emergency Committee Regarding the Outbreak of Novel Coronavirus (2019-nCoV)*, World Health Organization, 30 January 2020.
11 *See WHO Director-General's Opening Remarks at the Media Briefing on COVID-19—11 March 2020*, World Health Organization, 11 March 2020.
12 *See* Leonhardt, David, New York Times, *A Complete List of Trump's Attempts to Play Down Coronavirus*, 15 March 2020 (reciting 27 February 2020 quote from President Trump: 'It's going to disappear. One day — it's like a miracle — it will disappear.') (https://www.nytimes.com/2020/03/15/opinion/trump-coronavirus.html).
13 *See* Wu, Jiachuan, *Stay-at-Home Orders Across the Country*, 25 March 2020 (noting that '[t]he vast majority of states have officially ordered most residents to stay indoors, except for essential workers or in specific circumstances.') (https://www.nbcnews.com/health/health-news/here-are-stay-home-orders-across-country-n1168736).
14 CARES Act, §§ 1102, 1107(a)(6), 1107(a)(7), 1110 and 1112.
15 Paycheck Protection Program and Health Care Enhancement Act, Public Law No: 116-139 (04/24/2020).
16 CARES Act, § 4003.
17 *See IRS Provides Guidance Under the CARES Act to Taxpayers With Net Operating Losses*, IR-2020-67, April 9, 2020 (https://www.irs.gov/newsroom/irs-provides-guidance-under-the-cares-act-to-taxpayers-with-net-operating-losses).
18 CARES Act, § 4007.
19 Many companies took advantage of a loophole that made PPP Loans available to companies with fewer than 500 employees at a single location. For example, on April 22, 2020, Harvard University, with an endowment of more than $40 billion, agreed to return $8.6 million it had received under the CARES Act. *See Harvard to Return $8.7M Coronavirus Relief Funding from CARES Act* (https://www.foxbusiness.com/money/harvard-to-not-accept-cares-act-relief-funding. Similarly, Shake Shack Inc., a publicly traded corporation with nearly 8,000 employees, 189 restaurants and $104 million in cash and liquid assets on its balance sheet, obtained, and later agreed to return, a PPP Loan of $10 million

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funding for an additional $310 billion of PPP Loans,[20] many problems remain.[21]

For example, in order to be eligible for forgiveness of PPP Loans, employers are required to use the funds for designated purposes (payroll, group health care costs, rent, interest on mortgage loans) within eight weeks of receipt. Any portion of that loan used in that time frame for the permitted purposes could be forgiven, provided workers stay employed through the end of June 2020. However, many business had closed down their operations and laid off employees due to state mandated closure orders *prior to* PPP Loans becoming available. The PPP thus makes funds available to retain employees whose employment has already been terminated.

The PPP is also incongruous with the $600/week supplemental unemployment payments under the CARES Act.[22] Combining state unemployment benefits with the $600/week provided under the federal program, many employees are receiving greater compensation while unemployed than they received while employed, creating strong disincentives to returning to work.

Employers likewise are disincented to rehire employees and pay them with borrowed PPP funds. Forgiveness of these loans is conditioned on use of those funds for designated purposes within eight weeks, yet many affected businesses are subject to state closure orders and are prohibited from operating. Potential PPP borrowers thus must select between (1) taking out a PPP Loan, using the proceeds to pay employees at a time when non-essential businesses are closed, and hoping the loan will later be forgiven, and (2) maintaining the status quo, under which employees fare better financially. Under these circumstances, the PPP Loans are not an attractive option.

Conclusion

The CARES Act was a valiant effort to provide immediate financial relief to individuals and small businesses, in order to avert imminent economic disaster. The Act was necessarily rushed through Congress at breakneck speed in an effort to get cash into the hands of individuals and businesses before the onset of real hardship. Despite good intentions, the Act suffers a number of serious shortcomings.

First, the structure of the PPP was flawed. While the intent was to provide funding to small businesses in the form of forgivable loans, the use of outright grants rather than loans would have streamlined the process; specifically, direct grants to businesses from the Treasury Department would have eliminated the middle-man banks and the attendant red tape and customer favouritism.

Second, the eligibility requirements for the PPP -- including in particular the availability of funding for businesses with not more than 500 employees at a single location – appear to have been infected by the efforts of industry lobbyists. As a result, many large and financially stable organisations, including publicly traded companies with access to capital markets, were able to access PPP Loans, diverting resources from more worthy applicants.

Third, the PPP contains limitations on the use of funds that are insufficiently flexible. Conditioning loan forgiveness on specific uses of loan proceeds helps ensure that money flows in the right direction. The inclusion of payroll costs and building occupancy expenses on this list of permitted uses makes sense, but the list should be expanded to include suppliers and vendors with which a small business trades. Inclusion of these parties will facilitate the resumption of 'business as usual' and help the US economy recover more quickly.

Congress is reportedly working to address these and other problems, and to streamline the mechanics of programs like the PPP, to more effectively and efficiently provide the economic assistance necessary to stabilise the US economy and set it on the road to recovery. Hopefully Congress will learn from its experience to date, and with more time to contemplate enhancements to the CARES Act, will implement changes to remedy the extant deficiencies.

Notes

that was intended to assist *small* businesses. *See* https://www.npr.org/sections/coronavirus-live-updates/2020/04/20/838439215/shake-shack-returns-10-million-loan-to-u-s-program-for-small-businesses.

20 *See* Paycheck Protection Program and Health Care Enhancement Act, Public Law No: 116-139 (04/24/2020).

21 *See* Nitti, Tony, *Paycheck Protection Program Loans: Three Things The SBA And Banks Need To Agree On Now,* 6 April 2020 (identifying ambiguities and other problems in the PPP Loan application process) https://www.forbes.com/sites/anthonynitti/2020/04/05/paycheck-protection-program-loans-three-things-the-sba-and-banks-need-to-agree-on-now/#4ae15b741a32

22 CARES Act, § 2104.

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A Black Swan Event

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The outbreak

The rapid spread of the coronavirus (COVID-19) outbreak occurs at the time when the US economy was doing well relative to other advanced economies, thanks largely to last year's monetary and fiscal stimulus. To fend off the emerging slowdown in growth, the Federal Reserve had cut interest rates three times and the 2017–2018 fiscal stimulus was still in place.

The COVID-19 outbreak is an extremely powerful exogenous shock for the global economy. It started first as largely a supply shock in China and Asia, disrupting global supply chains, trade flows and production. It rapidly evolved into a severe demand and financial shock that affects all sectors of the economy. Policies of containment, travel restrictions, the closing of schools and universities, and social distancing measures, to cite a few, are decisions that severely impact aggregate demand. The services and retail sectors are particularly badly hit, but so are other sectors, such as the airlines and auto industries, the latter with the announcement of temporary shutdown of production. The payment system in the economy is disrupted with the sudden forced closure of small businesses and services, and both households and businesses find their cash positions severely weakened. The sharp drop in financial markets, collapse in risk appetite and ensuing rise in the dollar led to a severe tightening of financial conditions.

A sharp contraction in economic activity will define the second and likely third quarters. The intensity and length of the downturn is difficult to estimate. Much will depend on the evolution of the pandemic and the policy responses. As a point of reference, the US economy contracted by an annualised quarterly 7.2% in Q4 2008, followed by contractions of 4.5% and 1.2% in Q1 2009 and Q2 2009, respectively. Back then, it was a financial and economic crisis. Today it is a health and economic crisis and estimates of the annualised Q2 contraction of the US economy range from –10% to –24%.

Fill the gap

The policy responses have been swift but remain work in progress. The role of central banks in crisis-mode is to ensure ample supply of liquidity in the economy and the well-functioning of markets. In other words, they need to fill the gap left by the funding disruptions in multiple markets. Global central banks have provided several important emergency packages reminiscent of 2008 aimed to alleviate the tightening of financial conditions and support financial markets. In the US, the Federal Reserve has already conducted two emergency interest rate cuts, one of 50 basis points and one of a 100 basis points, bringing the Fed funds rate to near zero. In addition, the Fed resumed its direct purchases of securities (quantitative easing operations), and announced actions to ensure the flow of credit to specific markets, to households and businesses and provide US dollar liquidity arrangements with other central banks to meet the rise in international demand for dollars.

The role of fiscal policy is to fill the gap left by the collapse in aggregate demand related to business closures and ensuing layoffs. Illustratively, initial unemployment claims for the week ending March 14 jumped by 70K, the largest weekly jump since November 2012. Over several phases, the government is working on bills that address the healthcare crisis, loans to businesses and cash payments to individuals:

- Phase 1: Congress and the Administration passed an emergency relief bill of $7.6 billion. Discretionary spending targeting vaccine and R&D will stretch through 2030, with only $1 billion spent this year.
- Phase 2: Congress passed a $100–125 billion bill that awaits the President's signature. It provides testing for the virus, unemployment benefits and sick leave. This bill is key to buffer the impact of the massive layoffs that will likely occur.
- Phase 3: A bill of about $1.3 trillion is being negotiated in the Senate and targets direct cash payments to individuals totaling an estimated $500 billion, and loans, bridge loans and guarantees to businesses totaling $300 billion. This bill is most important as it assists households and businesses in coping with the forced closures and helps businesses whose balance sheets are strong to remain healthy.
- Phase 4: Pending Phase 3, a bill of $45 billion would target a supplemental budget for agencies.

The path forward

As mentioned, the policy measures focus on filling the gap left by the collapse in aggregate demand. To the extent cash payments go to people who remain employed, the cash will be saved. To the extent it goes to people who have become unemployed, it will be spent. The result is only a partial offset to the potential retrenchment in activity that will evolve in Q2. How early will the recovery begin and what will trigger it are subject to debate at this juncture. When the effects of the pandemic subside, the cash and liquidity injections in the economy, along with low interest rates, should provide support for a rebound in demand. The policy response, therefore, must be swift and bold.

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An Economic Catastrophe

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The economic shock

The scale and severity of the COVID-19 pandemic shut down the world. Social distancing measures, supply chain disruptions, and plummeting oil prices have pushed the global economy into recession, with the negative economic impact becoming more tangible in recent weeks. The US economy contracted an annualised 4.8% in the first quarter. With production, employment and consumption declining steeply in the second quarter, Q2 GDP expectations range between –30% and –37% (SAAR). The previous record rate of decline was –10% in Q1 1958.

The COVID-19 pandemic is a rare and unpredictable event – a black swan event. Such events are difficult to mathematically compute. Modelling the intensity and the duration of the decline in economic activity and the path of recovery is therefore a highly uncertain exercise. The juxtaposition of the unprecedented plunge in activity with an equally unprecedented policy reaction is sparking a widely discussed alphabet of potential recovery shapes: Z, V, U, L-shaped recoveries, to cite a few. A recent Brookings Institution paper[1] reviews these potential paths.

In the authors' view, the Z- and V-shaped scenarios are optimistic as the economy bounces back very rapidly after the social distancing is lifted. In a U-shaped recovery, activity stays low for quite some time and recovers slowly back to baseline. The more pessimistic scenario is L-shaped, as the pandemic has a permanent effect on GDP, with a permanent loss of capital and slowdown in productivity growth that precludes GDP to re-attain its baseline level. Even if economic activity returns in quarters following the second quarter decline, it will take some time before the GDP re-attains its pre-COVID-19 level. Some project it will not happen before the end of 2021.

The sudden closure of businesses and plunge in activity brought massive layoffs, crushing consumers' financial well-being. The number of unemployed reached 23.1 million in April. This is the largest monthly increase in the history of the series dating back to 1948. The rate of unemployment rose to 14.7% from a multi-decade low of 3.5% in February. The rate would have been closer to 23% were it not for the fact that approximately 5 million persons were erroneously classified as employed but absent from work and another 6.4 million persons dropped out of the labour force. The unemployment rates estimated during the Great Depression were around 25%. Prolonged unemployment erodes skills, leads to more discouraged workers exiting the labour force and restricts the consumer's ability and willingness to spend. A quick bounce-back in confidence is doubtful, particularly in the absence of therapeutics and/or vaccine against COVID-19. This suggests an initial lengthy time of subpar growth in consumer spending, notwithstanding the pent-up demand for certain services.

Business confidence has also been shattered. The mid-America business confidence diffusion index dropped to 14.5 in March from 58.8 in January. The NFIB Small Business Economic trends declined to 105.6 in March from 114.5 in January. Business investment spending had been weak going into the pandemic, and the collapse of aggregate demand will likely trigger a surge in bankruptcies, which in turn will slow the recovery in corporate investment. The recently weak corporate earnings reports for Q1 point in that direction. The risk is that the erosion of capital formation leads to loss of productivity and potential output, that is, the L-shaped recovery alluded to earlier.

Policymakers have learnt from the last crisis in adopting a 'do-whatever-it-takes' approach to counter the shock. Both the monetary and fiscal policy responses have been swift and forceful. But more is still needed.

The monetary policy response

The Federal Reserve announced the first interest rate cut as early as on March 3, brought the policy rate close to zero, resumed its asset purchase program, which was widened in both scope and size, restarted its numerous lending facilities, and added new facilities to

Notes

1 Louise Sheiner and Kadija Yilla, 'The ABCs of the post-COVID economic recovery', Monday, 4 May 2020 (https://www.brookings.edu/blog/up-front/2020/05/04/the-abcs-of-the-post-covid-economic-recovery/?utm_campaign=brookings-comm&utm_source=hs_email&utm_medium=email&utm_content=87461855).

households and businesses. The aggressive supply of liquidity has mitigated the freezing of certain market segments and eased market dislocation.

The fiscal policy response

On the fiscal side, it took Congress just a week to pass a bill that was 2.5 times as large as the one passed in 2009. During April, Congress and the Administration passed several bills to assist households and small businesses, totalling close to $2.7 trillion. But the epic deterioration in the labour market underscores the urgent need for additional federal aid. As of this writing, Congress is working on new legislation but bipartisanship is thinning out. Republicans focus on aid to corporations, while Democrats focus on aid to households and state and local governments.

The divergence of views already has pushed some members of Congress to focus on the impact of the federal aid on the budget and debt outlook and away from the collapse in activity. The Congressional Budget Office projects the federal deficit to reach 17.9% of GDP in the current fiscal year (ending September 2020) and 9.8% next year. Not surprisingly, the debt-to-GDP ratio would also rise, to 101% this fiscal year and 108% next year, up from 79% at the end of the fiscal 2019.

The focus on the debt outlook is in our view premature. Fiscal austerity returned too soon in the US and Europe in the aftermath of the Great Recession and led to subpar growth for the ensuing decade (and a second recession in Europe). Premature withdrawal of fiscal stimulus when the path of the pandemic and the impact of easing lockdown measures are still not fully understood, may intensify the downturn and delay the recovery.

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