Past, present and future:

The impact of the COVID-19 pandemic on restructuring and insolvency laws in Europe

Prof. Christoph G. Paulus cites examples from the past and the present that can help us prepare for future similar events

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The past

We should refrain from believing that Europeans have never before encountered experiences similar to those that we have lived through during the last say 1½ years – the contrary is true. This has – not only but to a high degree – to do with the belligerent history of Europe.

Events such as the 100 years war between France and England, the 30 years war between almost everyone against everyone on German soil, the world wars with their comparatively short duration – they all had disastrous effects on the population and their economic activities. The treatise on the then applicable insolvency law by David Mevius, *Theatri Concursus Creditorum Diaskepsis de Cessione Bonorum*, published in Greifswald in the year 1637 can be fully understood only when keeping in mind that this politician, scholar and diplomat wrote against the background of the 30 years war. Moreover, in the 5th century BC (sic!), the famous Greek physician Hippocrates has written on "epidemics".

But even if we look back to the much more recent history, I am sure that we all find in the previous decades examples for sudden changes of our national insolvency laws due to unforeseen circumstances. As a German I can contribute to this list the two or three events within the last 20 years or so in which summer rains of exceptional intensity for several days in a row caused entire regions alongside rivers (well, even small ones, even creeks) to find themselves literally under water – shops, businesses and factories included.

Each of these events caused the legislator to react on the spot and to primarily suspend the owners or entrepreneurs from the notorious duty to file for insolvency within three weeks after fulfilling an opening reason. Our Greek friends can add to that disaster list, as it were, their experiences some ten years ago in the course of their debt crisis. Insolvency law's application was then suspended for a very fundamental economic reason: there was no market on which an insolvent's estate could be liquidated.

The German and the Greek experience made me write some eight years ago on the need to distinguish between our usual and traditional "good weather insolvency law" and to contrast it to a "bad weather insolvency law" which steps in in situations which are beyond the usual and taken for granted set-up of facts. This is far from being an innovative idea – after all, in

many legislative acts and bankruptcy treaties from the Middle Ages on one finds again and again exceptions from the bad treatment of bankrupts in cases of "flood, fire, and other disasters". In my cited article I further recommended to develop ideas on how to shape bad weather insolvency law – in order not to become caught off guard every time again and again when a black swan enters the scenery.

The present

This brings us directly to the present. Given that it was occasionally announced that we enter an era of epidemics, it was not really an "unknown unknown" event, but still a sort of a black swan (a "known unknown") when last year (2020), in March, the pandemic was globally announced and the lockdowns started one after the other. The longer they took, the clearer it became that insolvency laws, too, had to be adjusted to the new situation – at least temporarily.

Regarding application of that law, Cyprus was probably the most rigid jurisdiction when it suspended the entire operation of her insolvency law for a specified period of time.[1] Italy moved in a similar, but somewhat less dramatic, direction; it suspended the entry into force of its revised insolvency law in order to prevent confusion and irritations about the new law in an anyway turbulent and tumultuous time; the old law, thus, had to be applied further on.

It is on purpose that I mention these two rather extreme examples at the outset. Clearer than all the other national reactions they point to the core of all those alterations: it is about mitigating the harsh consequences of the "everyday" insolvency law or the good-weather insolvency law.

Like in those historical examples given above when a flood, a fire, a war or other acts of God had hit parts of the population or its entirety, the present pandemic intruded into our lives without anyone's fault and without warning. There was no one to blame for it, there was no mismanagement, there was no rough creditor, no careless debtor, no wrong insurance, nothing – it just happened. Under these circumstances it was felt throughout Europe and the entire world that the use of insolvency law in the "normal" way would have been inappropriate. A more or less randomly collected list of legislative examples[2] proves the point:

- The duty to file when and if an opening reason is given was suspended not only in Germany, but also in Belgium, the Czech Republic, Estonia, Lithuania, Luxembourg, Poland, Portugal or Spain.
- Other jurisdictions, such as Finland or Lithuania, limited the creditors' rights to file.
- France, for instance, manipulated its insolvency test in order to provide debtors with a breathing spell.
- In Belgium,[3] creditors were barred from levying a preventive or executory attachment and payment periods were prolonged; this was also done in Bulgaria, Croatia, Cyprus, Finland, Hungary, Italy, Portugal,

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Romania and Spain.

- The Netherlands put into practice the enactment of their WHOA (wet homologatie onderhands akkoord) as a protective measure for the debtors. This new law which transposes the Directive on Restructuring and Insolvency[4] into Dutch law entered into force around the beginning of the pandemic. The German equivalent[5] owes its incredibly expedited enactment also, to a certain degree, to the pandemic. And it is to be assumed that other Member States have this effect also in mind when transposing the Directive into their domestic law.

To be sure, these examples refer just to insolvency laws and actions closely related to it; they are not, however, by far, the only measures that were taken by national legislators in order to overcome at least the most painful hardships of the pandemic.[6] In Germany, for instance, lease contracts for commercial premises became addressed, as well as vouchers for travel tickets or cultural events to give but a few examples. All these measures have in common – at least to a certain degree – the idea to abstain and/or to get free from the rigid application of the good weather law and to soften its effects.

Before coming back to this latter observation one more word about state intervention and support might be justified. It is perfectly understandable that legislators on a literally global scale have offered deferrals and loans as part of that softening package. However, what is well meant today might turn out as a critical impact tomorrow. For one day the deadline will be arrived on which the sum has to be repaid – additionally to the then daily costs.

What is needed then, accordingly, is a double income (or an accumulation of savings). If that doesn't exist the amount of non-performing loans will increase and threaten banks again.[7] It is probably well known that not only the Directive on Restructuring and Insolvency, but others, as well, serve i.a. the purpose to reduce the amount of these very NPLs. In their aggregation they have the potential to ruin entire banks (Slovenia and Italy have fresh memories to such threats) – and since bank collapses always carry the risk of bringing the respective state into troubles, this is a serious problem.[8]

The future

The historical examples to which I referred *supra* teach us that it would be wise to prepare for upcoming similar events; this is even more true when and if the said prediction should be correct that we enter an era of pandemics. In order not to be hit again by surprise it seems to be a good idea to develop – better now than tomorrow – a sort of catastrophe law which draws from the lessons learned so far and which is, nevertheless,

flexible enough to become quickly adapted once the new situation is forming.

Once this conclusion is accepted the task arises to find out what the lessons are that we should learn from the past events. It is here where things get an interesting if not fascinating twist. Since most of the legislative measures have in common to mitigate the sharp edges of not only insolvency law, but also of other areas of law. The bad weather law reacts to a certain degree to the changed circumstances similar to the nascency of equity from the 12th to 17th centuries to the severity of common law. The continental law had a similar evolution some 1500 years earlier when the power of *bona fide* was discovered and unleashed by the Roman jurists.[9] This concept has equivalents nowadays in all civil law codifications one way or the other – in Germany it is sec. 242 of the Civil Law Code.

This parallelism explains why in the Covid 19-legislation often rules as the *clausula rebus sic stantibus* or the compromise – a contract which is best described in German law as one in which both parties step down from their initial 100%-claim – are referred to, either directly or at least implicitly. This is particularly true for the abovementioned examples of insolvency legislation: the debtor's duty to file serves primarily the task to protect the creditors – now, they have to wait, but the debtor, on the other hand, has not more than a deferral. The same is true for the restrictions on creditor filings, for the definition of insolvency, or for the statutory extension of payment deadlines. All these measures have in common – to give the debtor some breathing spell since the pandemic came over mankind like an act of God.

When we now broaden our view and include what else has been done by the states and the European Union, we learn that we have to go a step further for a full understanding of the lesson to be learned from the pandemic. More or less each member state of the European Union has set up an aid program of mostly so far unheard-of amounts. And beyond that, even the Europeans have set up an impressive list of support:

- The European Commission follows a two-partite action plan: the first one aiming at powering resilience and recovery by spending €750 billion in supporting member states to recover, kick-starting the economy and helping private investment, and learning the lessons from the crisis; whereas the second one comes alone with a reinforced long-term budget of €1.1 trillion;
- The European Central Bank has also set up a €750 billion (for the time being) help package which contains, i.a., measures aimed at temporarily increasing the Eurosystem's risk tolerance for facilitating access to credit, and easing the usage of credit claims as collateral. Particularly, the latter step is designed to increase the additional credit claims framework by, i.a., accepting loans with lower credit quality;
- The European Stability Mechanism offers a €240 billion program by providing for the coming 2½ years on favourable lending terms and no macroeconomic conditions attached to the loans,[11] and
- On 18 May 2020, a French-German proposal was presented to set up a €500 billion rescue package, which came as a surprise after the extended discussions about whether or not Eurobonds should be issued as a token of European solidarity.

The last word is decisive: solidarity! Since all those incredible sums are not paid by some third parties but by us Europeans. When we realize this mechanism and when we think about where we have a similar one – even for centuries[11] – we become aware that insurance law is based on a strikingly similar mechanism, based on the solidarity principle. In cases of emergency, it is necessary to stick together and to push aside the usual antagonisms resulting from individual rights.

Conclusion

My conclusion, therefore, is that legislators should prepare for the next disaster: after the pandemic is before the next pandemic. The appropriate guideline for this preparation is to study intensely the solidarity principle of the insurance law and to make it the center pillar for a... catastrophe law. ■

Author's note: This article is based on a presentation made at the 10th European Insolvency and Restructuring Conference on 15 June 2021.

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Footnotes:

1 Similar decisions were made in Bulgaria, India, Cyprus, Romania and Spain.

2 All taken from www.insol-europe.org/technical-content/covid19.

3 Similarly in Scotland.

4 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

5 On the StaRUG cf. Paulus, The New German Preventive Restructuring Framework, Rivista Orizzonti del Diritto Commerciale 2021, p. 9 ff.: www.rivistaodc.eu/Article/Archive/index_html?ida=171&idn=25&idi=-1&idu=-1.

6 On those further measures cf. https://insol.azureedge.net/cmsstorage/insol/media/documents_files/covidguide/30%20april%20updates/2-covid-map-17-may.pdf.

7 Cf. just ECB's Guidance to banks on non-performing loans, available at www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf.

8 On this, cf. *Paulus*, Europe in the Corona-Crisis, Norton Journal of Bankruptcy Law and Practice 2020, p. 545 ff.

9 On this cf. *Kunkel*, Fides als schöpferisches Element im römischen Schuldrecht, Festschrift für Paul Koschaker, vol. II, 1939, p. 5 ff.

10 Cf. press release from May 15, 2020.

11 Modern insurance law is usually said to have originated in Venice, cf. *Nehlsen-Stryk*, Die venezianische Seeversicherung im 15. Jahrhundert, 1986. To be sure, risk minimising efforts can be traced back deep into antiquity.