

The ripple effect of a crisis: should Insolvency Law be rescued as well?

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A. Regulatory Framework



I. Factors contributing to a crisis

- *Internal factors*
 - Board crisis
 - Opportunism/shirking
 - ...

➔ Strong focus on internal factors in the aftermath of the financial crisis in 2008
- *External factors*
 - COVID-19 crisis
 - Energy crisis
 - Economic recession (e.g., financial crisis)
 - ...

➔ Current focus
- Link between external and internal factors:
 - External factors have a considerable impact on companies' governance!

II. Regulatory (insolvency) measures

- Belgian measures
 - *Legislation:*
 - Temporary moratoria
 - Pre-pack reorganisation
 - Facilitating the commencement of reorganisation procedures
 - Permanent measure?
 - Fewer documents required when *filing* for a reorganisation
 - State guarantee schemes of loans granted to businesses of EUR 50 billion in total.
 - *Case-law:*
 - Prolongation of the duration of the moratorium/suspension period following a restructuring plan (cf. Ondrb Ghent (section Kortrijk), 24 March 2020, *TIBR* 2/2020,RS-6).
 - Reduction of rent payments based on good faith (unreported).

II. Regulatory (insolvency) measures

- *Temporary moratorium* (cf. Royal Decree Nr. 15; Law of 20 December 2020)
 - Implemented twice:
 - 24 April 2020 until 17 June 2020;
 - 24 December 2020 until 31 January 2021
 - Scope of application:
 - Only enterprises that *were not* insolvent as of 18 March 2020
 - Effect:
 - Suspension of certain enforcement measures by creditors (e.g., not applicable to immovable property)
 - Suspension of managerial obligation to file for insolvency
 - Protection against ability for third parties to file for insolvency/judicial dissolution
 - Protection against termination of agreements because of payment default
 - No effect on directors' duties and liability procedures (e.g., wrongful trading) against directors (↔ England and Wales)
 - Criticism
 - Broad application – no application necessary (↔ England and Wales)
 - Protection against termination of agreements because of payment default: very limited (!)
 - Necessity?

II. Regulatory (insolvency) measures

- *'Pre-pack' reorganisation*
 - Debtor-in-possession
 - Private (confidential) preparatory procedure
 - Drawbacks/challenges:
 - Subject to oversight/control of judicial officer
 - Application must be made to Enterprise Court (↔ England and Wales)
 - Conversion into public (non-confidential) reorganisation
 - Only introduced in April 2021
 - ➔ Not used very often in practice.
 - Reform in 2023?

II. Regulatory (insolvency) measures

- United Kingdom (England and Wales)
 - Moratorium procedure (*permanent* measure)
 - Restrictions on ability to file winding-up petitions
 - Wide(r) power given to Secretary of State
 - COVID-19 loan guarantee scheme
 - Temporary suspension on wrongful trading actions (↔ Belgium)
 - No suspension of any other liability procedures
 - Only psychological effect?
 - Should the regulatory framework be more lenient towards directors in times of an (external) crisis?

III. Non-exhaustive list of regulatory (non-insolvency) measures

- UK measures
 - Company Law: temporary relaxations regarding corporate formalities (cf. CIGA 2020)
 - Labour and Social Security Law: wage subsidies by the government, job retention scheme
 - Tax measures (e.g., VAT deferral, business rates relief..)
 - Financial support: Bank of England measures (e.g., usage of capital and liquidity buffers, no stress tests etc..), Coronavirus Business Interruption Loan Schemes and Future Fund, payment deferrals on consumer and investment credit..
- Belgian measures
 - Company Law: temporary relaxation regarding corporate formalities (e.g., annual general meetings could be held virtually – Royal Decree nr. 4 of 9 April 2020)
 - Labour and Social Security Law: Wage subsidies by the government, *de facto* moratorium by BE government
 - Tax measures: reduced VAT rate on certain products and affected industries, *de facto* moratorium by BE government
 - Financial support: banking measures taken by ECB and implemented by national bank of Belgium (e.g., usage of capital and liquidity buffers), payment deferrals of investment credit..
- Aim: attenuating further liquidity/cash flow problems

B. Role of Insolvency Law

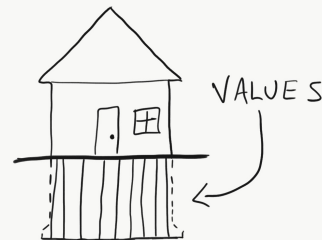


I. Insolvency Theories

Main insolvency theories	Criticisms
<ul style="list-style-type: none">• Creditors' Bargain Theory• Communitarian / stakeholder Theory• Multiples Values Theory	<ul style="list-style-type: none">• No protection of vulnerable parties• Competing interests / accountability (?) / vague• Vague / protection of whom? How?
<ul style="list-style-type: none">• Broad principles underpinning regulatory framework	

II. Insolvency values

- Insolvency values
 - Efficiency – costs/benefits analysis of the rules
 - Pareto
 - Kaldor-Hicks
 - Fairness – Equality: formal v. substantive? Justice? Rule of Law?
 - Accountability and transparency – 4 criteria of Bovens
 - Information delivery
 - Justification of decisions
 - (Dis)approval of decisions
 - Possibility of consequences (remedies)
- Cumulative application
- Importance : ability to design clear (improved) insolvency framework



III. In whose interests should the insolvent company be governed?

- Who?
 - The creditors whilst having regard to non-controlling unsecured creditors.
 - *Non-controlling unsecured creditors = creditors who are unable to influence the decision-making process prior to and/or during an insolvency procedure*
- Why?
 - Clarity *ratione personae*
 - Economically logical: unsecured creditor = residual risk-bearer
 - Protection of vulnerable parties (\Leftrightarrow creditors' bargain theory)
 - Opportunity to design a clear(er) regulatory framework

IV. How should the insolvent company be governed (I)?

- Directors' (& officeholders') perspective
 - Increased information requirements catered to vulnerable factions of unsecureds (transparency)
 - Prior to the onset of an insolvency procedure: transparency vs. market reaction?
 - During reorganisation – DIP / officeholder-led rescue?
 - During insolvency/bankruptcy – important role for officeholders
 - Relaxation of / leniency towards directors' accountability?
 - No. Mix-up of internal/external factors
 - Liquidity problems, revenue loss... : caused by *external* factors
 - Liability procedures: assessment of *internal* 'factors' (e.g., governance by directors/officeholders)
 - "Alarm Bell" procedure (BE): shifting of onus of proof?
 - Business judgment rule

IV. How should the insolvent company be governed (II)?

- Creditors' perspective
 - Stimulating creditor engagement
 - During rescue + insolvency/bankruptcy procedures (BE (!) + UK)
 - Derivative actions
 - Public trust: financing creditors' claims against directors/officeholders
- Society's perspective
 - Ombudsman – public enforcement of directors' (and officeholders') duties

V. Importance of long-term insolvency governance reforms (I)

- Societal/public impact of insolvency law:
 - Enhancing corporate rescue *when possible* – informal (confidential) workouts/pre-packs
 - Orderly winding-up of businesses *when necessary*
 - Effective insolvency/bankruptcy (\Leftrightarrow restructuring) system: discrepancy between restructuring and insolvency regime in BE!
 - Accountability of officeholders, control and influence of (unsecured) creditors, timing, transaction costs, incentives... (Belgium vs. UK)
- Protection of weaker/vulnerable parties
 - Increased chance of repayment of (unsecured) credit
 - Reduction of insolvency ripple effect risk
- Enhancing accountability + fairness
 - Protection of going concern value of businesses
 - Strengthening of market trust



V. Importance of long-term insolvency governance reforms (II)

- Summary
 - Strengthening corporate rescue and protection of vulnerable creditors
 - Aim to (i) **rescue** as many enterprises/companies in financial difficulties as possible and (ii) **minimise the impact of insolvency** of third parties/stakeholders
 - Positive impact on society/markets
 - Insolvency/bankruptcy regime
 - Good governance may reduce the risk of an insolvency ripple-effect
- Criticism:
 - Governance measures are important ... certainly in times of crisis!
 - More important regarding internal factors/crisis?
 - Limited Impact on distress caused by external factors?
 - Link between external and internal factors!
 - Board of directors of debtor-companies affected by external factors

VI. Need for short-term (*ad hoc*) insolvency measures?

- Targeted support to address imminent cash-flow problems
 - Protection of lenders
 - Government-backed loan guarantee schemes
 - No subordination of shareholder loans (not applicable in BE/UK)
 - Temporary suspension of the right of creditors and obligation of debtor to file for insolvency/dissolution
 - Moratorium on the ability to (i) obtain a conservatory or executory seizure of movable and immovable goods and (ii) terminate existing contracts during reorganisation.
 - ☐ Filing required – no automatic application of moratorium procedure to debtors
 - ☐ No need for specific moratorium procedure? Difference between BE and UK.
 - ☐ On continuation of existing contracts: broad application; Insolvency Law > Contract Law
 - Directors' duties
 - "Alarm bell" procedure (Belgium): shifting of onus of proof to creditors (instead of directors) or more leniency towards term limits/corporate formalities (good faith principle + business judgment rule)
 - Limiting cost of legal advice regarding insolvency governance
 - Pro bono advice by lawyers – scheme to be set up by bar association?
 - Which companies? Revenue/income limits?
- *Ad hoc* measures as lender of last resort to attenuate liquidity problems



VII. Limits of Insolvency Law

- Transaction costs of a restructuring/insolvency procedure;
- Insolvency-related solutions:
 - May give breathing space to distressed companies
 - May limit an insolvency ripple-effect risk
 - May not solve the cause of the problems: existence of losses, lack of cash-flow (liquidity) and sufficient revenues.
- Fiscal, social, financial, economic etc.. measures would still be necessary.



C. Conclusion



Conclusion - Final remarks

- Link between external and internal factors triggering an insolvency event
- Long-term good governance measures important (but neglected during externally triggered crises?)
 - Protection of vulnerable creditors
 - Increase of rescue chances
 - Reduction of insolvency ripple effect risks
 - Enhanced market trust
- Targeted *ad hoc* measures could still be relevant to avoid/reduce liquidity crisis
- Insolvency Law has.... its (potential) limits when confronted with external crisis