The Bankruptcy Rush: Rethinking Director Duties in Crisis

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Abstract

Bankruptcy scholars often debate whether directors should have special duties that arise when a company is financially distressed. This Article shows how the specter of personal liability associated with those duties can push managers to file for bankruptcy early, thereby creating "bankruptcy congestion" in times of crisis. Such congestion, in turn, can overwhelm the court system and flood the market with assets for sale.

This Article is the first to analyze the congestion costs of director duties during a macroeconomic crisis—namely, the Covid-19 pandemic. Focusing on Germany, Australia, and the US, this Article examines the potential congestion costs and avoidance techniques that were used during the early days of the pandemic. By comparing various reactions, this Article illustrates how market floodgates naturally evolve, potentially controlling the bankruptcy stream, and how costly director duties can be during a crisis. This comparison offers innovative insights into the interplay of legal and economic factors during uncertain times.

In light of those insights, this Article proposes effective strategies for dealing with bankruptcy congestion, which holds significance for governments facing frequent crises due to climate change and interconnected financial markets. It asserts that lenders are often better suited than regulators to limit bankruptcy filings, since they have the skills, resources, and information to monitor borrowers and determine when bankruptcy is appropriate. To make markets more crisis resilient, this Article suggests that regulators should be cautious when intervening. Instead, they should encourage market floodgates, limit claims against owners and managers, and develop court alternatives.