The Limits and Logic of the EU Harmonisation Process in the Wake of the Covid-19 Pandemic

Younger Academics Network of Insolvency Law (YANIL)

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Introduction[*]

Harmonisation of insolvency laws has been at the top of the EU institutions' agenda for the last decade. This frenzy precipitated in the aftermath of the Global Financial Crisis. European institutions have been prolific in creating a comprehensive EU-wide framework. These efforts culminated with the recast European Insolvency Regulation (2015) and the Preventive Restructuring Directive (PRD, 2019). The sweeping nature and devastating effects of the Covid-19 pandemic, however, have put both the pre-insolvency craze and harmonisation momentum to a halt.

The European institutions have lately put all their eggs in one basket focusing predominantly on preventive restructuring. Little attention has been paid to the harmonisation of other, more frequently used formal insolvency procedures. The crisis ensuing from the Covid-19 pandemic reveals the *limits* of such one-sided approach. For countless companies across the Europe, preventive restructuring mechanisms are of little help to deal with the consequences of lock-down measures.

Member States reacted by implementing piece-meal laws to control the economically and financially destructive effects of the pandemic. The Younger Academics Network of Insolvency Law (YANIL) board discusses national responses to Covid-19 from six European countries – Denmark, France, Germany, Italy, the Netherlands, and the United Kingdom (UK) – to determine if the *logic* of harmonisation remains compelling.

1. Adjusting tried and tested measures

France, Italy, Germany and the UK reacted with a "safe harbour" approach, by making use of existing and reliable procedures.

The French Government is not departing from its extensive toolkit, comprised of five pre-insolvency measures. Rather, it has mostly tweaked existing provisions. France has not modified the threshold of insolvency criterion of payment failure situation. However, the financial situation of the debtor is now assessed as of 12 March 2020, applying the insolvency threshold on that date. Consequently, debtors who were solvent on 12 March can still use preventive restructuring mechanisms even if they are insolvent at the time of filing.

Italy follows a similar approach. The current legislative response relies on the existing toolkit, coupled with the introduction of some emergency measures. The country also opted to postpone the entry into force of the new Insolvency Code to 2021, believing that practitioners and courts prefer dealing with the crisis caused by the pandemic with tested procedures. Key emergency measures include: (i) a six month postponement of legal obligations arising from pre-insolvency compositions and debt-restructuring agreements; (ii) the possibility to amend, postpone deadlines or file new plans in pre-insolvency compositions and debt restructuring agreements that have not yet been approved by creditors; and (iii) a general stay until 30 June 2020 for any bankruptcy filing and insolvency petitions for most companies.

Germany's legislative response has seen temporary adjustments to its current insolvency law regime: (i) to encourage directors to continue trading by a suspension of filing obligations and a relaxation of director's liability (for debtors not insolvent by 31 December 2019) and (ii) to incentivise debt capital

[*] This text reflects the law as of 22 May 2020.

investments by suspensions of claw back provisions, the principle of lender liability, and the subordination of shareholder loans.

The UK has also fallen back upon an "old reliable" procedure: administration. The "light touch" administration (see *Debenhams'* second time's the charm attempt to administration) applies the existing insolvency procedure in an innovative way. In light touch administrations, administrators rely on a provision of the Act to give consent to the board to continue to exercise certain board powers during the procedure. As a result, administration is transformed into a debtor-in-possession procedure. The directors' powers are exercised within agreed parameters, enabling the directors to run the business without fully handing over to administrators, so long as administrators have a reasonable belief that the company can be rescued.

2. Introducing new restructuring and insolvency mechanisms

The crisis has also been used by some countries to accelerate or re-think the introduction of new insolvency and restructuring mechanisms.

In the Netherlands, pending discussions on introducing a pre-insolvency proceeding in the *Wet homologatie onderhands akkoord* (WHOA) have intensified since the outbreak. The WHOA, a debtor-in-possession procedure, was drafted in line with the PRD but its scope is wider than mere prevention of insolvency. It is designed also to be used to prevent the imminent collapse of companies that could be rehabilitated through restructuring. Italy also introduced a new Insolvency Code, which promotes the use of alert and composition procedures.

The UK Government recently introduced a Bill on Corporate Insolvency and Governance that aims to protect otherwise viable companies from collapse by: (i) providing protection for directors who continue trading through the pandemic; and (ii) suspending the use of statutory demands and winding-up petitions without court review where the pandemic has prevented a company from satisfying debts. These temporary changes will continue until at least 30 June. The Bill also introduces permanent measures, including a restructuring plan (with cross-class cram-down) and a temporary "company moratorium" to facilitate discussions on a rescue plan. Once approved, these procedures could prove effective in preventing the collapse of distressed yet viable companies.

3. Non-insolvency solutions

The Covid-19 pandemic has triggered calls for emergency fiscal and legislative measures to specifically support distressed companies and their employees. These non-insolvency solutions share many commonalities, ranging from suspension of tax payments, state guaranties/loans, subsidies for businesses and freelancers, and measures halting redundancies dictated by economic reasons.

While these measures have been deployed by all countries discussed herein, it is interesting to note that Denmark has relied solely on non-insolvency measures in its response.

Conclusion

The Covid-19 crisis has highlighted some of the *limits* of European substantive harmonisation efforts of the last decade. The crisis has pushed some countries to pause their current efforts around preventive insolvency. Regulatory and legislative attention was (re)directed towards more hybrid and formal restructuring and insolvency proceedings. Other countries have perceived their insolvency

frameworks as well-equipped to deal with the crisis. Therefore, they have merely tweaked existing mechanisms or introduced emergency measures to support their economy.

Falling back on state-centric insolvency solutions is not surprising. As seen in the wake of the Global Financial Crisis, national policies tend to shift towards rejecting supranationalism, protecting sovereignty, and preferring solutions that prioritise domestic interests in times of crises. Nevertheless, this discussion reveals a shift away from preventive restructuring towards the other end of the insolvency paradigm, suggesting the emergence of a phenomenon of natural convergence across the EU. Despite the limited supranational coordination and Member States' reversion to solutions protecting domestic interests, many of the adopted strategies exhibit striking similarities.

It must be acknowledged that although the European harmonisation effort has been put on the back burner, the EU is not completely absent from the Covid-19 crisis. For instance, the Commission and the Council put in place an EU-wide framework tackling some aspects of the crisis, such as relaxation of state aid rules and loans to some Member States.

Despite previously known and accepted challenges and bottlenecks, it is argued that harmonisation efforts should nonetheless be extended to other areas of insolvency, including formal procedures. In taking next steps, EU institutions should bear in mind the convergence phenomenon that has emerged during the crisis and rely on future studies to determine the effectiveness of the state-centric solutions implemented during this period. Such empirical evidence could represent the bedrock of "phase-2" of the European substantive harmonisation effort in insolvency.

To conclude, while the crisis revealed the limitations of a harmonisation effort focused on the narrow area of preventive insolvency, it does not challenge the relevance of harmonisation. When moving forward after the pandemic, the EU should also ensure that formal insolvency regimes too are resilient enough in times of crises when prevention is no longer an option. The *logic* of harmonisation remains compelling, despite the *limits* evidenced in the wake of the Covid-19 pandemic.