Global Public-Private Law Approaches to COVID-19 – Insolvency Law in China and Europe*

I. Introduction

On 3rd July 2020, the SMU School of Law held the second webinar of its Virtual Academic Series themed 'Global Public-Private Law Approaches to COVID-19'. Chaired by Professor Lau Kwan Ho (SMU), the speakers – Professor Gao Simin (Tsinghua University) and Professor Kristin van Zwieten (University of Oxford) compared the legal implications of the COVID-19 outbreak on Insolvency Law in China and Europe.

II. Legal implications of COVID-19 on China's insolvency law

Background to China's insolvency law

Professor Gao first noted that China's Enterprise Bankruptcy Law ("**EBL**") (June 2007) had indicated a shift from an administrative approach to a market approach for debt resolution. For instance, Interpretation (III) of the EBL had responded to issues raised by the World Bank report in 2019.[1] This included clarifying the priority of post-commencement finance in the distribution of assets for financing during proceedings, impairment and voting issues and information access for creditors. However, she noted that Article 2 of the Interpretation might be potentially problematic due to the lack of clarity regarding financing during the proceedings under the requirement of the debtor's continual operation. She also stated how priority being given to certain debts under Article 2 remains open to judicial interpretation in future cases.

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1 World Bank, "Doing Business 2019: Training for Reform" (2019) <https://elibrary.worldbank.org/doi/pdf/10.1596/978-1-4648-1326-9> (accessed 22 July 2020).

China's response to the pandemic

Professor Gao then discussed China's response in targeting the liquidity issues for enterprises which were caused by the COVID-19 outbreak. The Supreme People's Court of China had issued the Guidance on the Proper Handling of Civil Cases Involving the Novel Coronavirus Outbreak in Accordance with the Law (No.2) ("**Guidance**"). She noted various Articles in the Guidance that encouraged out of court settlement, by determining the cause of insolvency and reducing the procedural effect of delay caused by the outbreak or prevention and control measures.

First, Article 17 of the Guidance aimed to mitigate the effect of an onslaught of bankruptcy applications, by directing the court to guide the debtor to resolve its debt crisis through out of court settlement. *Second*, Article 19, in drawing a distinction between insolvencies caused by the outbreak and those that are not, allows a "long arm of automatic stay" to be used in the enforcement proceeding if an enterprise is found as insolvent but has value as a going concern. *Third*, Article 22 aims to maximise the value of a debtor's asset and encouraging financing in proceedings. *Fourth*, Article 20 helps to ensure that delays in reorganisation procedures caused by the pandemic are not included in the period stipulated by EBL. *Finally*, Article 21 allows a creditor who is unable to declare his claim on time due to the pandemic to be exempted from bearing the costs for the claim.

Several measures were also taken to assist the court's ability to handle the increase in insolvency cases during the crisis. *First*, judicial assistance reforms by the Supreme Court in 2017 led to the creation of a special division handling insolvency cases. *Second*, the People's Bank and the Department of Treasury provided bailout funding for distressed enterprises, to reduce the number of insolvency applications to the court. Lastly, China's online judicial trial system also allows procedures such as creditor meetings to be held online, to prevent delays in insolvency proceedings.

III. Legal implications of COVID-19 on Europe's insolvency law

UK's insolvency law in the context of the pandemic

Professor van Zwieten first drew parallels between changes in China and the UK. The 2016 World Bank's Doing Business Report[2] had also prompted the UK government to propose substantial changes to their rescue regime.[3] However, these changes in the UK were only implemented later as part of recent legislation introduced in response to the pandemic.

EU's insolvency law in the context of the pandemic

Acknowledging that Europe had no uniform insolvency law, Professor van Zweiten noted this would complicate any attempts to compare insolvency related legal developments between China and the EU. Historically, there was a significant difference between EU member states in their substantive insolvency law rules governing domestic or non-cross border insolvency cases. However, she believed this had since changed with the enactment of the European Restructuring Directive[4] in 2019 – an effort at aligning the domestic insolvency laws of member states. She further noted that the focus of the Directive was important in responding to the pandemic, with restructuring or reorganisation-oriented laws being the most plausible

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2 Doing Business website <http://www.doingbusiness.org/rankings> (accessed 22 July 2020).

3 The Insolvency Service (UK), Summary of Responses: A Review of the Corporate Insolvency Framework, September 2016 at [1.1].

4 Directive (EU) 2019/1023 of the European Parliament and of the Council, 20 June 2019.

methods (amongst existing insolvency procedures) for delivering relief to businesses that become distressed due to the pandemic.

Member states also had the liberty of designing their response to the Directive, as it adopted the more modest regulatory strategy of approximation, rather than a complete harmonisation of laws. Consequently, the baseline in terms of substantive insolvency rules and institutional capacity (e.g insolvency courts, trustees, insolvency practitioners) differed amongst member states. In any event, the Directive could not be quickly modified (due to the nature of EU law-making) to enable rapid relief for distressed businesses. Hence, insolvency law related responses to the pandemic had to be delivered at the member state level. And given the differences in the member states' pre-pandemic baseline in terms of resources, policies, and priorities, their responses would vary.

IV. Comparison of the responses between EU and China

Professor van Zwieten stated that the starting point in most jurisdictions was distinguishing between a) businesses already distressed prior to the pandemic ("not viable"), and b) those that had become distressed after ("newly distressed"). The latter was the main target of policy interventions. Businesses with turnaround prospects would be able to continue operating, by extending the time for negotiation and implementing reorganisation plans, while assets of non-viable businesses could be redeployed elsewhere.

The EU's emergency insolvency legislation reflected this approach. For newly distressed businesses, insolvency rules that usually require the cash flow insolvent debtor to file for commencement of insolvency proceedings have been relaxed. Examples include: a) amendments to the Germany's Insolvency Code, b) the Swiss COVID-19 Insolvency Law Ordinance relaxing a similar rule for debtors who demonstrate solvency at the prescribed pre-pandemic point in time and c) the French Insolvency Ordinance that employs a similar method to assess a debtor's eligibility for relief. Further, the ability of creditors to compel initiation of insolvency proceedings has been restricted to distinguish between not viable and newly distressed businesses so that relief is targeted at the former.

Professor van Zwieten suggested that China's guidelines appear to have focused more on facilitating rescue through the courts. Conversely, efforts have been made in the EU to keep debtors out of court proceedings as far as possible.

Legal implications of the pandemic on cross-border insolvency

Professor van Zwieten noted that the recent focus had been on delivering relief at a domestic level to newly distressed businesses. While this enabled some businesses to stay out of formal insolvency proceedings, a significant number of cases would nonetheless be expected. In the EU, this would not pose a major policy problem, as such proceedings will be subject to rules under the EU Insolvency Regulation. However, she acknowledged that the regulation had its drawbacks, due to its strong protection for rights *in rem* which complicated cross border enforcement of restructuring plans.

Beyond the EU, there would be greater uncertainty. For instance, a significant number of jurisdictions have yet to adopt the UNCITRAL Model Law on Cross-Border Insolvency. Even if adopted, it would not necessarily produce the tools needed by a foreign court or insolvency practitioner. States faced difficult choices in implementing the new model law and the method of adopting it. Another challenge would be assisting law-makers in relevant jurisdictions to produce rules that were fit for their purpose. Such regulatory resources would not exist in many

jurisdictions, and regulators would have to rely on rules that presently exist or come up with the least costly workaround. She noted that insolvency practitioners and courts would play a very important role here, and one could expect to see innovations in cross-border insolvency law outside the EU.

Future developments

Professor van Zwieten also addressed the problem of businesses that were already considered not viable prior to pandemic and were presently tied up in pending insolvency proceedings. She considered the approach in China's Guidance, which allows the court to enable the assets of non-viable debtors to be redeployed. This would be vital in ensuring that the losses associated with the collapse of such ventures would not be aggravated by leaving these debtors to languish in pending proceedings. The approach taken would then depend on the number of pending cases prior to the pandemic, as some jurisdictions have more cases than others.

Rescue financing for distressed businesses would be an increasingly prevalent issue, since capital was needed in longer restructuring proceedings. In the current crisis, more businesses would need new restructuring solutions. Supervision by insolvency practitioners of recently introduced free standing moratoriums would be the main pressure point in terms of overseeing insolvency proceedings.

It was uncertain whether the insolvency profession has the resources to be able to deal with the scale of the future caseload. Generally, reorganisation-oriented laws are capable of being delivered without much judicial oversight. She stated that the residual role courts occupy in determining where moratoriums might be inappropriate and even their additional role under the new form of moratoriums would not be as judicially intensive in comparison.

Regarding the preservation of viable businesses, Professor van Zwieten expressed interest in seeing how policy makers would address this, comparing the different approaches and their results over time.

V. Closing Remarks

In closing, the speakers noted that it remained to be seen whether these temporary provisions would have a permanent impact in insolvency law after this pandemic, with more jurisdictions opting for an open-textured approach which gave debtors more freedom. They emphasised that bearing in mind the conditions in which conventional insolvency law procedures were used before the pandemic's onset would be important in developing legal rules that remain applicable in the post-pandemic world.