Covid-19 Challenges and Bankruptcy Proceedings (Novelties and Changes in Bankruptcy Laws of Some European Countries and Russia)

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Abstract

The COVID-19 virus pandemic has become a serious challenge to the modern economic paradigm in the world, leading to a sharp decline in supply and demand as a result of quarantine and changing consumer behavior due to the need for social distancing. Its predictable outcome will be a global economic downturn, which will affect many enterprises and organizations in various industries, as well as individuals engaged in entrepreneurial activities. In these circumstances, there is a need to solve the problem of debts of insolvent entities in a civilized manner by creating a new legal environment for relations between creditors and debtors to resolve debt during the crisis caused by the pandemic.
The article examines the legislative measures taken within the framework of the bankruptcy institute in European countries (Germany, Italy, France) and Russia in order to overcome the economic crisis caused by the COVID-19 virus pandemic; a comparative legal analysis of the effectiveness of legal incentives adopted in states is carried out.

Keywords: bankruptcy, debtor, creditor, debt restructuring, moratorium, COVID-19

1. INTRODUCTION

In the world legal doctrine, a large number of works are devoted to the study of insolvency relations (bankruptcy). The study of these issues is of undoubted interest, since the institution of insolvency is a mandatory attribute of a market economy, which allows for structural changes and creates conditions for the redistribution of capital from unprofitable industries to other areas of the economy. This is an interdisciplinary institution that must take into account the interests of a whole range of subjects, often with opposite interests, but united by a common competitive process, which is regulated not only by the sphere of civil law, but also affects the legal aspects of criminal, administrative and financial branches of law.

The COVID-19 pandemic has become a serious challenge for the current economic situation in the world. Taking into account the falling demand in the domestic market and the reduction in international trade volumes, the world economy is expected to experience a global recession in 2020. And as a result, there is a real prospect of bankruptcy of a large number of business entities, as well as ordinary citizens.

According to the forecast of the International Monetary Fund, the recession will affect the global economy and amount to 3%. The eurozone economy as a whole will contract by 7.5%, Germany-7%, France-7.2%, Italy-9.1%, Spain-8.0 %, Russia – 5.5% (International Monetary Fund, 2020). Expert opinion also tends to believe that the pandemic will take a protracted character and may cost the world economy about $ 35 trillion until 2025 (Curran & O'Brien, 2020).

According to the forecast of Euler Hermes (the largest international insurance company in the global credit insurance market), in 2020 the number of corporate bankruptcies will increase worldwide by1-3%, and in Western Europe by 16%. According to a study by Coface (another credit insurer), the number of insolvency cases will only grow, so by the end of 2021, the number of bankruptcies in France should increase by 21%; more than 60,000 companies will be affected, providing almost 200,000 jobs. In Spain, 22% of enterprises are

expected to collapse, in the UK-37%, in Italy-also 37%, in the Netherlands-36%. The crisis will affect even the more powerful German economy, where 12% of enterprises will go bankrupt (Euler Hermes, 2020).

In the current circumstances, the authorities of a number of states, in order to overcome the economic crisis, adopted liberalizing amendments to the bankruptcy legislation aimed at supporting companies and citizens affected by the COVID-19 virus pandemic.

2. METHODS

In this study, a comparative legal method was widely used, which made it possible to study and compare various measures taken by States in the context of the COVID-19 pandemic in the field under consideration, to identify similarities and differences between them, and to predict the possible consequences of their application.

The authors' use of system-structural analysis in the course of their work made it possible to determine the main directions of state policy in order to develop an adequate response to the coronavirus pandemic in order to ensure the stability of economic and legal systems in the countries under consideration.

The formal legal method became the basis for systematization of state-legal processes and phenomena that took place in foreign countries and Russia in the field of banknote legislation, which the authors used together with a comprehensive analysis of statistical data and, above all, economic indicators of economic entities.

3. RESULTS AND DISCUSSION

3.1. FEATURES OF THE BANKRUPTCY LEGISLATION

Historically, in all countries, including countries of case law, the sources of legal regulation of bankruptcy relations are legislative acts. Bankruptcy legislation (along with tax legislation) in all developed countries is one of the key regulators of the economic system, with the help of which strategic tasks of socio-economic development of the country are solved.

In France, insolvency rules are contained in several regulations. In the French system and in systems originating from it, the main role in bankruptcy is played by the court, and the influence of creditors on the process is very small. The bankruptcy provisions are concentrated in Book *VI of the French Commercial Code* (*Code de Commerce de France*) (2010), which consists of two titles. The first title includes rules for preventing the debtor's difficult economic situation, as well as rules on the procedure for amicable settlement of relations between the debtor and its creditors related to such a situation of the debtor. The second title contains rules governing the judicial procedure for the restoration and liquidation of enterprises. The French system of bankruptcy regulation is characterized by a pronounced debtor orientation, preference is given to rehabilitation of the debtor's enterprise. This fact is also evidenced by the title of the second regulatory act in the field of bankruptcy, *Law on the Restoration of Enterprises and Judicial Liquidation ("relative au redressement et a la liquidation judiciaire des entreprises") No. 85-98 dated January 25, 1985* (https://www.legifrance.gouv.fr) *and Decree No. 85-1388 dated 27.12.1985 of the same name (https://www.legifrance.gouv.fr).*

In Germany, the source of legal regulation of relations related to insolvency is *The Insolvency Regulation (German: Insolvenzordnnung) dated October 5, 1994* (Germany, 1994), which entered into force in 2000. The regulation regulates the entire complex of insolvency relations: initiation of bankruptcy proceedings and its consequences; management of the debtor's property and the procedure for its implementation; the procedure for satisfying creditors' claims; certain types of bankruptcy proceedings. In German legislation, in contrast to the French system of "enterprise recovery", the main priority is given to protecting the interests of creditors (Closset & Urban, 2019). In Germany, bankruptcy means either liquidation or a settlement agreement - no recovery procedures. In addition, German law does not impose a moratorium on all obligations of the debtor from the moment of commencement of bankruptcy proceedings, which does not allow the debtor to use the bankruptcy for its own benefit. The German bankruptcy regulation system is characterized by a pro-credit orientation.

Bankruptcy proceedings in Italy can only be initiated against companies or individual entrepreneurs. Italian bankruptcy law is regulated by Law No. 267 dated 16.03.1942 "Rules for conducting bankruptcy proceedings, Preventive satisfaction of Claims procedure, Administrative Bankruptcy procedure" (http://www.procuragenerale.trento.it), (Disciplina del fallimento, del concordato preventivo, dell'amministrazione controllata e della liquidazione coatta amministrativa). The other important rules that apply to bankruptcy are regulated by the Italian Civil Code. These provisions apply primarily to commercial

organizations or individual entrepreneurs whose main activity is the production of goods or their sale, as well as the provision of services (small traders are excluded from this category). An analysis of the provisions of Italian law shows that the main purpose of insolvency is to protect the interests of creditors. In this regard, as a rule, all procedures, with rare exceptions, are mainly aimed at liquidating an insolvent enterprise and removing it from the market.

In the UK, a single procedure for regulating bankruptcy is established *by the Insolvency Act dated 1986* (Great Britain. *Insolvency Act 1986*). English law provides for a management regime for the rehabilitation of the debtor, but this regime is little used, as it is usually blocked by a creditor who has a "floating" security right for all the debtor's assets. Thus, English bankruptcy law is also pro-credit (Franks et al., 1996).

In the United States, insolvency relations are regulated by the federal *the Bankruptcy Code dated 1978* (https://www.govinfo.gov). Bankruptcy proceedings are also governed by the U.S. Supreme Court's Bankruptcy Procedure Rules. The US bankruptcy law is classified as a one-time law, since it is based on a reorganization idea that provides a debtor in a difficult financial situation with the opportunity to get rid of debts and start all over again (Glenn & Pasvogel, 1980).

In the Russian Federation, the third *Insolvency (Bankruptcy) Law of the Russian Federation*, adopted in 2002, is currently in force, in which the legislator made a maximum effort to balance the interests of both the debtor and the creditor. However, with the introduction of chapter III.2 in the above-mentioned law in 2017, "Liability of the debtor's head and other persons in the case of bankruptcy", it can be said that elements of a distinctly pro-creditor nature (Tkhagapso & Kuter, 2019) have appeared in the law (Tkhagapso & Kuter, 2019).

3.2. INSTITUTE OF INDIVIDUALS BANKRUPTCY

In many countries, the current civil legislation includes institutions for bankruptcy of individuals who are not entrepreneurs, because "historically, the theory of the competitive process ... it was formed on the basis that only an individual can be declared insolvent (bankrupt)" (Belykh et al., 2001). In the legislation of many foreign countries, including the UK, Germany and the USA, special insolvency procedures for consumer citizens have been developed and are widely used in practice to resolve such situations. So, in the UK, bankruptcy proceedings are distinguished in relation to the property of individuals (bankruptcy) and companies (winding up). Bankruptcy proceedings are opened at the request of the debtor, creditor or prosecutor's office in case of malicious insolvency. Before submitting the application, the creditor must apply to the debtor with a claim for payment of the debt.

In Germany, according *to section 11 of the Insolvency Regulation dated October 5, 1994*, any individual can be declared insolvent. Insolvency proceedings are initiated at the request of the debtor or one of its creditors (Hess et al., 2001).
Relations related to insolvency between the member States of the European Union are regulated by *EC Regulation on insolvency procedures No 1346/2000 dated on May 29, 2000* (European Council, 2000). This Regulation, after coming into force on May 31, 2002, applies to all legal entities and individuals and establishes a system in which a court decision of one member state is recognized by other states (Yarkova, 2006).

In the United States, insolvency relations are regulated by *the Bankruptcy Code dated November 6, 1978.* Bankruptcy proceedings may be initiated against individuals and legal entities (partnerships, corporations, municipalities), except for state entities. The debtor can only be a person who resides, has a business or property in the United States, or is a municipality (Epstein et al., 1993). U.S. insolvency laws, unlike those of European countries, are of a "perpetual" nature. The essence of this position is that when applying the insolvency procedure to the debtor, the interests of the debtor are more protected:

- a "fresh start" policy is implemented, which allows the debtor to write off the remaining debts and "start life from scratch";
– if the debtor submits an application for its own insolvency, it has the opportunity to impose rehabilitation procedures on the court;
- the court may apply various deferrals and discounts of debts, etc. If the debtor is an individual, then upon completion of the distribution of the bankruptcy estate, the court makes a decision on exemption from debts. The decision does not include requirements for collecting taxes, fees, alimony, as well as repayment of the loan provided for training (Stepanov, 1999).
The current Russian bankruptcy legislation also contains an indication of the possibility of declaring a debtor citizen bankrupt from October 1, 2015. The mechanism of bankruptcy of individuals in the Russian Federation,

along with fair satisfaction of the creditor's claims, also provides for the introduction of rehabilitation procedures for a debtor citizen related to the provision of benefits to a citizen, the possibility of settling his debts. The revival of the institute of insolvency of individuals in Russia is one of the main areas of improvement of the insolvency legislation, which took into account international experience in this area.

3.3. "LIBERALIZATION" OF BANKRUPT LEGISLATION

Structural differences in the economic systems of states determine the peculiarities of legal regulation of the institution of bankruptcy in different countries. However, despite these differences, the financial crisis caused by the COVID-19 pandemic-19 has led to similar changes in the bankruptcy legislation of many states, primarily aimed at protecting the property interests of the debtor.

The most common method of "liberalizing" bankrupt legislation in the world is a temporary moratorium on creditors' filing applications for declaring a debtor insolvent. It is usually imposed for the duration of restrictions related to COVID-19, or for a longer period of time necessary for the intended restoration of debtors' solvency. As a result of these measures, the number of bankrupts in the UK, despite the crisis, decreased by about 30 percent from April to June compared to the same period last year. In Germany, this figure has decreased by almost 60 percent, while a similar situation is observed in France and Spain. Undoubtedly, such a measure is not aimed at restoring demand for goods and services, as well as economic activity of economic entities, but only allows to temporarily postpone the onset of insolvency of the debtor in the absence of additional economic and other incentives.

The next most popular measure is an increase in the minimum amount of debt required to initiate bankruptcy proceedings compared to the pre-crisis period. For example, the amount of debt under which small businesses can qualify for bankruptcy proceedings under the new subsection V of Chapter 11 of the US Bankruptcy Code increases for a year from $2.7 million to $7.5 million.
In addition, in the countries affected by COVID-19, a number of measures can be identified that represent additional guarantees that provide for the protection of the debtor's interests and are aimed at maintaining, resuming economic activities or performing restructuring (for example, non-application of financial sanctions for late fulfillment of monetary obligations; easing requirements for loans issued by shareholders to their companies, etc.)

Only the most popular measures used by states are covered here. Below, we compare the approaches of different countries in this area and present a brief overview of them.

3.4. GERMANY

In Germany on March 27, 2020, the Law "On Mitigation of Consequences of Pandemic COVID-19 in civil, bankrupt and criminal procedure law" was adopted (Germany, 2020). According to this law, the moratorium on bankruptcy applies to all companies that have signs of insolvency (with the exception of those whose bankruptcy is not related to the COVID-19 pandemic). In respect of them, *a delay is introduced until 30.09.2020 for the debtor to file an application for declaring the company insolvent* (in Germany, as in many countries, for example, in France and Russia, the bankruptcy law stipulates the obligation of the debtor to file an application for bankruptcy if there are signs of insolvency). This rule can be extended until March 31, 2021. However, please note that this postponement applies only to companies whose insolvency is caused by the COVID-19 pandemic and which did not have signs of insolvency as of December 31, 2019.*Creditors will be able to file for bankruptcy of the counterparty only if it was already insolvent as of March 1* (Barcaba & Kaufman, 2020).
The amendments also provide for a *number of additional guarantees aimed at protecting the interests of the debtor* from further challenging payments and actions aimed at maintaining, resuming business operations or performing restructuring. For example, payments (including those made with delay), changes in the type of performance of obligations, replacement of collateral made in the period up to 30.09.2020 in the normal course of business can only be challenged if the creditor knew that there was no prospect of restoring solvency.
In order to encourage financial support of companies from their shareholders and third parties, *a significant part of restrictions on providing financing to companies with signs of insolvency is removed.* In Germany, the rule on subordination of loans that owners of shares can provide to an enterprise was abolished. If earlier, in the event of bankruptcy of companies, such loans were returned to shareholders only after the claims of other creditors were repaid, now, for example, the claims of shareholders who issued such loans before September 30, 2020, are considered in bankruptcy cases on an equal basis with the usual claims of creditors.

3.5. FRANCE

In France, a health emergency regime has been introduced for the period from March 24 to May 24, 2020. At the same time, on March 27, 2020, amendments were made to the Law on Bankruptcy, which changed the terms and procedure for bankruptcy for companies and individuals who experienced the negative consequences of the crisis.
Previously, French bankruptcy law required a debtor who learned that it was impossible to repay his debt at the expense of his property assets to apply for bankruptcy within 1.5 months.
Now, an entrepreneur or company can assess its viability at the moment - March 12, 2020. *If the status of payments is assessed as negative, the law gives the debtor three months after the end of the emergency to file for bankruptcy, i.e., until August 24.* For example, companies may not file for bankruptcy if, as of March 12, they have ceased to perform their duties to creditors, but the deadline for non-payment of debt is less than 45 days. Lenders will also not be able to initiate this process.

In addition, companies will be able to take advantage of one of the bankruptcy procedures, some of which were normally unavailable to them.

In addition to external management or bankruptcy proceedings, it will be possible to apply procedures for restoring solvency (appointment of an ad hoc attorney, opening of a rehabilitation procedure), as well as reconciliation procedures. This preventive procedure allows company managers to obtain assistance in negotiations with creditors, restructure debts, or otherwise ensure sustainability in the firm's operations during a crisis.

The amendments to the French legislation are also interesting because they offer the possibility of opening a number of legal procedures in electronic form. This lays the foundation for their implementation and subsequent monitoring without organizing a hearing. For example, these amendments allow debtors to apply to the court by e-mail (or regular), sending any necessary materials and documents.

In some cases, when the organization does not have sufficient funds to cover current expenses (for example, to pay salaries to employees), *the opening of bankruptcy proceedings may allow to take advantage of special protective measures*. In this case, the Wage Insurance Association can assume the obligation to pay wages. Previous debts may be frozen in this situation.

3.6. ITALY

Italy was also no exception, as the most common measure was a temporary moratorium on creditors filing applications for declaring a debtor insolvent. In the amendments to the bankruptcy legislation, it was established that all bankruptcy applications filed between March 9 and June 30, 2020, regardless of whether they were filed by creditors or debtors, will be considered automatically unacceptable. For certain restructuring procedures, the deadline for meeting the terms of the debt restructuring plan will be automatically extended by 6 months if the original deadline expires between February 23, 2020 and December 31, 2021.
The changes also affected the process of recapitalization of companies (joint-stock companies and limited liability companies). This is usually required if the company's assets fall below a certain value. If recapitalization is not performed, the company is considered liquidated. This regulation is suspended until the end of 2020 (Fischer, 2020).

3.7. RUSSIAN FEDERATION

The Russian moratorium on bankruptcy is generally similar to the restrictive measures that have been put in place in many countries around the world and provides individual business entities with time to overcome the consequences of the pandemic. It is entered by *the Resolution of the Government of the Russian Federation No. 428 dated 03.04.2020 "On the introduction of a moratorium on the Initiation of Bankruptcy cases at the Request of Creditors in respect of Individual debtors* (Russian Federation. Decree of the Government of the Russian Federation No. 428). The moratorium was valid from April 6 to October 6, 2020 and was extended by the Government of the Russian Federation according to *Regulations of the Government of the Russian Federation No. 1587 dated 01.10.2020 "On extending the Moratorium on the Initiation of Bankruptcy Proceedings on the Application of Creditors in respect of Individual Debtors"* (Russian Federation. Decree of the Government of the Russian Federation No. 1587) until January 7, 2021. At the same time, the Government of the Russian Federation has the right to extend the specified period without restrictions. Unfortunately, the moratorium does

not apply to all companies, but only to some, namely: systemic and strategic organizations. A list of companies affected by the moratorium by name is available on the website of the Federal Tax Service of the Russian Federation (https://service.nalog.ru).

In the period of the moratorium provides a range of measures aimed at limiting the rights of creditors: a) the creditors may not file a petition in bankruptcy debtors; b) suspends the obligation (not the right) of a debtor's application for bankruptcy; c) not charged late fees and other financial penalties for delay of performance of monetary obligations; d) suspended the enforcement proceedings, penalties on property (not removable arrests and other restrictive measures on the property); e) the ban on the foreclosure of the mortgaged property; f) the prohibition of set-off, if it is a violation of priority of creditors.
At the same time, along with restrictions on the rights of creditors, measures aimed at preventing the withdrawal of assets by unscrupulous debtors are fixed. Among the latter, the following can be distinguished:
- if bankruptcy proceedings are initiated within 3 months after the end of the moratorium, all transactions of the debtor made during the moratorium period are recognized as null and void, except for transactions made in the normal course of business, the amount of which does not exceed 1% of the book value of assets;

- in other cases, creditors have the right to challenge transactions concluded by the debtor within 1 year before the moratorium, during the moratorium and within 1 year after the moratorium, on special grounds provided for by the bankruptcy legislation;
-the withdrawal of the participant from the limited liability company with payment of the actual value of the share;
- it is forbidden to pay dividends and distribute profits.

4. SUMMARY

The introduction of amendments to the bankruptcy legislation is not a panacea and an optimal solution to the problems of economic entities affected by the economic consequences of COVID-19. To support them, comprehensive measures are needed that include not only legal remedies, but also economic, financial and tax incentives. Given the high probability of subsequent "waves" of the COVID-19 pandemic in October-December 2021, the measures taken by states will either confirm their effectiveness or ıposignal the need to develop the next "recipe" for the recovery of the global economy.

5. CONCLUSIONS

Summing up, we note that most of the legal measures taken to counteract the crisis in the countries under review have an identical focus. But, at the same time, a pragmatic and rationally balanced approach, enshrined in German law: Moratorium on bankruptcy for those entities capable of overcoming the crisis; availability of instruments, contributing to overcome the crisis and, above all, special regime for obtaining the loans during the period of moratorium; absence of privileged and underprivileged entities, as in Russia, and a strict prohibition on creditors to bankrupt a debtor, seems preferable.
It is also necessary to take into account the experience of the United States in this area. Countries' use of measures similar to those set out in the U.S. Bankruptcy Code dated 1978 and the Small Business Reorganization Act dated 2019 (SBRA) in response to the pandemic, as well as the benefits of the "*debt in possession" concept* (Chapter 11) will allow the global community to cope with the consequences of the crisis, in our opinion, much faster. Time will tell how each of the models used by the States turned out to be more viable.

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