

Legal Convergence in Developing the Anti-crisis Potential of Bankruptcy Institute as Responding to the Negative Economic Impact of Covid-19 Pandemic

Y. N. Folgerova^a, K. A. Minnullina^b and E. P. Tatarinova^c

Federal State Budgetary Educational Institution of Higher Education «Vyatka State University», Kirov, Russia

Keywords: Pandemic, Covid 19, Legal Regulation, Bankruptcy, Insolvency.

Abstract: The insolvency (bankruptcy) institute has a special role in the crisis management measures system, given its rehabilitative potential and selection mechanisms inherent in it. The crisis phenomena caused by the Covid-19 spreading serve as the legal regulation problems catalyst in this sphere, which actualizes its improvement necessity to minimize the pandemic negative economic effect. Insolvency law adaptation to the Covid-19 new challenges, given its spread scale, is a challenge faced by all legal systems without exception. This article attempts to systematize and structure the Government's response at the national level to the institution of insolvency, aimed at minimizing the negative consequences of the pandemic. The analysis allows us to demonstrate that disparate, uncoordinated measures have common trends and patterns. Based on the conducted research, in conclusion, proposals are formulated that would allow taking into account foreign practice to determine the strategy for the development of the institution of insolvency in the Russian legal system in order to increase its effectiveness as a mechanism of anti-crisis regulation.

1 INTRODUCTION

The covid-19 pandemic had a negative impact and revealed vulnerable point a social and public health spheres, it is also paralyzed business activity and led to the «worst economic crisis since the Great Depression of the 1930s» (Sapir, 2020). As a response to the negative trends caused by the economic shock, many countries are responding with a package of legal and economic measures for stabilization. At the first stages, negative effect of covid-19 pandemic has largely been handled as an essentially national matter. Nevertheless, the continuous phenomenon of global economic interdependence determine the tendency towards similar responses to the spread of the virus eventually.

The phenomenon referred to as the «copycat coronavirus policies» that was the result of regulatory emulation (Alemanno, 2020). This study aims to answer the question whether there is a similar pattern in the legislation in the field of bankruptcy

(insolvency). In conditions economic downturn, the legal regulation of bankruptcy (insolvency) deserves special attention from the point of view of its anti-crisis potential. The most dynamic development of legislation in this area is during the crisis. The Russian legal system is no exception. The Ministry of Economic Development has prepared a draft of large-scale reforms to the federal law on insolvency (bankruptcy), aimed at optimizing procedures and improving the effectiveness of the rehabilitation component. The findings of this study reveal that fragmented and uncoordinated national responses have common trends what is caused by the unity goal of minimization economically and financially destructive effects of the pandemic.

2 RESEARCH METHODOLOGY

The study key objective is to assess the crisis phenomena impact caused by the Covid-19 spread on

^a <https://orcid.org/0000-0001-6980-278X>

^b <https://orcid.org/0000-0002-0585-2072>

^c <https://orcid.org/0000-0002-2066-0618>

the insolvency institute state and legal regulation in the Russian legislation, which was based on the formal-legal method. The work starts with the insolvency institute role in the anti-crisis regulation system. It helps to identify this institute low-efficiency problem in the Russian legal system, which is caused by pro-creditor concept prevalence. The study was accompanied by the statistical method used, in particular, the data analysis from the information about bankruptcy Unified Federal Register, further confirms the thesis about the bankruptcy legal regulation fundamental problems in the Russian Federation

The article further attempts to systematize the responses implemented by states to minimize the pandemic negative economic effect, directly reflected in the insolvency institute legal regulation, to identify patterns and trends. This study objective was to identify the most effective strategy for the bankruptcy institute modernization, which solution is based on the comparative analysis and convergence methods.

In the course of the study, the measures taken during the pandemic in the different states insolvency legislation sphere were divided into two stages: first, emergency measures to prevent bankruptcies a massive wave; second, subsequent reforms to «smooth the insolvency curve». On the general scientific methods basis, the bankruptcy institute development basic tendencies have been revealed, and their analysis has allowed designating the legislation perfection most effective and perspective strategies in this sphere. The conclusion suggests ways to reform the bankruptcy institution in the Russian Federation, directly aimed at its anti-crisis potential development.

3 RESEARCH RESULTS

3.1 The Institution of Insolvency Significance in the Anti-crisis Regulation Measures System

The institution of insolvency (bankruptcy) occupies a special place in the state institutions system to support business entities in the recovery process from the crisis, given the selection mechanisms and rehabilitation opportunities inherent in it. Bankruptcy on the global economy scale serves as one of the anti-crisis regulation tools, aimed at improving financial and economic stability (O.N. Lvova, 2016). This institution special importance is determined by its main functions:

1. bankruptcy prevention and avoidance under temporary economic downturn conditions;
2. corporate solvency restoration with economic feasibility and viability to viable entities, through the crisis exit tools provision;
3. the insolvent entity liquidation takes into account all parties (stakeholders) interests, which implies the debtor's assets effective and fair distribution.

On this basis, the bankruptcy institution provided the mechanisms inherent in it are effective, can act as a powerful tool to protect business entities affected by the COVID-19 pandemic negative economic consequences. It is worth agreeing with the opinion that «bankruptcy is not a problem, but a solution especially for large companies» (D. A. Ellias, D. Triantis, 2020). In addition, pandemic crises pose the massive corporate bankruptcies threat and catalyze inefficient insolvency mechanisms problems. Based on the above, the Covid-19 pandemic has actualized the ensuring the bankruptcy law institutional capacity problem by maximizing its anti-crisis potential.

3.2 The Bankruptcy Institution Transformation to Minimize the Pandemic Negative Economic Impact

Taking into account the pandemic spreading scale, all legal systems without exception faced the minimization the negative economic impact task. Insolvency laws have changed in Germany, Great Britain, Italy, the USA, Poland, Colombia and other states, including Russia. At the same time, the initial disparate measures caused by the emergency are quickly replaced by the legal regulation convergence, the so-called «copycat coronavirus policies» (J. Krastev, 2020), which is due to identifying and modelling the most effective strategies of response under the external factors influence.

There is no denying the differences in the ongoing reforms some elements, for example, most countries took the existing regulations optimization and modification path (on a temporary or permanent basis), in other states support measures were taken by introducing special regulations. However, in general, it seems possible to identify response certain regularities and stages.

3.2.1 The Emergency Response Phase

The pandemic response first phase was characterized by fragmented, uncoordinated measures designed to prevent a massive wave of bankruptcies and to allow

time for businesses to recover (N Shchukina, V. Varfalovskaya, A. Bekaeva, 2021). Measures at this stage were time-limited and subject to cancellation (or review) depending on the pandemic scale and impact in a particular country.

One of the first measures taken in jurisdictions a number is the provisions' suspension imposing an obligation on controlling persons to initiate bankruptcy proceedings if there are objective insolvency indications. In some jurisdictions, such as Germany, a rule was adopted for a time reasonable period, in some others, such as Spain, such an obligation suspension was introduced for an emergency period.

Most states suspended bankruptcy procedures initiation by creditors, including Russia, the so-called moratorium on bankruptcy. However, concerning creditors' rights to apply for bankruptcy states a number followed the not prohibition path but correction towards insolvency threshold increase concerning the claims' amount and periods during which they are not fulfilled. In Singapore, for example, the amount of insolvency was increased tenfold and the period within which the debtor failed to meet the claim was doubled. Indian law initially restricted the creditors' rights to initiate bankruptcy proceedings, but a moratorium was subsequently imposed (A. Jinda, 2020). Despite the different approaches in essence they are defined by a common objective, which is characterized as taking into account the pandemic negative impact in assessing the introducing bankruptcy procedures reasonableness concerning a person.

3.2.2 Subsequent Reform Stage (The Institute Improvement and Adaptation to New Challenges)

The measures taken at the initial stages had a stabilizing effect, however, the crisis phenomena determine the reforming the legislation on bankruptcy necessity in increasing its anti-crisis potential direction. Experts predict an increase in the corporate' bankruptcies number, which determines the legislation ensuring effective legal regulation task in this area, which provides for procedures optimization, as well as its individual mechanisms adaptation to new challenges.

States a number, such as Denmark, have perceived the crisis as a reason for legislation a major reform, which have been postponed for a long time. In other jurisdictions, where there is no need for radical reforms, transformations take place through

the optimization of existing norms and their adaptation to new challenges.

Given that the bankruptcy anti-crisis potential is largely determined by the rehabilitation procedures effectiveness, their improvement is one of the law reform main trends, through procedures simplification and conditions for their introduction. Thus, in countries, a number (the USA, Singapore) the rules on thresholds of creditors' consent for the procedures introduction and financial reorganization plan approval were revised or abolished.

In the mass bankruptcies forecasts view, one of the reform key areas is characterised by the new preventive restructuring mechanisms introduction. These tools should help to reduce the burden on the courts, as well as reduce the costs associated with bankruptcy proceedings. Recommendations to introduce preventive restructuring mechanisms in the insolvency institution were developed by the European Union back in 2019, but the crisis phenomena prompted lawmakers to enshrine them legally (E. Ghio, J. Gant, G. Boon, D. Ehmke, L. Langkjaer, E. Vaccari, 2021). European states a number are adopting special rules on restructuring, providing for the possibility for entities in financial distress to restructure debts through an agreement with creditors outside the bankruptcy framework. Thus, the Dutch bankruptcy law (Faillissementswet, DBA) introduced the procedure «Wet homologatie onderhands akkoord» based on the preventive restructuring American model, also a new German restructuring law (StaRUG, SanInsFoG) may be noted.

The second direction in adjusting the institute of insolvency is the debtor's good faith principle expansion. Thus, in some states, the rules of directors' liability have been revised and softened, in particular, for payments and transactions made in the insolvency indications presence (the USA, Germany, Great Britain). In jurisdictions where subordination mechanisms for corporate loans are applied, this institution has been suspended (Italy, Germany, Spain) due to the attracting external capital objective problem in the crisis environment (K.V. Zwieten, 2020).

Taking into account the fact that in crisis conditions the bankruptcy highest risks have small business entities, the third direction is characterized by the bankruptcy procedures special (simplified) regimes establishment concerning them. This regime specific is to establish a faster and simplified procedure to minimize costs. For example, new rules for microenterprises have been introduced in Colombia. In jurisdictions where such rules are

already in place (USA), attempts are being made to expand the subjects range falling under special treatment, in particular, such rules extension to include medium-sized enterprises. The recommendations developed for simplified insolvency procedures rules for small and medium-sized enterprises are the international organizations' responsibility (UNCITRAL, the World Bank).

4 RESULTS AND DISCUSSION

The first phase emergency response measures, although fragmented and uncoordinated, were aimed at preventing bankruptcies from a massive wave by giving business entities a certain period to recover. Although individual elements differed from jurisdiction to jurisdiction, in essence, they all had the same objectives, by restricting or prohibiting the bankruptcy procedures initiation. The measures in this phase were characterized by a time limit.

The legislation on insolvency in Russia was not an exception. In the Bankruptcy Law enshrined a provision allowing for a moratorium introduction in emergencies. It was in force until 7 January 2021 in the most affected industries certain debtors respect. At the same time, the Russian bankruptcy institution specifics, determined by the pro-credit concept, stipulated the establishment, simultaneously with the additional measures moratorium, to prevent the debtor's assets withdrawal.

The moratorium is «postponement a kind» concerning entities with insolvency signs due to the circumstances exceptionality and essentially a rehabilitation mechanism. However, its introduction has aggravated the debtor and creditors balancing the interests' problem. In particular, it has brought to the fore the such a measure admissibility issues in dishonest debtors respect, as well as its rationality in person respect, whose crisis financial condition arose before the pandemic. As a response, the Supreme Court explained that the creditor's application checking stage does not provide an opportunity to identify abuse by the debtor, countering such behaviour is possible only on the mechanisms «ex-post» basis, directly in the bankruptcy case, after the moratorium lifting.

To date, foreign experience shows that the emergency response measures were subject to a targeted, case-by-case approach. That is, the effect of these exceptional measures was extended only to the entities (depending on the industries or types of activities), which financial condition was most at risk due to the Covid-19 spread. Because their application

to entities whose insolvency was not caused by the pandemic negative effects would inevitably conflict with their creditors' interests (A. Gurrea-Martínez, 2020). At the same time, experts acknowledge that such a measure's introduction in Russia had the expected positive effect.

The response second stage is already characterized by greater focus and consistency, which main task is to smooth the bankruptcy curve. This stage implies reforming the legislation on bankruptcy to increase its anti-crisis potential, optimization, adaptation to the crisis phenomena caused by the pandemic.

As the Covid-19 spreading a result, the economy real sector and, in particular, small business entities turned out to be in the most vulnerable position. This specificity determined the general tendency to strengthen the continuation (pro-debtor) component and the focus on increasing the efficiency and effectiveness of rehabilitation mechanisms. The continuation trend most striking example of the is the change in the «crisis» definition in Italian legislation, which is now defined as a significant economic and financial imbalance» (Decree 147/200), which indirectly creates opening bankruptcy proceedings validity proof a higher standard in the debtor consent absence.

The need issue to reform the Russian legislation on bankruptcy was raised even before the pandemic. This institution fundamental problems are evidenced by the Unified Federal Register statistical data of the information on bankruptcy (The Statistical Bulletin, 2021). The key shortcoming is recognized is the rehabilitation procedures inefficiency, which indicates this institution has low anti-crisis potential. Reforming the legislation on insolvency in strengthening its rehabilitative orientation direction was and remains a topical issue, widely discussed in the doctrine. It is necessary to admit that the crisis phenomena caused by the pandemic accelerated its resolution. At the moment the large-scale reforms draft to the legislation on bankruptcy is under consideration, providing radical changes of rehabilitation procedures, which, cannot be recognized as exhaustive and optimal to minimize the pandemic economic consequences.

The bankruptcy institute improvement as crisis management a mechanism should be accompanied by continuing orientation additional measures. The doctrine proposes various approaches to solve this problem, in particular, by enshrining debtors' rehabilitation special mechanisms, whose insolvency is associated with the economic nature' an emergency. However, granting preferences to debtors a certain

category on this criterion basis seems unreasonable. Based on the foreign experience analysis, insolvency legislation improving the efficiency and adaptation is seen in the special bankruptcy regimes preventive measures and consolidation improvement concerning small businesses. Of course, their borrowing should be accompanied by taking into account the insolvency regulation national specifics.

5 CONCLUSIONS

The Covid-19 pandemic spread predetermined essentially new challenges for the legislator in the insolvency legal regulation sphere. Responses to the pandemic negative economic consequences in the bankruptcy institution serve as the legal convergence processes a reflection due to the goals and objectives uniformity, as well as the need to identify the most effective model (strategy) to strengthen this institution anti-crisis potential. The most preferable approach is pragmatic and consistent, reflecting the interests of all, without exception, business entities. Thus, despite all the negative consequences, the insolvency institute context can be considered in a positive aspect, as evidenced by the following arguments.

First, the economic crisis phenomena catalyzed bankruptcy legislation deficiencies and problems and contributed to its more dynamic reform;

Second, the pandemic facilitated of harmonization and legal convergence process with undeniably positive effects;

Thirdly, the economic instability conditions predetermined the insolvency institution concept global revision towards the pro-debtor orientation. The bankruptcy destigmatization advantages are manifested in the institution liberalization and increasing its rehabilitation component effectiveness. The foreign countries experience in adapting national bankruptcy laws to the pandemic crisis makes it possible to identify the reform most promising areas: to improve the efficiency and to optimization of existing rehabilitation procedures, consolidate the preventive restructuring mechanisms, focus on the debtor good faith expansion and controlling persons, and introduce special insolvency regimes for small business entities.

REFERENCES

Alemanno, A., 2020. The European Response to COVID-19: From Regulatory Emulation to Regulatory

- Coordination? *European Journal of Risk Regulation*, 11(2): 307-316.
- Ellias, J.A., Triantis, G., 2020. Congress is ignoring the best solution for troubled companies: bankruptcy, *Fortune*, <https://fortune.com>.
- Ghio, E., Gant, J., Boon, G., Ehmke, D., Langkjaer, L., Vaccari, E. (2021). Harmonising Insolvency Law in the EU: New Thoughts on Old Ideas in the Wake of the COVID-19 Pandemic. *International Insolvency Law Review*, <https://www.academia.edu>.
- Gurrea-Martínez, A., 2020. Insolvency Law in Times of COVID-19 (June 9, 2020). Ibero-American Institute for Law and Finance, Working Paper, <https://papers.ssrn.com>.
- Jindal, A., 2020. IBC (Amendment) Ordinance 2020: Straddling Between Manoeuvre and Ambivalence, <https://ibclaw.in>.
- Lvova, O. A., 2019. Rehabilitation Potential of a Business Bankruptcy: to Determine, to Measure, to Increase. *ECO journal (ECONomics and industrial Engineering)*, 6: 83–102.
- Sapir, J., 2020. Would the lock-down induced economic contraction be a prelude to a major depression? *Economics and Mathematical Methods*, 3(56): 5-25.
- Shchukina, N., Varfalovskaya, V., Bekaeva, A., Salinas, L. (2021). Anti-crisis state regulation of business under pandemic conditions: results and challenges. *Economic Annals- XXI*, 1-2(187): 90-98.
- Zwieten, K.V., 2020 The Wrong Target? COVID-19 and the Wrongful Trading Rule. *Oxford Business Law Blog*, <https://www.law.ox.ac.uk>.