

Mothballing the Economy: Business Law Hibernating through the Corona Crisis

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The spread of COVID-19 has met most countries unprepared. Governments around the world are scrambling to respond to the pandemic. Through different tweaks to the law, they strive to curtail its worst effects.

At the first level, the state intervenes as the guardian of order and protector of life and health. It imposes proscriptions and prohibitions, such as curfews, social distancing, the closure of shops or restaurants, and travel restrictions. As a result, social life is grinding to a halt. In this context, the risks for public and private interests need to be carefully weighed. Questions that must be decided include: Which services are “essential” and need to continue despite the crisis? Supermarkets? Bakers? Leisure clothing shops? Which parts of the economy can be excluded from the shutdown because they pose no or little risk? For instance: manufacturing? Or construction?

At a second level, states try to limit the negative economic effects of their doings on the first level. In effect, they attempt to “mothball” companies and business relationships for the duration of the crisis, so that they can continue thereafter as if the past months have not happened. The idea is to put the economy into a deep-freeze.

Here are some example techniques that have been used for mothballing. The rules on insolvency have been relaxed, like the liability for wrongful trading or the duty of the directors to apply for the opening of an insolvency procedure. Companies were allowed to postpone the dates for shareholder meetings and for mandatory audits. Banks were spared from stress tests and ordered to defer dividend payouts. Sanctions for not meeting contractual obligations have been mitigated or excluded, for instance by banning the eviction of tenants for failure to pay the rent. Yet the most effective mothballing has been achieved by very simple measures, as illustrated by China’s extension of the New Year by a couple of days.

In all of these cases, the legislator acts as a regulator by intervening into the functioning of the market. In this context, difficult decisions need to be made, involving many conflicting private interests. These include: Which obligations or duties are suspended, and which not? For instance, do rents need to be paid or not? Must debt be serviced or not? Who is bearing the risk of any suspension – the creditor or the debtor?

The Corona Crisis in Light of the Law-as-Culture Paradigm

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There is one remarkable exception from mothballing: the financial market continues to operate in most countries. Financial markets operate as gauges of the future. They constantly evaluate the economic impact of the crisis, adjust prices, and reallocate capital. That is why they have so far been spared from hibernation. Some (mostly European) countries merely have stymied parts of their activities, in particular short selling, in order to avoid the worst reactions to the pandemic.

Not everything lends itself to “mothballing”. Life goes on despite the deep freeze of the economy. Employees need to be paid, food must be bought, children’s mouths be fed. Deep-freeze legislation cannot change or satisfy these basic necessities.

As a result, the state intervenes on yet another level, this time as a substitute for the market. It bails out companies, distributes subsidy, gives loans or guarantees or pays cash directly to those in need. In other words, what the market used to deliver is now provided by the state. The bill for the taxpayer will be huge, but there is no other chance: The state is the ultimate insurance for every part of the economy and society. In this context as well, important decisions need to be made. Which industries or companies shall be bailed out, and on what terms? Who is to benefit from a subsidy, and how much? Who is eligible for a loan or a direct payment?

The answers are intimately connected to the decisions taken on the first two levels. For instance, it only makes sense to think about subsidies for the industry where manufacturing was disallowed. And it is not sensible to pay support to individuals that continue to get salaries.

The three levels of intervention can be summarised in the following way:

	Level 1	Level 2	Level 3
Function of the state	Guardian of order	Market regulator	Insurance
Type of intervention	Freezing social activity through <ul style="list-style-type: none"> • bans • curfews • closures • social distancing 	“Mothballing” the economy through <ul style="list-style-type: none"> • alleviation of duties under insolvency law • postponement of corporate events • suspension of reporting and other regulatory duties • moratorium on contractual obligations 	Substituting the market through <ul style="list-style-type: none"> • bail-outs • subsidies • loans • guarantees • salary payments • direct cash hand-outs
Interests at stake	<ul style="list-style-type: none"> • life & health • continuity of economic activity 	<ul style="list-style-type: none"> • business existence • income of shareholders and bondholders • interests of creditors 	<ul style="list-style-type: none"> • business existence • individual subsistence

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All types of measures, the freezing of social activity, the mothballing of the economy and the substitution for the market, are decided on the national level. There is no global authority to steer them. Not even the European Union has achieved uniformity in this regard. The Nation-State is definitely having a come-back. It was never really gone but now forcefully demonstrates again that it is the ultimate holder of power. The crisis is a reminder that the market and the state are two complimentary forces. The latter not only sets the conditions for the functioning of the former, but also acts like an emergency power generator where the market fails.

This type of simultaneous strong state intervention on three levels is unprecedented for Western economies. There have been previous emergencies, such as the oil crisis or the global financial crisis, but they were triggered by a single event and limited in time. In their aftermath, there has been enough time to adapt the economy to the new conditions. The difference of the Coronavirus crisis is that it is both extremely urgent and extremely long. It completely paralyzes societal life for an unforeseeable period of time. Perhaps the closest analogy is indeed the war time, but even back then economic activity continued, because it was merely shifted to the production of arms and other war goods.

The need for “hibernation” through “mothballing” is a rather new phenomenon. There can be no doubt that important legal questions will arise or have already arisen from the technique. They concern the interpretation of the new measures. They also imply previously existing rules, such as frustration, change of circumstance or force majeure. There will also be questions about conflicts of law, i.e. which state should decide over the temporary suspension of private relations.

It is extremely difficult to predict the consequences of the crisis for business law. Some structural changes are likely to remain. National laws must cater for the possibility of similar emergencies in the future. More time and attention will be spent on crafting specific rules for “black swan” events. Legal systems need to become more resilient. This will only be possible if they allow quick and flexible reactions to unforeseen situations. The mechanics for “hibernation” will therefore have to be enshrined into a more permanent framework. In other words, we will have more provisions allowing the suspension of the regular rules and a back-up regime that will take their place. The exceptional state will be normalised through law. To paraphrase Clausewitz, mothballing is not the end, but the continuation of the economy with other means.

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