ARTICLE

# A First Decade of Corporate Restructuring in Finland

Pekka Inkeroinen, Partner, and Anders Bygglin, Associate Lawyer, Hannes Snellman Attorneys at Law Ltd., Helsinki, Finland

## General statutory framework and history

Insolvency proceedings in Finland can be divided into two categories, according to whether the objective of the proceedings is liquidation or restructuring. The former category includes bankruptcy proceedings, as regulated by the new Finnish Bankruptcy Act of 2004. The latter category, on the other hand, includes the adjustment of debts of an individual, as enacted in the Finnish Act on the Adjustment of the Debts of a Private Individual of 1993, (the 'Adjustment Act'), as well as corporate restructuring, as regulated by the Restructuring of Companies Act of 1993 (the 'RCA').

In the international context it should be noted that the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (the 'Insolvency Regulation') is applicable law in Finland.

Finnish bankruptcy proceedings are purely a matter of the liquidation of the subject of the proceedings and the fast realization of any assets, in order to satisfy creditors' claims. Finnish bankruptcy regulations do not provide for any form of intermittent takeover of the subject of the proceedings, e.g. by a trustee, for the purpose of keeping a company viable until further measures, or in order to facilitate a possible sale of the business operations as a whole. At the commencement of bankruptcy proceedings, the debtor forfeits control of all leviable property, which, after the precise time of adjudication on the bankruptcy, is considered to belong to the creditors through the bankrupt's estate.

The reorganization of an entity, on the other hand, as regulated by the RCA, means that the debtor retains the right to control the normal day-to-day activities of the company during the restructuring period, although an administrator has to give his consent to certain significant business decisions, such as taking out a new loan. The reorganization of a corporation is in many ways similar to the adjustment procedure for the debts of an individual, since the goal is to save the subject of the proceedings from bankruptcy.

The RCA was enacted in 1993, at a time when Finland was in the midst of the worst economic depression the country had faced since the end of the war in 1945. The pure liquidatory character of the bankruptcy regulation then in force soon proved insufficient to deal with the new economic conditions, which were forcing many companies, large and small alike, into bankruptcy. It was soon realized that many companies that in theory seemed to have prospects went bankrupt simply because of a momentous but drastic change for the worse in their own private finances. It was perceived that these companies did not 'deserve' to go bankrupt and be liquidated, but the legislation then in force had no instrument to offer for dealing with these kinds of situations.

The RCA, which was enacted as a result of this situation, is still in force, largely unchanged. Now, approximately ten years after the Act entered into force significant experience and practice has accumulated in and around the restructuring of companies. The RCA, which was enacted quickly at a time of need, has surprisingly met with only a little criticism and few demands for change. There has, as with any new regulations, been a need for smaller technical amendments to the Act, but the nature of the RCA is still the same as in 1993, and at present no concrete reforms have been proposed. One of the major criticisms that has been raised is that too many companies which could be written off as having 'no hope' are undergoing restructuring. These cases often naturally end up in bankruptcy sooner or later, something which is very much contrary to the idea of restructuring proceedings in the first place.

## Brief overview of the RCA

The main purpose of the RCA, as mentioned before, is to provide a company that is in financial difficulties, but has the potential for survival with protection from its creditors in order to avoid bankruptcy. When restructuring proceedings are initiated, the court appoints one or more administrators. A company under restructuring retains the right to control its normal day-to-day operations during the restructuring period. However, consent from the administrator is required for important business decisions.

As a general rule, the initiation of restructuring does not affect the debtor's contractual relationships except for those regarding debts and collateral. The

beginning of the restructuring process does not have an effect on the debtor's duty to fulfil agreements where no money is involved. The RCA prohibits the debtor from terminating any agreement that is necessary for the continuance of the debtor's business without the consent of the administrator.

The purpose of restructuring is the adoption of a restructuring programme that arranges the payment of debts. The legal effects of restructuring proceedings apply only to so-called restructuring debts. Only monetary debts that were incurred (at least conditionally) before the commencement of the restructuring proceedings are deemed to be restructuring debts. Consequently, the commencement of restructuring proceedings does not affect the debtor's obligation to fulfil a contract requiring a specific performance.

Restructuring proceedings are commenced if the Court finds that at least one of the prerequisites of the RCA exists, and unless there is no hindrance to the commencement of the restructuring proceedings according to the same Act.

It is important to notice here, although the limited space of this article does not allow for further elaboration on the matter, that the RCA does not take into account financial considerations, i.e. whether it can be envisaged that a company actually has the potential for survival. A later analysis will show that this has been one of the sources of criticism against the RCA.

The adjudication of restructuring proceedings results in a period of protection, during which no debts that have accrued prior to the proceedings may be paid, collected, or enforced. Under the section stipulating a prohibition to enforce debts, the following transactions are, inter alia, forbidden:

(a) the realization or any other use of collateral;
(b) the termination of a debt or an agreement on which a debt is based, in the event of a delay in payment. However, running accounts and other similar debt arrangements may be terminated; and
(c) set-off (with certain exceptions). The Act prohibits the use of collateral for the payment of those debts that relate to a time period prior to the commencement of the proceedings.

Acts in violation of the prohibition to enforce debts are usually deemed invalid. The period of protection lasts until the restructuring programme is approved or the proceedings are interrupted by the court.

The commencement of the restructuring proceedings does not affect the payments of debts that arise during the protection period. Debts that are not considered to be restructuring debts are required to be paid on their normal due date. These regulations relate to cases where the debtor's obligation is specified as a sum of money.

An important part of a restructuring programme is the restructuring of debts that have been incurred before the commencement of the restructuring proceedings. In this context, however, it has to be noted that judges and practitioners alike seem to agree that the restructuring of the debts itself can never be regarded as the only measure that should be taken when the company is threatened with insolvency.

In principle, the restructuring programme may:

(a) alter the schedule of the payment of debts;
(b) order that instalments shall first be credited as payments of principal and only thereafter as payments of interest (i.e. prioritizing payments of principal);
(c) reduce the rate of interest for the remaining term of the obligation; or
(d) reduce the amount of the unpaid debt (this does not apply to debts secured by collateral; see below).

The debtor is obliged to amortize restructuring debts only in accordance with the terms of the programme. The court may, however, at a later stage alter or annul the restructuring programme e.g. if the debtor fails to observe the terms of the programme or the debtor is placed into bankuptcy.

It is, however, important to note that the Order of Priority Act of 1992 (hereinafter the 'OPA') recognizes three kinds of restructuring debts and that the legal status of each of them is different. The types of debt are:

(a) debts secured by collateral;
(b) ordinary debts; and
(c) debts with the lowest priority.

Debts secured by collateral have a privileged position compared with both ordinary debts and debts with the lowest priority. Debts secured by collateral enjoy the following privileges:

(a) the unpaid amount of a debt secured by collateral may not be reduced in the restructuring of debts; and
(b) if the period of payment of a debt secured by collateral is extended, the extended period may not substantially exceed the period of credit remaining according to the original terms.

In addition, the reduction of the interest on a debt secured by collateral is subject to certain restrictions.

Under the OPA, claims that arise during the protection period following the commencement of restructuring proceedings are considered to have the same status as claims against the estate in the event that the debtor enters into bankruptcy.

## Recovery in restructuring

According to the general rule of the Act on Recovery to the Bankrupt's Estate (which applies equally to restructuring proceedings), a legal act can be recovered provided that the act itself, or the act in cooperation with other acts:

(a) has favoured a creditor to the detriment of another creditor;
(b) has transferred assets beyond the reach of creditors; or
(c) incurred additional debt to the detriment of existing creditors.

Provided the recovered transaction is a gift, or a contract with characteristics of a gift, a precondition for the recovery is that the debtor was at the time of the legal act insolvent or that the act itself was a factor leading to insolvency. In addition it is required that the other party to the legal act knew or should have known about the insolvency or the excessive indebtedness, or was aware of the true nature of the act and of the effect that the legal act would have on the debtor's financial situation and of the circumstances that caused the legal act to be considered improper.

In addition to the above general rule, specific recovery rules have been incorporated into the Act on Recovery to the Bankrupt's Estate. Under the said Act, the estate may recover a gift if it has been made within one year prior to the due date. A gift that has been given before this, but within three years prior to the due date may be recovered if it has been given to a person within the debtor's sphere of interest and it is not proven that the debtor was not excessively indebted nor became excessively indebted as a result of the gift. A transfer resulting from a sale, trade or any other agreement can likewise be recovered if it can be shown that the agreement was unbalanced to the extent that the transfer should be regarded as a gift.

## The RCA in practice – EKA, a case study

The RCA has in practice had quite a significant effect on the Finnish insolvency landscape. Some large restructuring proceedings have been initiated especially at the beginning of the last decade. It is, therefore, fair to say that the RCA has had a significant effect also on the lives of ordinary citizens – not only on insolvency practitioners. It may well be concluded that the RCA has also had effects on a macroeconomic scale.

A prime example of the restructuring of a large group of companies under the RCA was the restructuring of the EKA Cooperative ('EKA'), presently operating under the name of Tradeka. It is the largest restructuring under the RCA in Finnish history.

At the time of adjudication on restructuring proceedings in 1993 EKA was the fourth-largest group of companies in the country. In 2003 the overall turnover of the Tradeka group was EUR 1221.6 million and it employed some 5000 people.

When EKA underwent restructuring in 1993, some of the businesses of the Group that were not considered to be its core areas were immediately placed into bankruptcy. Not long after the initiation of the restructuring proceedings, two of the most important companies in the EKA Group were placed into bankruptcy. The liquidation of one of them, the Kansa Insurance Group, is still going on. The business of the other, the construction company Haka, is presently being continued by another European construction company. The Tradeka Group today comprises the core business areas, i.e. the retail trade and the hotel and restaurant businesses. The company finished its restructuring proceedings in 2003.

According to the programme the restructuring debts which amounted to approximately EUR 900 million were reduced by EUR 330 million, and during the duration of the programme debts totalling EUR 570 million were paid. These figures alone show that the restructuring of EKA was, at least by Finnish standards, a significant event.

## Criticism and praise

One criticism of the restructuring system that was raised around the time of the restructuring of EKA is that the system is contrary to the principles of fair competition. According to this view, restructuring is not necessary or even desirable, since bankruptcy is a normal part of a market economy, and only removes such companies from the market which do not have the prerequisites for survival in the first place, thus providing space and opportunity for other businesses that might have more potential.

At that time the circumstances which were considered to have an undesirable effect on competition were the shortened notice period for the workers of a company undergoing restructuring, and the rights of companies undergoing restructuring to terminate lease agreements with shorter notice. When restructuring in Finland was at its most intense at the beginning of the last decade, it was even suggested that the large institutional creditors spent too much of their time and energy contemplating large restructuring plans to the detriment of time and money spent on more viable companies and businesses.

The restructuring of the EKA Cooperative is only one example of restructuring, but a large one with an ultimately successful outcome. Hence, it is easy to dismiss the above-mentioned criticisms by referring to successful restructurings with an outcome as happy as the one for EKA/Tradeka. Voices criticizing restructuring are not heard as frequently as before.

During recent years criticism has, therefore, concentrated more on certain concrete and inherent flaws in the RCA than on actually questioning the necessity of an act such as the RCA.

One major criticism which has been raised is that restructuring proceedings are often adjudicated in cases where the subject does not necessarily have a sound basis for its business, i.e. in cases where bankruptcy sooner or later becomes a reality, regardless of the initiation of restructuring proceedings. This criticism is not necessarily ill-founded. As has been mentioned above, the RCA sets out certain criteria (insolvency, near insolvency or a joint application by the debtor and creditors), one of which has to be fulfilled for adjudication on restructuring to be possible. Furthermore, there may not be any hindrance to the adjudication on restructuring proceedings, i.e. none of the particular circumstances set out in the RCA must exist. Examples of a hindrance include incorrectness in the company bookkeeping, the belief that the proceedings are being sought only with an aim to abuse the system, or if the insolvency of the company in question is irreparable etc.

It is important to notice here that the question of whether restructuring is motivated from a financial, business-oriented perspective is not raised by the RCA. Whether it is likely that a company in the foreseeable future will introduce financial gain to the capital invested in it or not is neither a precondition for nor a hindrance to the adjudication of restructuring proceedings according to the RCA. This, in practice, results in a non-negligible portion of restructuring proceedings ending up in bankruptcy.

The main argument against this criticism is that it would in practice prove to be impossible for a judge to make an assessment of a company's prospects in terms of strategic decisions and financial forecasts, and that it is, therefore, only possible to regulate the adjudication of restructuring in law in the present manner.

A second argument which has been advanced is that of a 'second chance'. If nothing else, it has been argued, rehabilitation proceedings should always be the first option, as opposed to liquidation proceedings. In case of doubt, restructuring proceedings should be granted regardless of the fact that even a quite large part of the restructuring proceedings end up in bankruptcy. It is argued that this way at least the viable companies and businesses are given a second chance and spared liquidation.

Whether one finds one or the other of the above views to be more convincing and reasonable, there seems today to be no questions raised about the necessity for a restructuring system per se in Finland. On the other hand, it is not argued that the restructuring system is perfect and entirely without flaws.