Restructuring in Estonia: Why should companies prefer restructuring proceedings instead of bankruptcy proceedings?

In every business' lifespan there may be periods, where the business doesn't have enough finances to pay their business partners on time. That doesn't mean that the company has to go bankrupt. Often, the reason for solvency problems might be that a planned positive money flow gets held up unexpectedly for some vital reason. Once the obstacle is cleared, or the market improves, the company can continue their business successfully.

When they started to draft up the restructuring law in Estonia in February of 2006, one of the main goals was to give entrepreneurs the chance to overcome temporary solvency problems under, so called, court protection. Similar laws had already been passed in most European countries, but in Estonian legal field restructuring was still a completely new institution. Beforehand there was only one course of action when faced with solvency problems – bankruptcy. Although, even during bankruptcy proceeding, it is still possible to save the company – through so called healing, but it rarely works. Restructuring was supposed to create an alternative to bankruptcy.

Although both bankruptcy proceedings and restructuring proceedings are technically insolvency proceedings, their essence and goals are complete opposites. While bankruptcy proceedings are about liquidating the company, restructuring is aimed at preserving it. A new term has risen in legal terminology – temporary solvency problems, that can be overcome by applying restructuring measures. Timewise, the restructuring law fell into a very opportune time – in December 2008, Estonia had already been hit with the economic crisis. When the legislator had expected about 10-20 restructuring applications per year, then already during the next two weeks after the restructuring law had entered into force, almost a hundred applications were submitted.

From a social perspective, restructuring has a very positive effect: through preserving jobs and satisfying claims (even partially) through restructuring proceedings, the state has the chance to save their financial resources. **The two main target groups, who benefit the most of restructuring proceedings, are the entrepreneurs with solvency problems and their creditors**. And, as paradoxical as it may be, the company undergoing restructuring can at the same time be a creditor in another restructuring proceeding.

So, during restructuring proceedings the company's and its creditors' interests collide, but is the conflict of interests as serious as it seems? In this article I wish to explain that **it is completely possible to merge the company's and its creditors' interests successfully**, which often ensures a successful restructuring.

It's obvious, that restructuring proceedings are carried out in the interest of the company undergoing restructuring. The company gets a chance to continue their business, which means preserving the entrepreneur's livelihood. The conflict between the restructured company and the creditors arises from the fact that during the restructuring proceedings, the company can transform the creditors' claims. Most of the time, it means reducing and expiating the claims. Naturally, this is not something that the creditors are particularly happy with. Every creditor would like to receive their claim in full. Usually, the creditor has already paid the VAT on the goods and services and waited for their money for months. Let's not forget that the creditors have their own invoices to pay. Any mention of only partially paying the creditor's claim is like waving a red flag in front of a bull. So, it comes as no surprise, that the creditors' first reaction to a company, who is in debt to them, initiating a restructuring proceeding, is rather negative.

So, what could those shared interests be, that would make the creditors favor restructuring? In order to answer that question, we have to remember the main goal of restructuring – restructuring is a measure to avoid bankruptcy. Creditors should consider what would happen to their claims if instead of initiating restructuring proceedings the company would initiate bankruptcy proceedings. In other words – in what amount would their claims be satisfied in bankruptcy proceedings?

During a bankruptcy proceeding, the sums received from selling the company would be distributed between the creditors. First ones to have their claims met would be the creditors whose claims are secured by a pledge, only then will the remaining sum be divided between creditors, whose claims were not secured. Talk to any trustee in bankruptcy and you'll hear that there aren't many bankruptcy proceeding where the creditors, whose claims were unsecured, get more than 40% of their claim satisfied. Often, there isn't even enough money to cover the cost of the bankruptcy proceeding. And since most of the claims are a result of a usual economic activity – creditor has sold goods or services – they end up being unsecured. That means, that in most cases, when it comes to bankruptcy proceedings, the creditors can only get 0%-40% of their claims met.

The supreme court has indicated in one of their decisions that companies can pay the creditors less during a restructuring proceeding than they would during bankruptcy proceedings. As a specialist, who has dealt with restructuring proceedings, I can assure that creditors can usually get anywhere between 50%-100% of their unsecured claims repaid. Often the claim is only expiated, not reduced. Let's assume, that the restructured company offers to pay 60% of the unsecured claims. Doesn't seem like much, and it isn't, but it's significantly more than 0%-40% that they would get if the company went bankrupt.

This is the main reason why restructuring can be beneficial to creditors as well. The company essentially protects the creditors' interests when initiating the restructuring proceedings. And yes, choosing the lesser evil might not be the road to bliss, but when you think about it, choosing 60% over 40% is just the reasonable thing to do.

In order to repay the creditors' claims, the restructured company must get them to approve the restructuring plan. The restructuring plan is sent to creditors about 30 days after the restructuring proceedings have been initiated. Every creditor has a chance to vote about whether the restructuring plan should be approved or not, and they have to do so by the set deadline. My advice to all the creditors is to not cast your vote based on your first emotion. All restructuring plans, that the author of this article has been a part of, offer a substantially better solution for creditors than bankruptcy proceedings could.

Better yet, try to find out what you could get in a bankruptcy proceeding. If the amount of satisfied claim will be higher in restructuring proceeding, then it makes sense to vote for the restructuring plan. Even if at first it seems unfair to voluntarily give up a part of your claim. Restructuring plans, drafted by the author of this article, usually include a bankruptcy estimate, which clearly shows the amounts you would get in a bankruptcy proceeding, which makes deciding a lot easier.

As you can see, restructured companies and their creditors really do share common interests. I sincerely hope, that the articles that have been published during the month of December can help change the attitude towards restructuring even by a little. Two main points that business owners should take from these articles is that 1) there is no need to fear restructuring – you will also help protect the interests of your creditors, and 2) when you find yourself in the middle of a restructuring proceeding as a creditor, don't make your decisions based on your immediate emotions – the rational thing to do might seem unfair, but financially it is always more beneficial to approve the restructuring plan.

Need help with restructuring? Contact Veikko Toomere!

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