

# **Bankruptcy and a fresh start: stigma on failure and legal consequences of bankruptcy**

## **Finland**

### **TITLE 1. INTRODUCTION**

The main provisions of Finnish insolvency law are found in the Bankruptcy Act (9.11. 1868). Consistent with the practice at the time, most of the Bankruptcy Act mirrored sections of Sweden's bankruptcy legislation. The Bankruptcy Act has since been amended on several occasions, most significantly during the recession of the 1990's, and interpretation by the courts has further modified its application. Despite these changes, however, many parts of the original Bankruptcy Act remain in force as originally drafted in 1868.

Bankruptcy is essentially an asset distribution procedure. In the case of insolvency, the Bankruptcy Act's purpose is to allow an equal distribution of a debtor's assets in order to satisfy creditors' claims. In economic terms, bankruptcy is primarily a judicial procedure that brings to a close the ongoing activity of businesses that are unprofitable or otherwise not financially viable.

While the Companies Act (29.9.1978/734) centrally regulates the liquidation process, separate provisions of Finnish law govern bankruptcy, restructuring, and the adjustment of debts of a private individual. This divergence in insolvency legislation is a relatively new phenomenon. Current laws on restructuring and adjustment of debts arose out of the deep recession witnessed in Finland in the 1990's. Traditional bankruptcy was considered too harsh for most individuals and often impractical for businesses that were economically intact but in need of reorganization. New laws were thus enacted to give debtors the opportunity to continue with business while recovering from financial difficulties.

The Restructuring of Enterprises Act (25.1.1993/47) deals with the rehabilitation of viable enterprises and the rescheduling of debts by emphasizing the active continuation of business during the restructuring process. This allows troubled enterprises to retain their employees, goodwill and other intangible assets during restructuring proceedings. The retention of employees furthers the social goal of maximum employment, and maintaining a business' income flow can often result in creditors receiving a greater proportion of their extended debts than they would have if the business simply wound-up its activities.

The Act on Adjustment of the Debts of a Private Individual (25.1.1993/57) attempts to remedy the financial situation of an insolvent private individual upon the issuance of a court order. Under this act, debtors must commit to a payment schedule for several years. By attempting to prevent the permanent displacement of indebted individuals, this act's goals are closely linked to Finnish social policy.

The Act on the Recovery of the Bankrupt Estate (26.4.1991/758) and the Act on the Priority of Claims (30.12.1992/1578) apply to all insolvency situations.

Central provisions of insolvency situations are to be found in the acts of insolvency legislation mentioned above. In addition, certain special statutes in other branches of law refer to the provisions of insolvency legislation.

A significant portion of the Bankruptcy Act deals with the different judicial phases of the bankruptcy procedure, as well as defining and regulating the status of debtor and creditor. Under Finnish law, both natural and legal persons may be declared bankrupt. Bankruptcy, however, is much more common among corporations and other legal persons. Proceedings may be initiated either by application of the debtor (voluntary bankruptcy) or upon the request of creditors (involuntary bankruptcy).

During a bankruptcy proceeding, the bankruptcy estate administers the debtor's assets. Proceedings continue until final settlement and clearance is achieved, all the bankruptcy estate's accounts are rendered and its property is realized, and the debtor's assets are distributed to its creditors.

In January 2002, a legislative working party passed a proposal of a government bill for a new Bankruptcy Act. When enacted, this proposal will clarify existing bankruptcy legislation.

The proposed new Bankruptcy Act focuses primarily on the form of bankruptcy proceedings and on modernizing certain formulations. The new act will not significantly alter the present status of creditors and debtors in, or the substance of, bankruptcy procedure; in fact, the substance of several of the original provisions of the 1868 Bankruptcy Act will continue in force even if the new Bankruptcy Act is enacted as proposed.

The proposal of the government bill will be presented to Parliament during the spring 2002. Once endorsed by Parliament, the reformed legislation is expected to become law in 2003.

## **TITLE 2. DEFINITIONS AND TERMINOLOGY**

The significant insolvency procedures used in Finnish bankruptcy legislation and practice are defined below. These procedures, as well as other pertinent concepts, are stated in both Finnish and English. Please note that, due to the lack of official translations from the Finnish authorities, the English terminology provided here may differ from terminology used in other similar literature or commentary.

### **1. “*Yrityssaneeraus*” hereinafter “*restructuring of enterprises*”**

The main provisions relating to the restructuring of enterprises are found in “*Laki yrityksen saneerauksesta*” (hereinafter “*Restructuring of Enterprises Act*”). A company in financial distress may avoid bankruptcy through “*saneerausmenettely*” (hereinafter “*restructuring proceedings*”). In most cases, the restructuring debts are reduced by a certain specified percentage.

The central figures in the restructuring proceedings are:

- i. “*Selvittäjä*” hereinafter “*administrator*”. The administrator is appointed by the court. In general, the administrator’s duty is to safeguard the creditors’ interests by preparing a proposal for the restructuring plan, monitoring the debtor company, etc.
- ii. “*Velkojatoimikunta*” hereinafter “*creditor’s committee*”. The creditor’s committee is a body that assists and monitors the administrator.

Other important terminology:

- iii. “*Menettelyn alkaminen*” hereinafter “*initiation of proceedings*”. This term refers to the moment at which the court decides to initiate restructuring proceedings.
- iv. “*Maksukyvyttömyys*” hereinafter “*insolvency*”. This term refers to the debtor’s other than temporary inability to pay its debts as they come due.
- v. “*Saneerausvelka*” hereinafter “*restructuring debt*”. This term refers to the sum of the debtor’s debts that arose prior to the initiation of restructuring proceedings, including secured debts as well as debts for which the consideration or amount is contingent, contested or otherwise uncertain. Liability deficits for pension foundations established by the debtor, however, are not considered restructuring debts.
- vi. “*Esinevakuusoikeus*” hereinafter “*security right (to property)*”. This term refers to the reservation of title and other security rights based on ownership, the pledge of chattels or liens on real property, the right of repossession, and the right of retention that results in a priority right in the property in question.
- vii. “*Vakuusvelka*” hereinafter “*secured debt*”. This term refers to a restructuring debt as security for which the creditor retains a security right to property belonging to, or in the possession of, the debtor. This security right is effective with respect to third parties. Such a restructuring debt is deemed to be secured only to the extent that, at the initiation of restructuring proceedings, the value of the security is sufficient to cover the amount of the creditor’s claim, after liquidation costs and claims having a higher priority are deducted.
- viii. “*Viimesijainen velka*” hereinafter “*subordinated loan*”. This term refers to a debt that may be paid only after all other debtors are satisfied.
- ix. “*Maksu- ja vakuudenasettamiskiello*” hereinafter “*automatic stay on payments and on deposit of security*”. After proceedings are initiated, the debtor may not pay any restructuring debts nor provide collateral security for such debts.
- x. “*Perintäkielto*” hereinafter “*automatic stay on the collection of debts*”. After proceedings are initiated, no measures may be directed at the debtor in order to collect a restructuring debt that is subject to the automatic stay on collection, or in order to ensure payment of such debt. Any such measures that have already been initiated may not be continued. This does not prevent, however, a creditor for filing a suit against debtor in court.

- xi. “*Saneerausohjelma*” hereinafter “*restructuring plan*”. The restructuring plan shall contain, *inter alia*, the statement regarding the debtor’s financial status and other circumstances affecting the restructuring, as well as orders on measures and arrangements affecting the debtor’s and creditors’ position regarding the continuance, alteration or termination of operations.
- xii. “*Saneerausohjelman vahvistaminen*” hereinafter “*confirmation of the restructuring plan*”. In general, the court is obliged to confirm the proposed plan, provided that a certain specified proportion of creditors approves it.

## 2. “*Selvitystila*” hereinafter “*liquidation*”

The main provisions on liquidation are found in “*Osakeyhtiölaki*” (hereinafter “*Companies Act*”), which applies to limited liability companies. Liquidation may occur under several circumstances, e.g., when the company’s equity has decreased below a certain specified level. Liquidation procedures are usually initiated by the shareholders’ meeting, however, in some cases a company may be placed involuntarily into liquidation by the court or the registration authority. Generally, liquidation ends with the company’s dissolution.

The central figures in a liquidation are:

- i. “*Yhtiökokous*” hereinafter “*the shareholder’s meeting*”. The shareholder’s meeting is entitled – and in some cases, obliged – to place the company into receivership.
- ii. “*Selvitysmies*” hereinafter “*the liquidator*”. Liquidators manage the company’s financial and other affairs during the liquidation. The liquidators are entitled to continue the company’s business activity only when considered appropriate in light of the aim of the liquidation.

## 3. “*Konkurssi*” hereinafter “*bankruptcy*”

The main provisions on bankruptcy are found in “*Konkurssisääntö*” (hereinafter “*Bankruptcy Act*”).

The central figures of a bankruptcy are:

- i. “*Pesänhoitaja*” hereinafter “*administrator*”. “*Administrator*” is a general concept covering the three roles mentioned below.
- ii. “*Väliaikainen pesänhoitaja*” hereinafter “*provisional administrator*”. Once the court declares the company bankrupt, the provisional administrator is liable for, *inter alia*, deciding whether or not to continue the business activity of the company, dismissing employees and drawing up the estate inventory. The provisional administrator’s term expires upon the appointment of a *trustee*. However, the provisional administrator may be appointed as a trustee as well.
- iii. “*Uskottu mies*” hereinafter “*trustee*”. The court appoints the trustee at the hearing of creditors. The trustee is liable for, *inter alia*, convening the creditors’ meeting, establishing the grounds for recovery and realising movable property. The

trustee's term expires when the prescribed time for proof of debt in bankruptcy expires.

- iv. "*Toimitsijamies*" hereinafter "*executor*". Unless the trustee is discharged from its duty, the trustee will act as executor after the expiration of the time limit for proof of debt. The executor's fundamental duties are to liquidate the property of the bankruptcy estate and, if necessary, commence a recovery action.
- v. "*Velkojainkokous*" hereinafter "*creditors' meeting*". The agenda of the creditors' meeting includes, generally, topics such as: "the provisional liquidator's status report"; "the continuance of business activity of the bankruptcy estate", "the liquidation of movable and immovable property", etc.

Other important terminology:

- vi. "*Maksukyvyttömyys*" hereinafter "*insolvency*". Insolvency refers to the debtor's other than temporary inability to pay debts as they fall due.
- vii. "*Konkurssihakemus*" hereinafter "*bankruptcy petition*". Either the creditor or the debtor may file a bankruptcy petition with the court (*voluntary/involuntary bankruptcy*).
- viii. "*Konkurssiin asettaminen*" hereinafter "*adjudication in bankrupt*". The bankruptcy starts once the debtor is determined by the court to be bankrupt, irrespective of whether the debtor or creditor filed the bankruptcy petition.
- ix. "*Velkojainkuulustelu*" hereinafter "*hearing of creditors*". The hearing of creditors includes three important phases: 1. the debtor swears to the correctness of the estate's inventory; 2. the court orders whether the bankruptcy will continue, become void or cancelled; 3. the trustee(s) is nominated; and 4. the notice of public summons is given *ex officio* by the court.
- x. "*Konkurssin raukeaminen*" hereinafter "*cancellation of bankruptcy*". Upon examining the amount of the bankrupt estate's assets, the court determines whether the bankruptcy will continue or be cancelled.
- xi. "*Takaisinsaanti (konkurssipesään)*" hereinafter "*recovery (to a bankruptcy estate)*". In general, the trustee is responsible for establishing the grounds for recovery. The trustee or a creditor may initiate recovery action, however, this is normally initiated by the receiver in stead of the trustee or a creditor.
- xii. "*Konkurssivalvonta*" hereinafter "*proof of claim in bankruptcy*". If the creditor fails to prove its claims in accordance with the Bankruptcy Act, the creditor generally forfeits its right to compensation.
- xiii. "*Saatavien riitautus*" hereinafter "*objection to claims*". The debtor, the creditors as well as the administrator are all entitled to contest the claims. The court will examine any such contest.

- xiv. “*Konkurssituomio*” hereinafter “*bankruptcy judgement*”. The judgement in bankruptcy includes provisions on ordering the claims, which have been duly lodged, to be settled or disallowed. A proof of debt is sustained if it hasn’t been traversed.

### TITLE 3. WARNING LIGHTS AND PREVENTION OF INSOLVENCY

#### The Existing Procedures to Detect Companies in Financial Difficulties

When a company does not have sufficient resources to fulfill its payment obligations, it normally acquires extra financing externally, whereby the company usually increases its short-term liabilities. If a company’s solvency is weak, its possibility to successfully attract extra finance is likewise weak. In this case, the company can defer its payments, which will naturally lead to a delay in payments. If this delay in payments extends for a long period of time, the delay will be seen as a disruption in payments. If the company’s incapacity to meet its payment obligations becomes more permanent, the company will probably face either restructuring or bankruptcy.<sup>1</sup>

Disruption in a company’s payments is usually the first sign of an upcoming insolvency and may often be predicted by analyzing the company’s annual report and accounts. Most Finnish companies are obliged to deliver their annual financial statements to the Trade Register after certain period from the end of the financial period. After the delivery the documents are considered to be public. If company is a part of group, the parent company’s consolidated financial statements must also be taken into account. A financier or contract partner may also necessitate that it may familiarize with the interim financial reports before entering into a financial or contractual relationship.

Financial statements may provide more specified information about the weakened financial status of a company as accountants are obliged to remark of certain irregularities in company’s capital and express them in the auditor’s report.

Public limited liability companies<sup>2</sup> have even stricter obligations to publish information according to the Securities Markets Act (26.5.1989 /495). The obligation comprises, *inter alia*, an obligation to publish prospectus prior to initial public offering and, after that, to inform of matters that may affect the value of the company.<sup>3</sup>

It is worth mentioning, that if the equity of a limited liability company has decreased below half of its share capital, the management of the company has, according to the Companies Act (29.9.1978/734), to convene the general meeting of the shareholders to handle the placing of the company into liquidation. In some cases a company may be placed involuntarily into liquidation by the court or the registration authority. Liquidation is a procedure where all the debts of a company are paid and the residue, if any, is distributed to the shareholders. It is, along with bankruptcy, a mean to prevent a company from running into deeper debts. There does not exist any general obligation for a company to file for its bankruptcy. Companies Act obliges, however, the management to place the limited liability company in liquidation under certain preconditions and to

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<sup>1</sup> Laitinen, p. 16.

<sup>2</sup> Companies that have their shares quoted in a public marketplace, i.e. a stock exchange.

<sup>3</sup> Securities Markets Act (26.5.1989/495), chapter 2.

file for bankruptcy, if company is unable to pay its debts with its assets<sup>4</sup>. The latter provision is obviously vague.

When analyzing a company's disruption in payments, the most significant variable is its equity ratio and its modifications. The other significant variables are company's profitability, size, growth and any delay in the publication of its financial statements. Investors often include terms or tolerated range of the balance sheet variables such as equity ratio, debt-equity ratio and return on capital, in finance contract as covenants to monitor the solvency of the company.

A company's background information can also be taken into account when explaining a disruption in payments. This kind of information is mostly connected to the management and the connections to other companies experiencing disruption in payments and to modifications of these two types of background information.

There are several companies that are specialized in providing companies a monitoring service of other companies. The monitoring informs of the changes in companies clientele at desired intervals. Companies can immediately react to the improved or weakened financial standing. Company may, for example, follow the payment pattern of the clients, follow the changes of business names, creditworthiness or the rating classification. The monitored subjects may comprise companies and managements, entrepreneurs, foundations, housing corporations, and consumers.

Commercial rating companies provide ratings that usually give a reliable reference on the financial status of companies.

The Official Journal (in Finnish "Virallinen Lehti") is one of the most important sources of information on the companies. Public summons in bankruptcies, notices of compulsory public auctions, summons to the meetings of creditors in bankruptcies, mergers and notices of the initiations of restructuring procedure are, *inter alia*, published in the Official Journal.

General macroeconomic circumstances, e.g., - activity in of the markets, the availability of financing, interest levels, a company's indebtedness and competitive position – affect the likelihood of bankruptcy. For example, a company's competitive position is clearly a conditional factor: it varies in different lines of business and it is difficult to measure with any degree of precision.<sup>5</sup>

A company's capital structure can vary in different lines of industry, and can be based on many factors, for example immovable assets, floating assets, capital consumption and equity ratio. A company's propensity to bankruptcy varies based on its line of business. As stated above, debt-equity ratio has a significant effect on company's susceptibility to bankruptcy. The likelihood that a company will experience a disruption in payments varies from business to business, and certain type of disruptions – for example delays of payment, bills of exchange, acts of protest and disruption in book credits – can often predict a forthcoming bankruptcy.<sup>6</sup>

A company's tendency experience a disruption in payments in different lines of business can be estimated by calculating the proportion of companies with disruption in payments from all companies in a line of business.<sup>7</sup> In determining the likelihood of a disruption of payments, developing models to explain and predict disruptions in payments in different lines of business can be helpful. For example a decrease in production, weakening economic outlook, reduction in the

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<sup>4</sup> Companies Act (29.9.1978/734), chapter 13, paragraph 11 a.

<sup>5</sup> Takala - Virén, p. 39 – 59.

<sup>6</sup> Ibidem, p. 39 – 40.

<sup>7</sup> Ibidem, p. 48.

volume of orders and changes in the utilization of capacity can help to predict disruptions in payments.

Stock exchange quotations provide information on different lines of business. However, this information is often volatile, and therefore must be used relatively.<sup>8</sup> Other sources of information that should be regarded with reservations are the press, various analysts, and the Internet, e.g. the websites of companies.

Banks and other financiers, insurance companies as well as tax authorities and the government guarantee authority naturally screen more systematically companies they are involved with as they often are the major creditors of every company. Tax authorities are able to monitor closely the disruptions in tax payments.

### Methods of Preventing Insolvency<sup>9</sup>

Developing of business activity in order to avoid insolvency usually creates a temporary need for extra financing. When a company is facing financial difficulties, its financial status is seldom such that it can finance development measures through income financing. For this reason, the company needs more equity or borrowed capital. If the owners are not able to invest more paid-up capital in the company, the company usually must turn to a bank in order to obtain borrowed capital. To do this, the company very often must present the bank with a business development plan to allow the bank to determine whether the company's threatening financial difficulties can be prevented. It is possible to agree to extend the payment schedule with the bank with installment payments. If the bank deems that the company's business activity will get prominently ameliorate in the future, it may reduce the interest or other financial costs of the credits for a certain period of time, subordinate old loans or grant the company new capital.

A nearly insolvent company is seldom able to offer securities. Therefore, it must be able to establish a number of factors regarding its financial status for investors of new capital before any investment is likely. Such factors include, *inter alia*, the current value of the company's property and securities, pending trials and tax debts. In order to make the investment of capital in the company profitable for investors, the company must yield profit in the long term, which requires healthy business activity with the income and the expenditure in balance. It is not uncommon, that contract partners require payments in cash when a company cannot provide them with securities. Diligent and efficient debt collection is a method for preventing the possible damage of the insolvency of other companies to the solvency of the collector.

A significant factor for a company's liquidity is its own terms of payment. With an adequate selection of terms a company may arrange funding efficiently. On the other hand, selecting deficient terms of payment may weaken the liquidity focally. The unnecessary amount of assets in reserves creates a problem with the turnover and may trigger insolvency.

A company is usually more or less dependant on its business partners. It should therefore observe the financial status of its business partners with the help of the above-mentioned monitoring services for example. Observing improves the collection and thus the liquidity of the collector company. In order to avoid credit loss, a company may use a reservation of title clause in its contracts. The legal praxis concerning the validity of reservation of title clauses in bankruptcies,

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<sup>8</sup> Ibidem, p. 56.

<sup>9</sup> See generally, Scmitz – DeWachter - Jaatinen p. 160 – 162.

however, is somewhat ambiguous. The provisions formed by the applicable legal praxis concerning such clause are to be included in the proposed Bankruptcy Act <sup>10</sup>.

Voluntary arrangements between the debtor company and its creditors may be agreed upon. Creditors other than banks, however, will rarely agree to a voluntary restructuring of debts. If the company also has significant debts to non-bank creditors, for example large tax debts, even banks may refuse to agree to restructure that company's debts.

If a company is unable to obtain equity or borrowed capital, the company's management may submit a petition for restructuring. This step is worthwhile if the company's business activity is profitable, but the business procedure does not cover its financing costs or if the company's business activity is affected by certain temporarily adverse factors, such as unsuccessful short-term investments.

## **TITLE 4. LEGAL POSSIBILITIES TO CONTINUE ECONOMIC ACTIVITIES**

### **Chapter 4.1. Restructuring of Enterprises**

#### *§ 1. Comprehensive description of the regime as well as its underlying philosophy*

##### 1.1. Description

The Restructuring of Enterprises Act (hereinafter "the Act") outlines the purpose and philosophical underpinning behind the restructuring of enterprises. According to the Act's provisions, restructuring proceedings may be undertaken when a viable enterprise is in debt and experiencing financial difficulties to rehabilitate the enterprise or preserve its operational requirements and rearrange its debts. Restructuring proceedings may concern, inter alia, the company's type of business, its organization, personnel, assets, capital structure, etc.<sup>11</sup> Accordingly, restructuring proceedings do not merely aim to rearrange a company's debts, but also to comprehensively reorganize the company. While the Act contains the relevant legal regulation governing restructuring of enterprises, certain e.g. labor and corporate laws will also generally apply to restructuring proceedings.

The Act's scope of application is quite wide. Restructuring may apply to single proprietors, farmers and fishermen, general partnerships, limited partnership companies, limited companies, cooperative societies, housing companies as well as to associations whose activities are economic in nature.

All creditors must be treated equally. Within restructuring, restructuring debts are usually reduced (it is worth mentioning that this debt deduction is the only restructuring procedure for which the Act provides detailed provisions). Restructuring debts are usually structured in such a manner that creditors are entitled to a certain percentage of the original debt. One must take a critical approach to the generalization that restructuring is an alternative to bankruptcy; if a company is not viable, restructuring is not a realistic option.<sup>12</sup>

According to the Act, both the debtor and a creditor may file the restructuring petition. The restructuring proceedings begin with a court order. If there is a bankruptcy petition pending against

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<sup>10</sup> Memorandum of a Working Party on the New Bankruptcy Act, 22.1.2002, p. 92.

<sup>11</sup> Koskelo, p. 14.

<sup>12</sup> Koskelo, p. 8.

the debtor at the time a restructuring petition is submitted, consideration of the bankruptcy petition is postponed until a decision on the initiation of the restructuring proceedings is rendered by the court. Restructuring cannot be initiated if the debtor company is in liquidation. After proceedings are initiated, an automatic stay on payments and deposit of security, as well as on the collection of debts, comes into force. Generally, the initiation of restructuring proceedings will not affect the debtor's existing commitments. The initiation of proceedings will, however, stop the accrual of penalty interest on the restructuring debt.

According to the Act, once proceedings are initiated, the debtor must obtain the administrator's consent in order to carry out its operations and transactions, which are not to be considered minor or customary.<sup>13</sup> Once the restructuring plan is confirmed by the court, the terms for restructuring the debtor's debts and other legal relationships regulated in the plan are defined in accordance with the plan. Unknown restructuring debts are extinguished once the plan is approved, unless such debts come to the attention of the administrator prior to confirmation of the restructuring plan.

## 1.2. Critical analysis

The Act came into force in 1993. Accordingly, from a historical point of view, the Act is somewhat novel piece of legislation. The Act is deemed quite successful and only minor amendments have been made to it afterwards.

Lawyers experienced in restructuring enterprises have taken notice of the fact that some creditors hold certain irrational, hostile or emotional attitudes towards restructuring. These creditors often view the debt deduction aspects of restructuring as unfair, without taking into account the fact that their interests would not likely be better served if the debtor company was declared bankrupt.

Confirming a restructuring plan often requires more time than originally anticipated, which can complicate the subject company's day-to-day business activities. Close collaboration between the debtor and its creditors, therefore, is a necessary aspect of any successful restructuring.

It has been said that restructuring proceedings are often used by enterprises without actual viability. According to one study, 31 per cent of all enterprises for which a restructuring plan was confirmed during the years 1993 – 1994, had, by 1997 been declared bankruptcy. This tendency to use the assets of a debtor company to support otherwise unprofitable business activities is undesirable from the creditors' point of view.<sup>14</sup>

### *§ 2. Classification of the procedure among branches of law, competent jurisdictions, overview of the procedure followed before these jurisdictions, implications of international private law*

Restructuring of an enterprise is classified as a non-adversarial civil matter.<sup>15</sup> As a general rule, restructuring proceedings are considered by the district court in the jurisdiction in which the debtor's administration is primarily conducted. However, in order to provide expert knowledge, there are nineteen specific district courts in Finland that deal with restructuring matters. The court in which the parent company's restructuring proceedings are pending also handle the restructuring of that company's subsidiary entities. If a matter concerning the restructuring proceedings of the parent company is instituted after the subsidiary's proceedings have begun, the court considering

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<sup>13</sup> It is possible, however, to carry out restructuring proceedings without an administrator. This type of restructuring is called "simplified restructuring proceedings". See chapter 13 of the Act and Koskelo, p. 32.

<sup>14</sup> Sundgren II.

<sup>15</sup> Koskelo, p. 30.

the subsidiary's restructuring may remove the matter to the court in which the parent company's restructuring proceedings are pending.

The role of the court in restructuring is similar to its role in regular civil cases, i.e., where disputes may be settled by the parties out of court (discretionary cases). Accordingly, the court does not take an active role in the process. Instead, the parties to the restructuring determine the progress of the case. The court resolves disputes at the parties' request. Except for issues involving a dispute between the parties, proceedings are usually carried out by one judge based on written documents submitted by the parties. Disputes are addressed in oral hearings in accordance with the general judicial procedural rules.<sup>16</sup>

Restructuring proceedings initiated in Finland deal with all of a debtor company's assets and debts. Any property of the debtor that is located abroad will also be used for the benefit of all creditors. However, the competence of Finnish administrators will not necessarily be recognized in another state. Foreign insolvency procedures are not normally recognized in Finland. An exception to this is the bankruptcy treaty that has been signed between the Nordic countries, according to which a bankruptcy initiated in one of the Nordic countries is recognized in the others. However, the treaty will be replaced by the EC Regulation on Insolvency Proceedings that will enter into force on 31 May 2002.

### *§ 3. Criteria to benefit for the regime*

#### 3.1. Description

It has been said that the grounds for restructuring are macroeconomic in nature.<sup>17</sup> At the same time, restructuring and other insolvency proceedings are also designed to benefit creditors. In other words, social factors, and any possible benefit to the debtor company, are not considered to be crucial when weighing one proceeding against the other.

Under the Act, if one or more unsecured creditor can show that it is probable that they would be better off after the debtor company's bankruptcy, compared with the compensation they would receive in an eventual restructuring, the restructuring plan may only be confirmed with that creditor's consent.<sup>18</sup>

#### 3.2. Critical analysis

It is worth noting that the essence of official restructuring proceedings does not differ from that of unofficial restructuring. In both proceedings, the fundamental questions are: are the creditors willing to give the debtor the opportunity to continue business activities via restructuring, and are the financiers willing to continue doing business with the financially distressed debtor company? In a market economy system, it is considered necessary for financiers to be able to independently decide whether or not to continue financing a company.<sup>19</sup>

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<sup>16</sup> Koskelo, p. 29 - 30.

<sup>17</sup> Koulu I, p. 2.

<sup>18</sup> In order to prevent the restructuring plan to be confirmed by the court, such creditor must vote against the plan.

<sup>19</sup> See Koskelo, p. 36 – 37.

## *§ 4. Specification of the possible initiators of the procedure*

### 4.1. Description

According to the section 5 of the Act, a petition for restructuring may be submitted by either (i) the debtor, (ii) a creditor or several creditors together excluding, however, any creditors the consideration or essential amount of whose claim is contested or whose claim is otherwise unclear, or (iii) a party for whom the debtor's insolvency would likely cause a financial loss based on their right to a claim for reasons other than partnership with that debtor (a "probable creditor").

If the debtor entity is a general or limited partnership, any partner with the right to represent the company may submit the restructuring petition. However, with respect to the internal decision-making of the debtor company, any decision to submit a restructuring petition requires the consent of all active partners in order to be valid. When submitting the restructuring petition, a general power of attorney from all partners is deemed sufficient to confer the partners' consent.<sup>20</sup>

Under the Companies Act, the submission of a restructuring petition for limited liability companies requires the consent of the shareholders' meeting, and a document reflecting such consent must be submitted to the court. However, the company's board may submit the restructuring petition, provided the then-current situation is in its view, urgent. The shareholders' meeting, however, has the final power to decide whether to proceed with the restructuring or withdraw the petition. The petition may be withdrawn at the direction of the shareholders at any time prior to the initiation of the restructuring proceedings.

### 4.2. Critical analysis

It is worth noting that irrespective of the section 5 of the Act, not all creditors with uncontested claims are entitled to submit a restructuring petition. According to the section 6, the debtor together with at least two creditors whose aggregate claims represent at least one fifth of the known claims against the debtor may always submit such a petition. A single creditor alone, or several creditors who do not conform to the above-mentioned requirements, may submit a restructuring petition when the debtor is already insolvent.

When the debtor is facing threatening insolvency, the last-mentioned creditors may submit the petition only if it is necessary to secure their considerable financial benefit or to prevent endangering such benefit. According to the government bill on the Act, a typical example of such creditor is a creditor with a long-term significant financial relation with the debtor.<sup>21</sup> The rationale behind this rule is that normal collection procedures are generally deemed sufficiently efficient to address the interests of creditors with only a minor claim.

As stated above, possible creditors are also entitled to submit the restructuring petition. In practice, the most significant example of a possible creditor is a guarantor.<sup>22</sup>

## *§ 5. Administration of the procedure*

Under the Act on Restructuring of Enterprises, the court appoints an administrator or, when necessary, several administrators, after initiating the procedure. The administrator's duties include

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<sup>20</sup> Koskelo, p. 51.

<sup>21</sup> Government bill on Restructuring of Enterprises Act, 182/1992, p. 22 and Koskelo, p. 56.

<sup>22</sup> Government bill on Restructuring of Enterprises Act, 182/1992, p. 22 and Koskelo p. 56.

preparing a proposal for the restructuring plan, following and supervising the debtor's operations, and taking measures to fulfill the purpose of the restructuring procedure and protect the creditors' interests.

If the creditors feel that an administrator is not required to monitor the debtor's operations, prepare the proposal for a restructuring plan or to otherwise carry out the restructuring, one may not be appointed.

A creditors' committee may be appointed to supervise and assist the administrator. As a certain interest group, the creditors' committee looks after the creditors' interests, and may not decide on matters concerning the debtor's restructuring.

A supervisor may be appointed to supervise the implementation of the restructuring plan on behalf of the creditors. The supervisor reports to the creditors' committee on the plan's implementation at times specified. If no supervisor is appointed, the debtor will supply the report.

According to the Act on the supervision of the Administration of Bankruptcy Estates, the Bankruptcy Ombudsman administrates the restructuring. The Bankruptcy Ombudsman has the right to inspect documents relating to the restructuring procedure and to attend meetings of the creditors' committee. The court may direct the administrator to fulfill a task or a duty pertaining to his office. The court may also dismiss the administrator at the request of the Bankruptcy Ombudsman or, if the administrator has fundamentally neglected his duties or if its fee clearly exceeds reasonable limits, reduce the administrators' fee as initially set by the creditors' committee.

#### *§ 6. Restructuring plan*

The administrator's duty is to prepare and submit a proposal to the court for a restructuring plan in collaboration with the parties. The parties may also prepare alternative proposals. Creditors enjoy an equal status in the arrangement of debts outlined in the restructuring plan.

The restructuring plan is divided into three parts: the assessment, the procedure, and the monitoring.<sup>24</sup> The restructuring plan must specify the measures and arrangements proposed to rehabilitate the debtor's operations, the administrator's justifications for such measures, as well as how such measures will affect the position of the debtor and its creditors. Matters concerning the debtor's assets, obligations, operations and plan for rescheduling debts should also be stated in the restructuring plan.

After the proposal for a restructuring plan is submitted to the court, the court will provide creditors the opportunity to comment on the proposal. The creditors may vote to either accept or reject the proposed plan. The administrator may revise the proposal in light of the creditor's comments, if considered necessary.

The restructuring plan may be confirmed with the consent of all creditors. If so confirmed, the plan's contents may differ from the provisions regarding the status of restructuring creditors contained in the Restructuring of Enterprises Act.

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<sup>23</sup> Koskelo, p. 210.

<sup>24</sup> Koskelo, p. 251.

The plan may also be confirmed once accepted by a majority of each of the creditor groups. Creditors are divided into three different groups according to their priority and the nature of their claims, as follows:

- (1) Secured creditors, according to the type of their security rights,
- (2) Unsecured creditors, according to other claims that have a similar consideration, and
- (3) Creditors whose claims are worth less than a specified amount.

However, the plan may not be confirmed if its contents either violate the rights or entitled interests of the debtor, a partner, a shareholder in the debtor company, or any third party, if the plan is unreasonable relative to the interests of any such person, or if there is a justified reason to presume that the conditions on which the plan's implementation is based do not in fact exist.

Once the plan is confirmed, it will set the parties' liabilities to pay restructuring debts and observe other legal relationships. The confirmed plan replaces any previous agreements by the parties regarding the debtor's debts. The confirmed plan is only of legal effect relative to the debtor's restructuring debts; restructuring debts not known at the time of the plan's confirmation are extinguished once the plan is confirmed. If the debtor defaults on an obligation to make any payments under the confirmed restructuring plan, that obligation may be enforced in a separate civil action.

In addition, the restructuring plan may include special grounds for terminating the plan. Termination means that the debts' conditions revert to their status before the plan was confirmed. If the debtor is declared bankrupt, the whole restructuring plan will terminate.

The contents of the confirmed restructuring plan may be changed only with the consent of those creditors whose rights are affected by the change.

#### *§ 7. The Actor's degree of protection implied in the procedure*

As a general rule, the debtor retains the right to dispose of his property and carry out direct operations after the initiation of the proceedings. The debtor may not incur any debts, unless such new debts are connected with the debtor's normal operations and the amount and terms of such debts are not unusual.

After the initiation of proceedings, the debtor may not pay any restructuring debt nor provide collateral security for such a debt. An automatic stay on payments and the collection of the debts, as well as the furnishing of security, come into force once proceedings are initiated. The debtor must obtain the administrator's consent to all operations and transactions that are not considered minor or customary.

No measure to collect or otherwise ensure the payment of a debt that arises prior to the initiation of proceedings may be directed at the debtor. The debtor's property may not be subjected to execution for any restructuring debt that arises prior to the initiation of the restructuring procedure, and any offset of debts is prohibited.

Those creditors who would have an equal right to receive payment outside of the restructuring procedure also enjoy equal status in the arrangement of those debts included in the restructuring plan. The arrangement of debts does not affect the permanence of content of a creditor's security right to the debtor's property. Restructuring debts are divided into three categories:

- (1) Debts secured by a collateral;
- (2) Secured debts; and
- (3) Non-secured debts.

Debts secured by collateral have a privileged position. Secured debts are protected up to the value of the security. Non-secured debts have a weaker position, and these debts are paid after the above-mentioned secured debts.. A creditor's arrangement to secure a debt may, however, be altered by substituting the security with some other sufficient security.

The operations of the debtor company may be restricted at the request of the administrator or the creditors if there is a risk that such operations are likely to injure or endanger the creditors' interests. In the event the debtor company takes abusive measures in carrying out its operations, the administrator may request that a court of first instance order the company to cease such measures.

During the restructuring procedure, shareholders' retain the right to make decisions regarding the company. This decision making power is, in practical terms, limited by the creditors' demands concerning the company's administration in the restructuring plan. The shareholders' position is dependent on the contents of the restructuring plan. The restructuring plan may include provisions as to what extent and under which conditions the owners may maintain shares in the enterprise. The status of owners differs in different corporate forms is based the specifics of the restructuring procedure.

The debtor's assets may not be distributed to shareholders during the period between the plan's confirmation and the plan's termination or conclusion, except for payments for services performed in accordance with the plan.

#### *§ 8. Termination of the procedure*

Restructuring proceedings terminate once the court confirms the restructuring plan.

However, the initiation of restructuring proceedings does not necessarily mean that the restructuring plan will be finalized and confirmed; restructuring proceedings may also terminate before they are completed. The initiation of proceedings simply begins the assessment process, which could possibly lead to the formation and confirmation of the restructuring plan. Proceedings may be interrupted without confirming the restructuring plan if it becomes clear during the proceedings that there are no obstacles present that prevent the confirmation of the restructuring plan.

After the court confirms the restructuring plan, the status of each creditor will be determined according to the plan. The debtor must observe the restructuring plan in all his actions. The most important obligation of the debtor is to pay its debts in accordance with the restructuring plan.

A supervisor may be appointed to supervise the implementation of the restructuring plan on behalf of the creditors. The supervisor, or when there is no supervisor, the debtor must report to the creditors' committee on the plan's implementation at times specified by the creditors' committee.

The restructuring plan is terminated when all creditors have been satisfied according to the plan. The supervisor or the debtor must provide a final report to both the creditor's committee and the individual creditors regarding the implementation of the restructuring plan without delay. This report shall be presented to the district court that heard the matter.

## *§ 9. Degree of information on the development of the procedure towards creditors*

### General procedural provisions

The court shall serve notice of the debtor's restructuring petition on those creditors who, based on the amount of their claims, are deemed significant as well as on other creditors from whom the court deems it necessary to hear on the petition. The court shall also reserve an opportunity to submit a written statement for those creditors, which must be submitted by the fixed date.

The administrator shall serve notice of its decision regarding the initiation of proceedings on those creditors noted in the petition and the debtor's statement without delay.

In preparing the proposal for the restructuring plan, the administrator shall negotiate with the creditors' committee and, if necessary, with other individual creditors and with a potential creditors named that in the petition. In addition to the administrator, certain other creditors, referred to in section 40 of the Restructuring of Enterprises Act, may submit a proposal for a restructuring plan. Those creditors have the right to obtain information necessary to prepare the proposal from the administrator.

In deciding on any additional comments to the proposal for a plan, the court shall reserve an opportunity for the parties in the matter to report any objections they may have to claims referred to in the proposal for the plan to the administrator in writing. Such objections must be submitted on or before the fixed date. The administrator shall serve notice of such objections on those creditors whose rights are affected by the objections in question on or before the fixed date.

After the court receives the final proposal for the plan, it shall divide the creditors into groups and determine which of those groups are eligible to vote. The court shall invite those creditors eligible to vote to notify the court in writing as to whether or not they accept or reject the proposal for a plan. Such notice must be submitted by the fixed date.

Once the court receives the voting report and if it deems necessary, it may reserve an opportunity for the parties to submit a written statement regarding the report and the arrangements on or before the fixed date. Once the court renders a decision confirming the restructuring plan and issues orders on matters relating to the plan's supervision, the administrator shall serve notice of the decision on the creditors.

The court shall publicly announce any decision initiating or terminating the restructuring proceedings or ordering an interim stay or otherwise restricting the debtor's authority. Notice thereof shall be submitted to the competent authorities, and a notation shall be made in the trade register and in other registers that are kept for various types of property and mortgages, as provided by the Restructuring of Enterprises Decree.

### The obligation to cooperate

The administrator shall provide the creditors' committee and the creditors a report on the assets, debts, and other obligations of the debtor as well as on the factors that effect the debtor's financial situation and its expected development without delay. The administrator shall inform the creditors' committee or, if no committee is appointed, the creditors, of what actions have been taken and what observations were made in the performance of his oversight, supervision and inspection duties, and

discuss with the creditors' committee in advance any significant decisions, regularly and whenever the need arises.

#### Priority of new credit

On the administrator's application, the court may order that any credit obtained during the proceedings and specified in a decision have the same or higher priority than a restructuring debt in respect of the debtor's property that was furnished for both debts as security. As a condition of this, the arrangement must secure financing during the proceedings, such that the risk of those creditors whose priority position would be weakened is not otherwise significantly increased. Before deciding a matter, the court shall give any creditor whose priority position is affected by the change an opportunity to be heard.

#### *§ 10. Costs related to the procedure*

##### The administrator's remuneration and compensation for expenses

The administrator is entitled to receive reasonable remuneration for his duties. This remuneration shall be paid out of the debtor's assets. The value of the debtor's business at the time of the initiation of the proceedings, the level of difficulty of these duties and the extent of the measures they require, the results achieved by the administrator, and other circumstances shall all be taken into consideration when determining the administrator's remuneration. At the administrator's request, the remuneration may be paid in partial payments in accordance with the progress of these duties if this is deemed appropriate in the light of the duration of such duties, the amount of work, and other circumstances. The administrator may also receive compensation from the debtor's assets for expenses incurred that are necessary to perform such duties. At the administrator's request, such compensation shall be paid before the administrator's duties end, if it is deemed justified based on the amount of expenses involved.

In practice, the administrator's reasonable remuneration in an ordinary restructuring is €150 – 200 per hour. The administrator should not spend more than 200 hours to an ordinary restructuring. Thus, the expenses of the administration should not exceed €40.000.

The creditor's committee, or if there is no such committee, the court, shall determine the amount of the administrator's remuneration and the compensation for expenses. The court shall decide on any disputes or objections raised by the administrator, the debtor, or a creditor contesting the creditors' committee decision on the administrator's remuneration or compensation if such objections are raised within fourteen days after receiving notice of the creditors' committee and within one month from the date of that decision.

In simplified restructuring proceeding, there is no administrator. As a consequence of this, there are no expenses related to the administrator's duties.

##### Expenses incurred by the creditors' committee

Unless otherwise ordered in the restructuring plan, the creditors in the group of creditors that the committee member in question represents are responsible for compensation for the members of the creditor's committee for necessary expenses incurred while participating in the committee's work.

Members of the committee of representatives may also receive remuneration for their duties if the group of creditors that the committee member in question represents so decides. The decision requires a simple majority of both the creditors, and must specify the amount of their claims.

Creditors in a group of creditors are jointly and severally liable for their payment obligations. The allocation of the payment obligations among the creditors shall be determined in proportion to the amount of their claims.

Expenses incurred while participating in the proceedings

Persons who want to exercise their right to propose a restructuring plan must prepare the proposal at their own expense. The parties in the matter shall also be liable for the other expenses associated with their participation in the restructuring proceedings.

### *§ 11. Competence, knowledge and functioning of insolvency courts*

#### 11.1. Description

In order to provide expert knowledge, restructuring matters are heard by nineteen specific district courts in Finland.

The court does not take an active role in the process. The restructuring matter's progress is based on the actions taken by the parties (discretionary case). The court's role is to control and monitor the case's legal formalities and to ensure that the minimum conditions of law are fulfilled.

#### 11.2. Critical analysis

Some district courts have heard less than ten restructuring matters per year. As a consequence of this, a court's ability to rule on restructuring matters and solve problems that arise during the proceedings can vary a lot.

### *§ 12. Publicity conditions*

#### 12.1. Description

A decision of the court initiating or terminating the restructuring proceedings or ordering the interim stay or the restrictions on the debtor's authority shall be publicly announced. Notice thereof shall be given to the competent authorities, and a notation shall be made in the trade register and in other registers that are kept for various types of property and mortgages as provided by the Restructuring of Enterprises Decree.

Both the draft of the restructuring program and the confirmed restructuring program are public documents and are available at the district court. During the proceedings the documents concerning the restructuring shall be delivered only to the creditors and members of the creditors' committee. The district court may, however, order a part of the restructuring program to remain confidential at the request of the administrator, one of the creditors or the debtor.

Neither the administrator, a member of the creditors' committee or a creditor, a person employed by them, or any assistant or an expert used by them may reveal or take advantage of the financial state, business relations or business secrets of the debtor that have come to their knowledge during the

proceedings without prior permission. A person who either intentionally or negligently violates this confidentiality is liable to compensate the debtor for any damages caused thereby.

## 12.2. Critical analysis

Since some creditors may compete with the debtor company, supervising the secrecy obligation is extremely difficult. For this reason, the restructuring program should be drafted so that the essential business secrets of the company do not appear in the restructuring program.

### **Chapter 4.2. Unofficial Restructuring**

#### *§ 1. Comprehensive description of the regime as well as its underlying philosophy*

##### 1.1. Description

Finnish law does not outline, define or regulate unofficial restructurings. Unofficial restructurings are comprised of the voluntary arrangements made between debtors and creditors with the goal of avoiding bankruptcy. This procedure's scope of application is comparable to that of an "official" restructuring, in that the procedure is used by all kinds of enterprises and private businesses. Furthermore, the restructuring may apply to the same spheres as with official restructuring, i.e. not only to a company's debts but also to branches of its business, its capital structure etc. An unofficial restructuring may succeed only if the creditors have sufficiently confidence in the debtor's viability.<sup>25</sup>

An unofficial restructuring is a contractual arrangement. In order to achieve success in a restructuring, the major creditors should, in practice, cooperate and create a scheme of mutual agreements under which debts are deducted, due dates rearranged etc. It is possible, though, to address all such issues in a single, multilateral contract executed between the debtor and all its creditors.

It has been said that, by providing a vehicle for official restructuring, the Restructuring of Enterprises Act of 1993 has increased creditors' willingness to give their consent to unofficial restructuring as well.<sup>26</sup> According to the government bill on the Act, this result was actually anticipated.<sup>27</sup>

##### 1.2. Critical analysis

There are numerous pros and cons to an unofficial restructuring. One significant advantage of an unofficial restructuring is that it is generally less costly due to the absence of bureaucratic expenses that are unavoidable in an official restructuring.<sup>28</sup> Moreover, unofficial restructurings emphasize a general principle of the market economy, that is, that financiers must be entitled to freely decide whether or not to continue financing a financially distressed company and, if so, on what terms.<sup>29</sup>

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<sup>25</sup> Kavanterä – Heiskanen, p. 21.

<sup>26</sup> Koskelo, p. 10.

<sup>27</sup> Government bill on Restructuring of Enterprises Act, 182/1992, p. 16.

<sup>28</sup> Koulu I, p. 38.

<sup>29</sup> See Koskelo, p. 36 – 37.

Unofficial restructuring does, however, give rise to the problem of free riding. In an official restructuring, it is often possible to disregard the opinion of the minor creditors and to force them into restructuring proceedings. This is not possible, however, in an unofficial restructuring based solely on voluntary agreements between the debtor and its creditors. As a consequence, the major creditors must accept the fact that some minor creditors may demand full payment from the debtor even though the major creditors would be satisfied with a partial payment. The free riding can be financially acceptable from the major creditors' point of view, provided, however, that they would not be better off after an eventual bankruptcy of the debtor company.

Although there are no legal obstacles for the tax authorities to take part in unofficial restructuring procedures, they usually refrain from such arrangements. This is foremost due to the probable difficulties concerning the monitoring of the debtor and the significant additional work arising from such restructuring procedures as a whole. Also the liability for a public act of the officials may be a cause for such prudence and guardedness. In addition, it is generally in the interest of the tax authorities to stop the accrual of tax debt by means of bankruptcy. However, the tax authorities may be more willing to participate in unofficial restructuring procedures if a bank has taken an active role in the restructuring procedures in question. If the tax authorities agree to participate in unofficial restructuring, they usually do not, however, accept any other debt deductions than a deduction or composition concerning accrued interests.

In unofficial restructuring, a public summons to the unknown creditors, by means of which an unknown debt would be precluded if the creditor in question did not meet such a summons, is not applicable. As a consequence, there is always the risk of an unknown creditor coming forward and presenting claims some time in the future.

A clear legal framework governs official restructuring procedures. Although both official and unofficial restructurings can, in theory, achieve the same financial result, the legal framework provided by an official restructuring is often necessary to achieve a result satisfactory to both the debtor and creditor, e.g., in the event a monitoring system is needed in order for creditors to be informed of the debtor's and the other creditors' behavior.<sup>30</sup>

*§ 2. Classification of the procedure among branches of law, competent jurisdictions, overview of the procedure followed before these jurisdictions, implications of international private law*

## 2.1. Description

The regime of unofficial restructuring is based on general contract law and law of obligations as well as on general legal principles. Under the law, debtors and creditors are free to agree on restructuring proceedings in contract and without formal requirements, provided the agreement does not negatively impact the rights of any third parties.

The debtor and its creditors may agree in contract on the jurisdiction of the restructuring. However, if the agreement between the debtor and its creditors does not specify a jurisdiction, the general provisions on competent jurisdiction will apply, under which the district court in the debtor's primary place of business is the place of competent jurisdiction.

The role of the court in an unofficial restructuring is limited to resolving disputes arising out of the contracts between the debtor and its creditors. The parties may agree on the applicable law. By

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<sup>30</sup> Koulu I, p. 8.

agreeing on applicable law, however, the parties may not obligate the court to act in any manner except to resolve contractual disputes. As a consequence, it is not possible, for example, to apply a foreign restructuring law that obliges a Finnish court to act in any other manner other than to resolve contractual disputes between the parties.

## 2.2. Critical analysis

In an unofficial restructuring, neither the debtor nor its creditors enjoys the safeguards of any special legislation. As a consequence, it is very important to formulate the restructuring contracts comprehensively and with due care.

### *§ 3. Criteria to benefit for the regime*

Due to the nature of the procedure, there are no official criteria to benefit for the regime. However, there is no logical reason for the creditors to settle for less than what they would receive from the debtor in a future bankruptcy.

### *§ 4. Specification of the possible initiators of the procedure*

Due to the nature of the procedure, either the debtor or a creditor may initiate an unofficial restructuring.

### *§ 5. Administration of the procedure*

Due to the nature of the procedure, administration may be arranged as agreed between creditors and the debtor.

### *§ 6. Restructuring plan*

The unofficial restructuring plan normally includes information on the financial situation of the enterprise and the measures taken in order to revitalize the enterprise. The unofficial restructuring plan does not, however, have to fill the criteria of the official restructuring plan. The unofficial restructuring plan formed by the criteria set forth in the Act may have the best possibilities to obtain approval from creditors.

In practice, the plan needs to be confirmed by all creditors involved in the unofficial restructuring procedure. The minimum requirements of equality and legal protection set forth in the Legal Transaction Act, which applies to contractual relationships in general, must be taken into account when forming the proposition for the plan.

The parties may request the court to confirm the unofficial restructuring plan. Only a confirmed restructuring plan is already as itself a ground for execution.

### *§ 7. The degree of protection of the actors implied in the procedure*

If the unofficial restructuring plan is confirmed in the court, it is a ground for execution if the payments are not made according to the plan. The Legal Transaction Act should be taken into consideration.

### *§ 8. Termination of the procedure*

The restructuring procedure is terminated when all creditors have been satisfied according to the restructuring plan. The plan may also include specific extinction grounds.

### *§ 9. Degree of information on the development of the procedure towards creditors*

Due to the nature of the procedure, degree of information on the development of the procedure towards creditors may be arranged as agreed between creditors and the debtor.

### *§ 10. Costs related to the procedure*

Due to the nature of the procedure, cost related to the procedure may be arranged as agreed between creditors and the debtor.

### *§ 11. Competence, knowledge and functioning of insolvency courts*

Due to the nature of the procedure, the role of courts in unofficial restructuring is limited to resolving disputes arising from the contracts in question. Courts are not involved to unofficial restructuring.

Unofficial restructuring agreement may be confirmed in a court if the general prerequisites<sup>31</sup> for restructuring are fulfilled. After the confirmation, however, the general rules of Restructuring of Enterprises Act shall be applied to the procedure and the nature of the procedure is simplified restructuring.<sup>32</sup>

### *§ 12. Publicity conditions*

#### 12.1. Description

Due to the nature of the procedure, degree of publicity may be arranged as agreed between creditors and the debtor.

#### 12.2. Critical Analysis

The agreed unofficial restructuring programme may be arranged to remain secret as agreed between creditors and the debtor. The company's essential business secrets are easier to protect in unofficial restructuring.

## **TITLE 5. LEGAL CONSEQUENCES OF BANKRUPTCY AND POSSIBILITIES FOR A FRESH START**

### **Chapter 5.1. Bankruptcy procedure**

The Bankruptcy Act, it is said, is neutral to debtors, in the sense that the debtor may be either a natural or a legal person. Bankruptcy proceedings are similar regardless of the legal form or

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<sup>31</sup> See Restructuring of Enterprises Act, sections 50 and 55.

<sup>32</sup> See Title 4, §11.

business of the debtor; only a small number of special provisions deal with specific groups of debtors. The most common of such groups is the estate of a deceased natural person.

### The Actors of the Bankruptcy Proceedings

Either the creditor or the debtor may file for debtor's bankruptcy. The debtor may always voluntarily file for bankruptcy without regard to any preconditions on its financial status. In order to file for a debtor's involuntary bankruptcy, the creditor must prove one of the six preconditions set out in the Bankruptcy Act<sup>33</sup>, in addition to having a clear and undisputed receivable from the debtor. On the basis of the creditor's petition, the court will provide the debtor with an opportunity to be heard.

The district court adjudicates a debtor in bankruptcy. In Finland, there are no special courts or jurisdictions to hear bankruptcy cases, unlike there are for restructuring matters<sup>34</sup>. In bankruptcy matters where the debtor is a natural person, the forum is the district court of the debtor's domicile; if the debtor is a legal person, the proceeding takes place in the location of the debtor's main administration. For legal persons, the true administration, and not necessarily the legal person's registered business address, is the relevant factor in determining the forum, as a registration address may be *de facto* obsolete.

If the court rules in favor of the creditor's petition, after the debtor has been given an opportunity to state of the petition, bankruptcy proceedings are initiated immediately thereafter. Regardless of whether the petitioner is the debtor or creditor, the court will appoint an administrator to govern the debtor's estate in its ruling.

Generally, enforcement authorities do not take part in the bankruptcy procedure. Instead, the procedure is administrated and carried out by special organs of the bankruptcy estate itself. The district court appoints a provisional administrator when it declares the debtor to be bankrupt. The provisional administrator's term technically expires once a trustee is appointed, however, the provisional administrator is usually appointed as trustee as well. The trustee is appointed by the district court at the hearing of creditors. The trustee's term expires when the prescribed time for proof of debt in bankruptcy expires. Unless the trustee is discharged from duty, the trustee will act as executor after the expiration of the time limit for proof of claims.

The creditor's meeting plays a significant role in the bankruptcy estate's administration. The estate's administrator convenes the meeting as soon as possible after the creditor's hearing and when required thereafter. The meeting is usually held approximately once per year, depending on the size and status of the estate. The administrator may convene a meeting for the major creditors as soon as possible after the initiation of bankruptcy procedure in order to receive an approval for the crucial matters arising usually immediately after the initiation of bankruptcy proceedings, e.g. sale of business. The creditors' meeting is the supreme authority over the bankruptcy estate, and the administrator must remit to it all major decisions. Decisions made in the creditors' meetings require the support of all creditors with claims amounting to at least one-half of all claims represented in the meeting.

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<sup>33</sup> Bankruptcy Act (9.11.1868), paragraph 6, section 2, subsections a) – f). The most common preconditions are c) an unsuccessful attempt of execution and d) negligence to satisfy creditors eight days after receiving a certified request for payment from a bailiff. The latter concerns only *merchants* as the wording of the archaic 1868 act states.

<sup>34</sup> See Title 4.1, § 11.

Upon initiating bankruptcy proceedings, the court must stipulate a date for the creditors' hearing to be held, normally within one month of its decision to initiate the bankruptcy proceedings. During the hearing, the provisional administrator submits an inventory of the debtor's estate to the court, at which time the debtor attests to its accuracy under oath. If the court rules that the estate is sufficient to merit full bankruptcy proceedings, the court appoints one or more trustees to replace the provisional administrator and stipulates in its decision a bar date by which creditors must prove and lodge their claims and interests with the court or the trustee. The latter is much more common. Regardless of whether or not there is a court order to prove their debts and interests with the trustee, creditors may still effectively lodge such debts and interests with the court. Creditors are notified of the bar date by a public summons *ex officio* by the district court.

Rights to payment, whether or not matured, disputed, secured, liquidated, contingent, or reduced to judgement, are admissible as claims to be lodged in the debtor's bankruptcy if such rights, or the circumstances on which such rights are based, arose before the initiation of bankruptcy proceedings.

### Lodging the Claims

Claims must be lodged in writing with the competent district court or, if so ordered, with one of the estates trustees; the latter procedure is more common. All proofs of claim against the debtor's estate must be filed on or before the bar date stipulated by the court. If a creditor fails to file a proof of claim in the manner prescribed by the Bankruptcy Act (9.11.1868), that creditor forfeits any rights to participate in the distribution of funds based on this claim from the debtor's estate. Both the amount and basis of the claim against the debtor's estate must be stated in the creditor's proof of claim. If the exact amount of a claim cannot be asserted with certainty, the maximum possible amount must be stated. If the creditor demands interest on its claim, either the amount of the interest or the basis for its calculation, as well as the period for which such interest is demanded, must be stated separately in the proof of claim. If the basis of the claim is an open or running obligation, the proof of claim must contain information as to how much of this claim as accrued prior to the initiation of the debtor's bankruptcy. If a creditor demands priority over other claims, that creditor must state the basis for such a demand in its proof of claim. Creditors who are holders of a lien or collateral are exempted from lodging their claims if they are content with receiving payment solely from the liquidated value of the lien or collateral. Claims secured by a floating charge must be lodged with the trustee as the rest of the claims.

Proofs of claim must be filed in either of Finland's two official languages, Finnish or Swedish. Any proof of claim filed in a language other than Finnish or Swedish must, by law, be translated by the trustee. The cost of any such translation may be deducted from the creditor's dividend.<sup>35</sup> As English is the *lingua franca* of modern business, proofs of claims in English are not translated by trustees in practice, but usually noted as being filed originally in English prior to translation into Finnish or Swedish.

The trustee must compile a list of all lodged claims after the bar date. This list must be submitted to the court at least two weeks before the court's deadline for the submission of written objections. Additionally, the trustee must provide a copy of the list to a creditor upon request. Creditors may submit any corrections or obvious errors found in the list to the court provided this is done prior to the court's deadline for the submission of objections.

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<sup>35</sup> Bankruptcy Act (9.11.1868), chapter 2, paragraph 24, section 2.

Either the trustee, the debtor, or a creditor may submit objections to lodged claims. All objections must be filed with the court in writing on or before the deadline stipulated by the court. The objection must state a specific demand, the facts upon which the demand is based, any available evidence, and what the objecting party seeks to prove with this evidence. If objections to a claim are raised, the court will hear the litigant parties in an ancillary court session.

The court pronounces its findings and conclusions in the final bankruptcy judgement on a stipulated date after the hearing of objections. The judgement indicates the admissibility and priority of all claims against the debtor's estate. Either the debtor or any creditor who has duly lodged a claim may appeal the court's decision.

## Recovery

Under the Act on Recovery to Bankruptcy Estates (25.4.1991/758), the executor and any creditors who have duly lodged their claims may seek to recover any of the debtor's assets that were fraudulently or preferentially conveyed before the initiation of the bankruptcy proceedings. The legal acts of the debtor that can be invalidated include e.g. a giving of a gift in certain circumstances, placing a security, payment of a debt that is considerable compared to the value for debtor's assets or carried out by using unusual means. Such acts can be reversed in the event that they have taken place within certain period of time – usually three months - before the petition for bankruptcy proceedings was submitted to the court.

## Order of Payments

Under the Act on the Order of Payments to Creditors (30.12.1992/1578), creditors with claims that are secured by a lien or collateral, right of retention, or a legally registered encumbrance on the debtor's property will receive payment from such property prior to the debtor's other creditors and without regard to their interests. The initiation of bankruptcy proceedings does not affect the right of secured creditors to obtain and enforce payment from such property. Claims secured by a floating charge are an exception to this rule, as they enjoy a right that resembles the right of the holder of a security. Floating charge enjoys a priority up to the extent they do not exceed fifty percent of the liquidation value of the debtor's encumbered business assets.

## The Supervision of Bankruptcy Estates

Under the Act on the Supervision of the Administration of Bankrupt Estates (31.1.1995/111) hereinafter the Supervision Act, the Bankruptcy Ombudsman supervises the overall actions of administrators. Despite the social and economical importance of bankruptcies, there was no actual official supervision of this process prior to the enactment of the Supervision Act, nor did any official body have the responsibility to develop the procedure connected to the administration of bankruptcy estates or bankruptcies in general. Tax administration and labor administration had been active in bankruptcies relating to the public interest, but their activity had its grounds on their status as creditors. The supervision by the creditors or by the Finnish Bar Association over its members was regarded as insufficient.<sup>36</sup>

The Bankruptcy Ombudsman is an independent authority. The Bankruptcy Ombudsman is attached to the Ministry of Justice, but only in a budgetary and organizational sense. The Justice Department cannot give the Bankruptcy Ombudsman any orders or instructions concerning the activities of the Bankruptcy Ombudsman. The Bankruptcy Ombudsman is subject to general legality control in its

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<sup>36</sup> Bankruptcy Ombudsman.

actions. The Bankruptcy Ombudsman must be impartial, and may not attend to the interests of any particular group, such as the debtor, a creditor or any special group of creditors. Despite the Bankruptcy Ombudsman's position as a government official, the Bankruptcy Ombudsman must be neutral to different groups of creditors irrespective of whether or not they are public corporation creditors or private sector creditors.

### Bankruptcy Statistics

The length of a bankruptcy depends primarily on the size of the bankruptcy estate. Technically, the shortest possible duration of a bankruptcy procedure is four months and two weeks, due to certain statutory terms protecting creditors. There is no period of limitation concerning the maximum duration of a bankruptcy proceeding. A large bankruptcy estate may easily be active for over eight years and it is not uncommon for very large estates to remain unclosed after ten years, even if the proceedings are inactive. The average duration of a bankruptcy is 1,5 years.

From a historical point of view, bankruptcy proceedings have been the most commonly used procedure when enterprises have faced critical economical or financial difficulties. Secondly, the overstrained enterprises usually take necessary measures too late, which do not leave room for other alternatives. However, taking into consideration the recent changes in companies' general financial structure as well as the changes in ownership structures combined with the increasing awareness of restructuring processes, the popularity of formal and informal restructuring will probably increase while bankruptcy procedure might to some extent lose its position.

The number of bankruptcies increased tremendously during the recession in the 1990s. Between 1985 and 1989, 12.665 bankruptcy petitions were filed, and this number more than doubled, to 29.466, over the following five years. A record 7.355 bankruptcy petitions were filed in 1992 alone. Since then the number of petitions has steadily diminished. There were 19.456 bankruptcies between 1995 and 1999, approximately 12.000 less than in the previous five-year period. There were approximately 3.200 petitions in 1999 and about 3.000 in 2000 and 2001.<sup>37</sup>

The average distributive portion received by creditors from bankruptcy estates is 22,2 percent of the original receivables. The size of a distributive portion appears to be linked to the size of bankrupt company. In bankrupt companies with debts of between €3.400.000 and €5.000.000, for example, the distributive share was approximately 35 percent. According to a study by Sundgren<sup>38</sup>, this can be explained by the fact that debtors follow larger companies more closely. These larger companies, therefore, tend to enter bankruptcy at an earlier stage, when they still have assets left to distribute.

The size of a creditor's distributive portion of a single debtor's estate depends naturally on the priority of that creditor's receivables in bankruptcy. The prioritization of receivables in the Act on the Order of Payments to Creditors (30.12.1992/1578) is described earlier in this Chapter. Creditors with non-prioritized receivables usually receive a smaller percentage. In more than one-half of all bankruptcies, non-prioritized creditors receive nothing, and the corresponding percentage on the other half is much lower than the average as a whole, approximately 8,4 percent. This does not, however, paint an accurate picture of the present situation, as wages paid by the Wage Security (an authority under the Ministry of Labor) has lost this priority in 1992. These wages usually represent a major portion of an estate's debts.<sup>39</sup>

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<sup>37</sup> The Statistics Finland ([www.tilastokeskus.fi](http://www.tilastokeskus.fi)). Statistics Finland compiles statistics only on the number of petitions, not on the number of actual adjudications from the petitions. See also Könkkölä – Liukkonen, page 1.

<sup>38</sup> Sundgren I. Sundgren studied 117 bankrupt companies during the years 1990 - 1994.

<sup>39</sup> Ibidem.

Approximately three-quarters of all persons who have been involved in a substantial way in bankruptcy are still in business. In spring 2001, 70 percent of all once-bankrupt entrepreneurs acted as a person liable or as a significant member of at least one active business organization.<sup>40</sup>

## **Chapter 5.2. Legal effects of the initiation of bankruptcy procedures**

Upon the initiation of bankruptcy proceedings, the debtor forfeits authority over its property and assets. This authority is passed to the body of creditors, i.e., to the bankruptcy estate. Any transactions entered into by the debtor or the debtor's agents related to these assets after the initiation of bankruptcy proceedings are void. With minor exceptions, under the Execution Act (3.12.1895), the execution of a debtor's assets is suspended after the initiation of bankruptcy proceedings and any execution measures that preceded the initiation of bankruptcy proceedings are deemed to be void. Payments on the debtor's invoices or other debts that precede the bankruptcy are likewise suspended.

The initiation of bankruptcy does not stop interest on a debtor's debt from accruing. If the creditor demands interest on a claim, it must be included in the proof of claim, which must be lodged on or before the bar date<sup>41</sup>. It has to be noted, however, that the interest that have accrued after the initiation of bankruptcy is considered posterior in the order of payment to creditors. Either the amount of the interest or the basis for its calculation, as well as the period for which such interest is demanded, must be stated separately in the creditor's proof of claim. If the basis of the claim is an open or running obligation, the proof of claim must contain information regarding how much of this claim accrued prior to the initiation of the debtor's bankruptcy.<sup>42</sup>

If a bankruptcy petition is pending when a petition for restructuring is submitted, consideration of the bankruptcy will be postponed until a decision is rendered on the initiation of the restructuring proceedings. The same procedure applies when a petition for restructuring is pending and a bankruptcy petition is submitted.<sup>43</sup> Even if the petition for restructuring is dismissed, the debtor may still appeal the court's decision. This aspect of the process is frequently criticized, based on the fact that, at this point, bankruptcy measures have often already made the initiation of reorganization futile, and there are thus no advantages in an accepted appeal for the dismissal of a petition for restructuring.

The lenders providing new money to a company before opening bankruptcy proceeding are not given any priority. Once bankruptcy proceedings have been initiated the debts arising after the initiation, from the actions of the administration of the estate, will have priority to the debts preceding bankruptcy (i.e. a debt that has arisen before the initiation of the bankruptcy proceedings) and are to be paid by the estate before any proofed claims.

## **Chapter 5.3. Legal effects of bankruptcy as such**

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<sup>40</sup> Pulkkinen.

<sup>41</sup> Lodging claims, see Title 5.1 above.

<sup>42</sup> Bankruptcy Act (9.11.1868), chapter 2, paragraph 24, section 1.

<sup>43</sup> Restructuring of Enterprises Act (25.1.1993/47), paragraph 24.

Bankruptcy generally has a significant effect on a debtor's contractual relationships and property rights. Bankruptcy indicates a debtor's inability to answer for its financial liabilities; therefore, it is relevant what happens to the debtor's contracts and property rights once bankruptcy procedures are initiated. As the Bankruptcy Act (9.11.1868) is focused to merely the procedural issues in bankruptcy, the legal practice regarding the debtor's contractual relationships and property rights in bankruptcy are formed by case law, other comparable legislative acts *ex analogia*, and scholarly literature. The principle is that contract clauses that have been stipulated only against bankruptcy are void.

The status of some contracts (e.g. employment) in bankruptcy is included in the laws concerning the contractual relationship in question (e.g. Employment Act 26.1.2001/55).

A legislative working party's recent memorandum proposes *expressis verbis* provisions on the status of contracts to the new Bankruptcy Act <sup>44</sup>. The status of a debtor's contracts is one of the most problematic issues in bankruptcy, especially in bankruptcy estates, where the debtor's entire business is often based on intangible assets.

According to the interpretation of the Bankruptcy Act, the initiation of bankruptcy proceedings does not automatically affect those contractual relationships of debtor that preceded the initiation of bankruptcy proceedings. In practice, even if a debtor's contract is binding after the initiation of bankruptcy procedures under principles developed under case law and relevant literature, this contract is not of much use to the debtor if the other party terminates the contract. By the time when an affirmative decision from the court is obtained, the damage done to the contractual relationship is usually irreparable and the affirmative decision futile.

#### **Chapter 5.4. 'Excusability' following bankruptcy**

The debtor is not discharged from any claim duly lodged in the bankruptcy proceedings unless such a claim is paid in full. Therefore, debtor's liabilities for full settlement of all claims lodged in accordance with the provisions of the Bankruptcy Act (9.11.1868) can also be satisfied with the assets or income the debtor may acquire in the future.

However, since the debtor usually is a company and will be wound up after the proceedings, there is not a debtor left to be liable for debts preceding the bankruptcy. This is the case even in the situations where the bankrupt business has been sold as a whole to the same entrepreneur that ran the business before bankruptcy.

#### **Chapter 5.5. Responsibility of the Company's management in case of bankruptcy of a limited liability company**

The management of the company does not have an obligation to apply for restructuring proceedings for the company. Companies Act (29.9.1978/734) obliges the management to place the company in liquidation under certain preconditions and to file for bankruptcy, if company is unable to pay its debts with its assets <sup>45</sup>. The latter provision is obviously vague.

There are not any provisions about the management liability in the Bankruptcy Act. Companies Act provides about the management's general responsibilities and liability for damages in public and

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<sup>44</sup> Memorandum of a Working Party on the New Bankruptcy Act, 22.1.2002, page 30 and 64 – 68.

<sup>45</sup> Companies Act (29.9.1978/734), chapter 13, paragraphs 2 a and 11 a.

private limited liability companies. The provisions of the Companies Act cover the whole existence of a company and there are not any special provisions concerning liability in bankruptcy.

According to the Companies Act the management may become liable towards the creditors in the following cases prior to bankruptcy. If a company's equity has decreased below half of its share capital, the management of the company has to convene the general meeting of the shareholders to handle the placing of the company into liquidation. If the meeting decides not to commence the liquidation process, another general shareholders' meeting shall be held within twelve months of the previous. If the equity by the time of the latter meeting does not equal at least half of the company's share capital and the meeting refuses to place the company into liquidation, it is the board of directors' responsibility to apply to a court to have the company placed in liquidation. In the event that the board does not fulfill this responsibility, the company shall operate on the personal responsibility of the board of directors i.e. the creditors of the company may collect any claims that have arisen after the obligation to initiate the liquidation, and which the company has not been able to pay.

If the management of the company intentionally act to the detriment of the interests of creditors, the Criminal Code (19.12.1889) able prosecution. According to Chapter 39 of the Criminal Code, a debtor, who knows on the basis of the existing or alleged financial difficulties that his action will be to the detriment of the financial interest of his creditor if he destroys his property, donates or otherwise assigns his property without an acceptable reason, transfers his property abroad in order to make it unreachable to the creditors or irrevocably increases the amount of his obligations and thus causes his insolvency or fundamentally aggravates it, shall be sentenced for dishonesty of a debtor to a fine or imprisonment for the maximum period of two years. A company itself cannot naturally perpetrate any of the above. The conditions and premises for *piercing the corporate veil* have been lately under an active discussion in Finland.

There are, of course, some *de facto* consequences for a management in a bankrupt company. The bankruptcy will be registered in the Trade Register and the personal data of the management in a bankrupt company may also be seen from the register extract. Nowadays, with efficient search engines and database services it is easy to retrieve a history of a specific person in possible managements in various companies. One may draw its own conclusions of a person that has been involved as part of the management in more than one bankruptcy.

In addition to managements liability, it is worth mentioning that according to the Bankruptcy Act and the administrator is liable to compensate a loss that he has caused, through an error or neglect in performing his duties, to the creditor, and, moreover to the debtor.<sup>46</sup>

## **TITLE 6. PROSPECTS AND RECOMMENDATIONS**

The central aim of bankruptcy proceedings is to satisfy creditors. An estate's administrator must endeavor to achieve the best possible outcome for all creditors, as the debtor's realized net funds must be divided proportionately among all creditors.

Bankruptcy procedures are not traditionally characterized as the fastest means to a fresh start. Although bankruptcy usually leads to the termination of business activities, the process may be used

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<sup>46</sup> Bankruptcy Act (9.11.1868), paragraph 70.

to reorganize and rehabilitate insolvent companies. The bankruptcy estate may sell its business activity to the owner of an insolvent company, thus using bankruptcy as means of reorganization and allowing business activity to continue without the heavy burden of non-salary debts. Salary receivables transfer with the business activities to the new company.

Using bankruptcy to reorganize insolvent businesses was more common prior to the enactment of the Restructuring of Enterprises Act. In terms of a fresh start, the problem with this approach is that owners of bankrupt companies are often insolvent themselves, and are generally not able to obtain financing sufficient to acquire the insolvent business. The administrator is liable for selling the bankrupt company's assets at a price that would injure the rights of the creditors and is thus incapable of disposing the assets at a discount price to the owner. More frequently, the purchaser is one of the bankrupt company's competitors in same industry – and being acquired by a competitor will generally work contrary to the troubled entrepreneur's goal of a "fresh start".

The first section of the Restructuring of Enterprises Act states that the Act's purpose is to reorganize an overburdened debtor's viable business activities. The Finnish restructuring procedure includes many elements that can be considered positive from the point of view of the business' survival, however, the goal of satisfying the creditors' interests also figures prominently in both the Restructuring of Enterprises Act and the Bankruptcy Act. Under the Restructuring of Enterprises Act, all creditors have the right to block the confirmation of a proposed restructuring plan if they can show that it is likely that their interests will be better served in bankruptcy.

Consequently, Finnish insolvency legislation, *de lege lata*, can be considered to be more favorable towards the creditors than the debtor.

Since a bankruptcy does not discharge the debtor from its liability to repay its debts, the practical difficulties in starting a new business after the insolvency procedure differ significantly depending on whether the debtor is a legal or a natural person. In practice, liability for debts applies only to a natural person, because legal persons in bankruptcy will generally liquidate.

Another practical difficulty for a natural person who desires to start a new business after bankruptcy may be the negative notation on their credit report. According to the Finnish Personal Data Act, such notations may be stored for up to five years.

With regard to the restructuring of enterprises, it is evident that one goal of any successful restructuring is that the debtor company be able to continue normal business operations after fulfilling the requirements of the restructuring plan. Although a well-timed restructuring might save an enterprise from bankruptcy, the procedure has not been widely accepted among entrepreneurs and creditors. Bankruptcy proceedings have been, and still are, the most commonly used procedure for an enterprise that faces critical financial difficulties.

There are several reasons why restructuring remains unpopular. Restructuring procedures generally apply to large companies with sufficient resources to endure the expensive and often lengthy restructuring procedure. The financial status of a company under restructuring must be strong enough to withstand new debts that arise during the proceedings and to make interest payments on previously secured debts.

A proposal of a government bill for a new Bankruptcy Act was passed by a legislative working party on 22 January 2002. The proposal will now be circulated for public and private comment and revision before being sent to Parliament for final action. Once enacted into law by the Parliament,

the new Bankruptcy Act will replace existing bankruptcy legislation dating from 1868 and subsequently amended on several occasions. The proposed new Act focuses primarily on the form of bankruptcy proceedings and on modernizing certain formulations.

The legislative working party proposes slight adjustments to the preconditions for ruling a debtor bankrupt based on a creditor's filing. However, the working party does not propose to alter the fundamental purpose such preconditions. The working party's goal in adjusting these definitions is, among other things, to prevent frivolous bankruptcy filings.<sup>47</sup>

One of the proposal's central reforms is the introduction of a procedure called "*julkisselvitys*" hereinafter "an official assessment". Existing law provides that bankruptcy proceedings may be suspended if the debtor lacks sufficient assets to complete the procedure. The proposal recommends that an official assessment would be used as an alternative to suspending bankruptcy proceedings where the bankrupt estate's assets are inadequate to continue the procedure. The official assessment could, for example, be used in a doubt of a malpractice.

The 1868 Bankruptcy Act addressed a creditor's lack of impartiality in voting only in the situation where the creditor finances the purchase of the debtor's assets and where that vote involves the sale of assets. The working party's proposal recommends expanding the Act to bar creditors from voting in any matter in which they have a close connection

The working party's proposal further proposes that the smaller distributive portions of the creditors' receivables must be paid at the earliest possible opportunity for an estimated amount as a final lump sum payment. The problem with this proposal lies in defining what constitutes a "smaller" distributive portion.

One stated goal of the new Act is to ensure that proper consideration is given to the debtor's rights and interests, however, the new Act does not significantly alter the present status of creditors and debtors in bankruptcy proceedings.

No further material amendments to the Restructuring of Enterprises Act are expected in the near future.

The Finnish recession of the early 1990's resulted in a more cautious approach to granting credit, especially where real property or stock is given as collateral. In addition, more attention is now paid to the realization price of a bankrupt company's assets. The level of excessive indebtedness rose in 2000 due to the economic downturn and the low interest rates that encouraged companies to borrow; it is safe to assume, therefore, that the number of bankruptcies will increase in the coming years. The bursting of the e-business bubble caused many to predict a wave of bankruptcies in the information technology sector, but, for the time being, fewer such bankruptcies than expected have been witnessed. Higher interest rates, a decrease in the general value of companies' assets due to the downturn and the negative prospects for certain industrial sectors are also be blamed for the predicted increase in the number of bankruptcies in the coming years.

## **TITLE 7. STATE OF KNOWLEDGE**

### ***Legislation***

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<sup>47</sup> Memorandum of a Working Party on the New Bankruptcy Act, 22.1.2002.

Act on the Supervision of the Administration of Bankrupt Estates (31.1.1995/111)

Act on the Order of Payments to Creditors (30.12.1992/1578)

Act on Recovery to Bankruptcy Estates (25.4.1991/758)

Advocates Act (12.12.1958/496)

Bankruptcy Act (9.11.1868)

Companies Act (29.9.1978/734)

Criminal Code (19.12.1889)

Execution Act (3.12.1895)

Legal Transaction Act (13.6.1929/228)

Restructuring of Enterprises Act (25.1.1993/47)

Securities Markets Act (26.5.1989/495)

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- Sundgren II* An article on Stefan Sundgren’s study on the relationship between restructuring and bankruptcies (<http://www.asiakastieto.fi/servlet/Ajankohtaista?T=nll&A=112.htm>)
- Takala – Virén* Takala, Kari – Virén, Matti: Maksuhäiriöiden ennakointi toimialoittain, Velkakierre 25 , November 2000