Finance, Competitiveness & Innovation Global Practice (FCI)

# Estonia

## Preventive Restructurings

Technical Note [Revised Draft for discussion]

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# Contents

## GLOSSARY

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| **BA** | Bankruptcy Act |
| **DIP** | Debtor-in-possession |
| **EC** | European Commission |
| **EU** | European Union |
| **IFRS** | International Financial Reporting Standards |
| **IP** | Insolvency Practitioner (in Restructuring) |
| **MOE** | Ministry of Economy |
| **MOJ** | Ministry of Justice |
| **NBE** | National Bank of Estonia |
| **NPL** | Non-performing Loan |
| **OA** | Official Administrator (in Bankruptcy) |
| **RA** | Reorganization Act |
| **SRSS** | Structural Reforms Support Service |
| **TC** | Tax Code |
| **WBG** | World Bank Group |

## ACKNOWLEDGEMENT

This report has been prepared by the World Bank Group (WBG) at the request of the Ministry of Justice of Estonia (MoJ), under a technical cooperation project funded by Structural Reform Support Service (SRSS) of the European Commission (EC). The objective of this report is to assist Estonian authorities in the design and implementation of measures to improve the effectiveness of the Estonian insolvency framework in order to foster sustainable growth and investment in accordance with Article 4 of the SRSS Regulation.

Several important factors bear on the scope of this report. First, it deals only with possible reforms to the insolvency regime as it applies to legal persons: no measures aimed at the insolvency of individual debtors are considered.[1] Secondly, while the paper will, where appropriate, make reference to relevant provisions of the Bankruptcy Act (the "BA") and other relevant laws, the focus of the analysis has been on possible reforms to the preventive restructuring regime under the Reorganisation Act (the "RA"). Thirdly, and most importantly, given the coming into force of the Preventive Restructuring Directive (the "EU Directive"), a number of amendments to the RA will be needed to achieve compliance with the EU Directive. In addition, a number of non-mandatory suggestions contained in the EU Directive will be highlighted for consideration by Estonian legislators.[2]

In the preparation of this report, the World Bank Group team[3] has consulted with different law and accounting firms, financial institutions, public agencies and other insolvency stakeholders interviewed during visits to Tallinn on March 18-22 and July 8-12, 2019. Feedback obtained during these visits has been essential to understand the context and provide the recommendations included in this Note.[4] The World Bank Team is extremely grateful with the stakeholders and authorities of Estonia for the cooperation and feedback shared with the team in the elaboration of this report.

Part One of this paper will deal with possible reforms to the restructuring regime which are not required by the EU Directive. Part Two will deal with the implementation of the European Directive.

[1] This is at the request of the Estonian authorities and as specified in the ToRs agreed in January 2019. Due to different factors, including an extremely favourable tax treatment of corporate income, the corporate form of doing business is widely popular in Estonia, and is likely to remain so. As a result, a focus on legal persons is likely to be of wider relevance for businesses of all sizes than in most other jurisdictions.

[2] The EU Directive formally entered into force in June 2019. Member States have two years to implement the Directive (plus an additional year if they encounter particular difficulties during implementation).

[3] Composed of Raquel Letelier (Senior Financial Sector Specialist, Task Team Leader), Fernando Dancausa (Insolvency Specialist) and Sandy Shandro (Senior Consultant and Insolvency Specialist) under the guidance and comments from Mahesh Uttamchandani (Practice Manager).

[4] See Aide Memoire prepared by the WBG Team after the March 2019 visit for details on mission's findings and list of meetings and stakeholders interviewed.

## INTRODUCTION

The insolvency system in Estonia was profoundly modernized after the 2008 financial crisis, when a restructuring procedure ("*Saaneremine*") was introduced through the enactment of the Reorganization Act. The RA complies with many international standards and can be considered a modern restructuring regime that takes into consideration the specific features of the Estonian market, including a strong preference for confidentiality and informality and a design that partially accommodates the needs of SMEs. The RA seems to be effectively implemented by the County Courts, which are administering the procedure efficiently with average durations below a year. The interaction between the RA the Courts seems to be optimal, although some issues have arisen with regards to the appeal process of certain key decisions.[5]

Estonia is indeed to be congratulated the reform introduced roughly ten years ago. The RA, with few exceptions, is not obviously in need of substantial reform. The timelines set out in the existing RA are not out of line with those of other jurisdictions, if not more ambitious. Access to the reorganisation procedure seems to be straightforward. Judges are highly respected and appear to be minded to permit restructurings to proceed in all cases where the debtor is honest and there is a realistic chance for a restructuring to be successful.[6] For those involved in reforming the Estonian restructuring regime, this will surely facilitate the task of making real improvements to the system, and in working to shape positive attitudes towards the reformed procedures in the future.[7]

However, the system faces some important challenges that should be addressed in the short and medium term to ensure its continued successful evolution. Some stakeholders complain that the restructuring regime is not operating as efficiently as it should: both take-up rates and outcomes are allegedly poor and the public perception of proceedings under the RA is that they are too often used as a means to delay or avoid a bankruptcy by debtors whose behaviour is irresponsible but not often sanctioned. These criticisms are present in many jurisdictions, even ones with the most advanced restructuring regimes.[8] Insofar as these challenges deal with the current system, they could be addressed with the Recommendations which appear in bold in Part One of this Report.[9]

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[5] See section 1.5.3 for more information on this point.

[6] Some judges are of the opinion that the debtor should be given a chance in every case where there is any possibility to restructure and the debtor appears to the court to be honest. It was this approach which was adopted when deciding, in 2018, that 8 applications to open a restructuring proceeding were rejected. Consistent with good practice elsewhere, judges seem very much inclined to accept the verdict of creditors when considering a confirmation application under RA s.28.

[7] Such optimal practice may not have been recognized by international indicators, including the Doing Business report or the OECD indicators.

[8] The American Bankruptcy Institute Commission to Study the Reform of Chapter was inspired by an awareness that most financially-troubled SMEs simply avoid Chapter 11 altogether. In the case of Estonia, they seem to be borne out by statistics from the OECD which, in its 2016 indicator for insolvency regimes, placed Estonia last among 34 OECD member countries

[9] It is important to keep in mind that the relatively small population of just over 1.3 million must, realistically, operate as a brake on any temptation to impose on Estonia the complicated restructuring legislative machinery found in other EU jurisdictions with larger populations and more elaborate supporting infrastructure. Reforms suggested in this paper will be made with this essential proportionality in mind.

## PART ONE – Reforms Not Required by the EU DIRECTIVE

### 1.1. Challenges faced by the current system

According to most stakeholders interviewed, the public perception of restructuring procedures in Estonia is rather negative. Some commentators felt that this perception was largely created in the early days of the RA (which came into force in 2008), and that the situation has improved in the last few years. This trend has been observed in neighbouring jurisdictions as well: whenever a restructuring regime is introduced for the first time, it takes some time for the public to begin to accept that the right of a debtor to rehabilitate itself is being put on a higher plane than the right of creditors to collect in full what they are owed.[10] Nevertheless, the perception remains. Specific criticisms of the present regime include:

1. Unworthy debtors use the RA to avoid or deliberately postpone a bankruptcy. This abuse of the procedure can enable dishonest debtors to transfer assets to third parties (including connected parties within the meaning of BA s.117) well before the commencement of any expected bankruptcy proceedings. Since the running of time to challenge such transactions starts at the time of the transaction in question, a dishonest debtor may hope that a bankruptcy will not happen until it is too late for such a challenge to be made.[11]
2. During the approval process, not all creditor claims are properly verified. False claims and/or claims from connected parties (including claims of the owners themselves) are sometimes admitted, with the result that fictitious or connected parties can vote on a plan and eventually control the creditors' assembly.
3. The RA imposes no limit on the amount of debt which a plan may seek to write-off, including tax debt. This is considered to be unfair to other taxpayers.
4. Insufficient financial knowledge and uneven standards of financial reporting[12] can mean a failure to understand the true severity of the debtors' problems. This can translate into unrealistic plans getting approved which do not work in the longer term.
5. Debtors come to recognise that financial problems are serious far too late, when the financial problems are too serious to resolve outside of a formal bankruptcy.[13] Part of the explanation for this is the stigma of financial failure, which is still a powerful feature of Estonian commercial culture. This stigma is intensified by the relative lack of anonymity in a country with a small population.[14]
6. The criteria which must be met in order to open a restructuring under RA ss.7 and 8 are set too low. As a result, it is perceived by some to be too easy for a dishonest or improperly-motivated debtor to gain access to the process.

[10] Ch. 11 of the US Bankruptcy Code is often cited as the paradigm set of rules of a culture which encourages restructurings of viable businesses. It has often been described as a "natural" development in a jurisdiction which clearly puts the right of a debtor to restructure above that of creditors to collect debts.
[11] This comment was made not only by commentators consulted in early 2019 but also in a 2013 report published by PWC entitled "State Chancellery: Study on the efficiency of insolvency proceedings" (the "PWC Report"). In that report, PWC mentions that the Estonian Judges' Association as well as the Estonian Banking Association make the same point.
[12] An auditing firm considered management boards are "too relaxed" about approving going concern financial statements.
[13] This observation was made by most of those interviewed, and also by the Estonian Chamber of Commerce and Estonian Bar Association interviewed by PWC in the preparation of their 2013 report (see abovepp.70 and 73).
[14] One judge observed that this stigma is much less a factor in the case of start-up businesses.

The impact of these criticisms on the success rate of applications made to the court to open a restructuring or to confirm a plan is considerable. Further, the reaction of other participants in the process whose cooperation is required to ensure a successful outcome is also affected. For example, suppliers to debtors in financial difficulty tend to react very strongly against the interest of a debtor in doing a restructuring. Banks (who, according to some commentators, do not monitor closely – or even, at times, at all - the financial performance of smaller borrowers) and tax authorities seem quite open to challenging debtors during reorganisation proceedings. These behaviours are not sufficiently counter-balanced by news of successful restructurings in the public domain. In summary, there has not yet been sufficient "buy-in" to an active and positive restructuring culture in Estonia.

### 1.2. Confidentiality and informality: enhancing OCWs

Although it is understood that the present RA is administered largely in private (in the sense that the proceedings are only open to participants, not the public), it is an illusion to think that the financial problems of a debtor applicant are in any meaningful sense kept "private". Indeed, as soon as the opening of a reorganisation procedure is approved, the moratorium on creditors' enforcement actions becomes effective, which in practice has a strong adverse effect on the business reputation of the debtor, especially given the size of the commercially-involved population of Estonia. Maintaining confidentiality and allowing restructurings to take place in a private an informal manner should therefore be one of the main objectives of any potential insolvency reform. As observed in other jurisdictions however, the problem of the stigma associated with admitted financial failure will most likely ease over time provided that the reorganisation regime can gain greater acceptance as legitimate means of preserving business value with minimum disruption to commercial operations.

In other jurisdictions, restructuring techniques do exist which aim to ensure that the debtor's financial problems remain confidential, at least until such time as a restructuring plan has been agreed. For example, in France, the *mandat ad hoc* procedure permits a judge to appoint an insolvency practitioner ("IP") to assist management of the debtor to negotiate an amicable restructuring with all or some of its creditors, suppliers and possible sources of fresh financing. The scope of the *mandat* is determined by the court in each case, without statutory limit in duration. The role of the *mandataire* is only to make suggestions and to persuade creditors of the merits of achieving a compromise. There is no stay of creditor action. Given the stage of development of the IP profession in Estonia, and, once again, the relative size of the commercial sector, it is not felt to be appropriate to recommend that this approach now be taken. Further, to add such a procedure to the preventive restructuring regime in Estonia would not constitute an act of "compliance" with the EU Directive, because even though the *mandat ad hoc* procedure does not give rise to a stay of enforcement actions it nevertheless requires the appointment of an IP (which is something the EU Directive seeks to make non-mandatory in many cases). In any event, the vast majority of restructurings in Estonia are already informal,[15] and, as far as it is possible to ascertain, this is being done in a satisfactory manner without the need for intervention of this sort.

[15] Approximately 95%, according to a major bank.

In recent years, with the cooperation of the World Bank and the IMF, a set of guidelines known as the INSOL Principles (the "Principles") have become known and accepted as a guide for financial creditors in coordinating and managing credit issues in larger cases.[16] The second edition of the Principles was published in May 2017. The Principles embody three concepts which are fundamental to any out-of-court restructuring: first, that creditors should refrain from taking any action which would reduce their exposure; that debtors should not take any action that would adversely affect the position of creditors as compared with their position as of the standstill date; and that new money is to have priority.

The Principles could usefully have the express endorsement of the Central Bank even though they have no binding nature.[17] It may be worth noting that the adoption of the Principles would be consistent with 4.5 of the EU Directive, which contemplates the possible adoption of out-of-court procedures as part of an overall preventive restructuring framework. As alternative, Latvia published some useful guidelines for Out-of-Court Debt Restructuring in some years earlier. These were re-approved by the Latvian Insolvency Issues Committee in February 2018. The Latvian guidelines bear many of the hallmarks of the INSOL Principles. There are many other examples.[18]

Accepting the view of many interlocutors that virtually all Estonian corporate debtors should be viewed as SMEs, it would be helpful to provide to the public a range of restructuring "tools" to assist debtors who are or should be reorganising. These tools could be publicised electronically so that any fear of stigma or loss of confidentiality which might otherwise inhibit a debtor from asking for assistance is eliminated. Assistance of this sort could take many forms. One example is attached to this report as Schedule 1. It is a Debtor's Checklist intended to assist a debtor to approach a reorganisation in an organised manner. This document is in most respects particularly suited to smaller companies. There are many other possible forms of assistance which could be made available in this way.

**Recommendation 1 – Consider the adoption of a set of informal out-of-court restructuring guidelines. Those guidelines could include a draft sample standstill agreement, accession agreement and checklists for participants. At the same time, consider making available to debtors and their advisers a range of tools, such as checklists for debtors and templates of reorganisation plans, to assist debtors in analysing their financial position and preparing a reorganisation plan. There is scope for these tools to be both general and sector-based (e.g. agriculture), given the presence of sector-based institutions in Estonia which could provide valuable input into the development of such tools, such as the Rural Development Foundation.**

[16] EU Member States which have adopted the Principles include: Austria, Croatia, Serbia and Romania.
[17] Such support was not part of the implementation process in Hungary, and this may have contributed to the lack of success of the Principles in that jurisdiction.
[18] Slovenia published a set of principles specifically tailored to the restructuring of SMEs in 2015.

### 1.3. Improving director's behaviour

#### *1.3.1. The commercial code*

It is invariably the case that a successful restructuring regime operates against the backdrop of a successful bankruptcy regime. Expressed differently, the bankruptcy regime should not provide incentives for the debtor to abuse the restructuring regime. This may not always be the case in Estonia. In the case of both private and public companies, the Commercial Code contains provisions which:

- Require members of the management board to perform their duties with "due diligence";
- Impose joint and several liability on the management board for breach of their duties;
- Require the management board of an insolvent company to submit a bankruptcy petition no later than 20 days after the date on which the insolvency becomes evident.[19]

In addition to these obligations and civil liabilities, until the deletion of s.385 of the Criminal Code which came into force on 1 January 2015, there was also criminal liability for failure to perform the obligation to submit a petition for bankruptcy punishable with up to one year of imprisonment. The explanatory memorandum to the deletion of s.385 stated in relevant part:

"*…the elements of s.385 have become extremely difficult to prove….It is always necessary to determine the moment when insolvency occurred…[which is] complex and time-consuming…[and, in any event] the board members are considered liable for such failure; therefore, additional criminal liability is excessive*."

Although one can agree with the above reasoning as far as imposing **criminal** liability is concerned, in **civil** cases (including bankruptcy cases) the imposition of liability for failure to file for bankruptcy in a timely manner is a task which courts in many other jurisdictions do take on, and it is undoubtedly best practice to do so.[20] Further, and importantly in the present context, the mere fact that the directing minds of the debtor are aware of the risk of civil liability has been shown in many other jurisdictions to operate as a strong incentive to better debtor behaviour throughout the zone of insolvency.

Recommendations on how to address the challenge posed by directors' potential misbehaviours are provided in the following section in the context of no-asset-cases, since both issues are closely related (see Recommendation 2 below).

#### *1.3.2. The No-Asset Cases*

In reality, the courts of Estonia are not enforcing in a regular manner the civil sanctions provided in the Commercial Code. It is understood that debtors tend to be fully aware of this both before and during any attempt – whether well-intentioned or not – to restructure under the RA. One cannot, however, blame the courts for this state of affairs, because the problem is due to two factors over which the judiciary has little or no control. The two factors are related.

[19] In the case of private companies, the references are ss.180 and 187 of the Commercial Code; for public companies the equivalent references are ss.306 (management board obligation to file for bankruptcy) and 327 (liability of supervisory board members)

[20] EU examples include Germany/Spain/Portugal (obligation to file for bankruptcy within 3 weeks/2 months/30 days of insolvency, with knowledge of insolvency in some way presumed by directors); the UK (where the concept of "wrongful trading" also requires a post facto analysis of the timing of actual insolvency of the debtor) and many others.

- First, although the evidentiary requirements which must be met in order to open a reorganisation proceeding under ss.7 and 8 of the RA are not onerous by international standards, if the court ***refuses*** to open a reorganisation there is neither guidance nor power given to the court on what to do as a next step. If the reason for the refusal to open a reorganisation is that the court considers that the debtor's business is no longer viable (and thus not capable of being successfully reorganised), then, unless an application to open a bankruptcy was made at the same time as the application to open a reorganisation,[21] it will remain the responsibility of the debtor alone to commence a bankruptcy proceeding after the application has been dismissed. Since an improperly-motivated debtor is unlikely to take this responsibility seriously, the obligation to file for bankruptcy clearly set out in the Commercial Code will be ignored. Based on the statistics available, such cases might not be rare: in 2018, for example, 8 of 19 applications to open reorganisation proceedings were refused, and comments of judges suggest that the reason for the refusals would almost certainly have been the non-viability of the debtor's business.
- Secondly, to the extent that the debtor tries to initiate a reorganisation too late or abuses the process of reorganisation by ill-founded applications or unrealistic plans, it must follow that the assets in the debtor's estate available to fund an eventual bankruptcy will be dissipated. In all such "no asset bankruptcy" cases, unless creditors are themselves willing to fund the bankruptcy,[22] it will be impossible as a practical matter for any bankruptcy trustee to be appointed and investigate the pre-bankruptcy conduct of the debtor and to take steps to enforce the provisions of the Commercial Code which the debtor may have ignored. Even if a creditor with the means and inclination can be found to fund the bankruptcy, the incentive for any individual creditor to do so is largely absent, as the proceeds of any successful litigation will be shared in accordance with the priorities in a bankruptcy, with the funding creditor receiving priority payment only of the bankruptcy deposit rather than the entire amount of that creditor's claim.[23]

"No-asset" bankruptcy cases should not be allowed to provide a shield for directors of insolvent debtors to act in bad faith and/or avoid potential civil liability. If this challenge can be met then the use of RA procedures to hide improper transactions, dissipate assets and "run down the clock" on avoidance actions will be greatly reduced. Public perceptions of reorganisation procedures will also improve significantly as a result.

To achieve these objectives, one or more of the following options could be considered (**Recommendation 2**):

*A) <u>Introduce Official Administrators</u>*

The introduction of an official (called here for the sake of simplicity an Official Administrator "OA") who would administer every bankruptcy which would otherwise not be fully administered due to a lack of funds in the estate. This would be a significant addition to the legal infrastructure in Estonia but given the apparent scale of the "abatement issue" it should

[21] This can be done under RA s.7(4).
[22] All those consulted considered this to be a rare situation.
[23] It is understood that creditors may, under the Law of Obligations, have standing to sue to enforce the obligation to file for bankruptcy if it can be said that the legal norm exists to protect creditors, but, here again, it is necessary to find the creditors with the time, money and inclination to undertake this exercise.

be considered. The OA could be an employee of the State and would be appointed as trustee in all cases where there are insufficient funds to open and complete a bankruptcy. The duties of the OA could vary depending on whether he is appointed as interim or permanent trustee (see below) but would always include the obligation to investigate director conduct and include an interview of directors to gain a full understanding of why the business failed. The OA would have the power to pursue, on behalf of all creditors (including, notably, tax creditors), the remedies which already exist under the Commercial Code. The challenge of providing funding for this service is not free from difficulty, but options include general government revenues, a share of unrelated Court revenues (e.g. filing fees) or a percentage of recoveries in all bankruptcy cases at a level calculated to be generous enough to make all the costs of the OA self-financing.[24] It is understood that consideration is being given to creating the office of Ombudsman in Estonia, and this initiative might be highly relevant to this recommendation.

*B) Eliminate the abatement of bankruptcy*

If it is decided to introduce Official Administrators in Estonia, then a potential reform that could be introduced simultaneously is the elimination of the notion of "*abatement*" entirely. The underlying rationale is that all insolvent debtors should be able to be put into bankruptcy and all reasonable steps should be able to be taken, within a bankruptcy framework, to investigate possible debtor misconduct.

At present, BA s.29 imposes abatement in the case of an insolvent debtor in two circumstances: (i) where the debtor's assets are insufficient to cover the costs of the bankruptcy as well as make a claim against a director; and (ii) where the assets of the debtor consist mainly of claims against third parties which might not succeed. If it is decided that the OA is allowed to fully "take over" bankruptcies in both cases, then no abatement would be needed. It is for consideration whether the costs of the OA could be recovered in whole or in part from the proceeds of any successful litigation against any director who did not properly discharge his or her duties and caused loss to the creditors. Such a means of recovering costs has already been accepted in principle in BA s.29(8).

A less intrusive alternative would be to require the OA/Ombudsman to be appointed as Interim Trustee (article 15 BA) only in cases where the debtor's assets appear to be insufficient to conduct the bankruptcy. If there is sufficient evidence that the debtor did not approach its financial problems as the law requires, then the Interim Trustee could continue to be in charge of the bankruptcy as above. But if there is no such evidence, abatement could still happen under BA s.29.

It is appreciated that these suggestions may have profound implications for the qualifications of the staff of the Office of the Ombudsman. These suggestions and others made as part of this Recommendation 2 are not intended to be mutually exclusive.

[24] The PWC Report (at p.14) suggests holding the board responsible for covering costs of the proceedings and/or imposing sanctions in case of breach of the Commercial Code obligation to file for bankruptcy, but this does not address the challenge of who is going to enforce this obligation. The PWC Report also records (at p.64) that the concern over no asset cases was raised in their meetings with the Chamber of Bailiffs and Trustees, including the possible solution of increased State spending to address the issue.

*C) Assigning priority to creditors funding the costs*

Consider amending the BA to permit the court (perhaps on the basis of a recommendation by an interim trustee, trustee, the OA or upon the application of a creditor) not only to allow one or more creditors to fund the bankruptcy but also to permit the claims of such funding creditors to be paid ahead of all other creditors of the same ranking from the proceeds of any successful action taken against directors for breach of their statutory obligations.[25] Such a reform could help resolve what has been referred to as the "massive problem" in the Estonian economy of the inability of creditors to enforce their (non-bankruptcy) civil claims against directors.[26] The day-to-day conduct of the case against the directors would remain in the hands of the trustee in order to ensure that maximum value is achieved from the claim.[27]

*D) Opening bankruptcy*

Consider permitting or requiring the court to order that a bankruptcy be automatically opened in all cases where an application to open a reorganisation is refused on the basis that, on the evidence before the court, the debtor is insolvent as defined by BA s.1. It is difficult to justify leaving this decision to the voluntary act of the debtor, or to leave it to creditors to do so (either of which might never happen or happen too late to serve the public interest in orderly and timely bankruptcies). As Recital 3 of the EU Directive point out, "…*non-viable businesses with no prospect of survival should be liquidated as quickly as possible*."

In order to strengthen the linkage between the RA and BA, there should also be an automatic bankruptcy order made in cases where a plan is rejected by creditors (perhaps more than once) or not confirmed by the court or not fully or properly performed, in the absence of special circumstances. There is at present a "gap" between reorganisation and bankruptcy proceedings which is not covered by the powers given to the court in RA ss.38-43 and s.49 to terminate reorganisation proceedings. It may also be appropriate to consider the elimination of the ability of a debtor to propose a "rehabilitation plan" under BA s.129 in cases where a plan has already been approved under the RA and has been followed by a bankruptcy.[28]

Similarly, consider imposing on the reorganisation adviser a specific obligation to petition the court for the opening of a bankruptcy proceeding as part of his or her duties under RA if the debtor is or becomes insolvent. Under RA s.16(3)2), the reorganisation adviser already has a duty promptly to notify the court and the debtor if the debtor is insolvent. There is also a duty to inform the creditors of the "economic situation" of the debtor under RA s.16(3)4). Given that the reorganisation adviser also has a duty to perform his or her duties with due diligence and honesty and to "*take the interests of all the participants in the proceedings into account*", it is arguable that a duty on the part of the reorganisation adviser to recommend to creditors that they petition an insolvent debtor into bankruptcy rather than participate in a fruitless reorganisation exercise already exists, but this obligation could be made explicit in the RA. In these cases, the reorganisation advisor that requested the opening of a bankruptcy proceedings should be allowed to stay in office and be appointed a bankruptcy trustee.

[25] Claims under the Commercial Code ss. 187(4)(5) and 315 (4)(5) can be filed by creditors but the object of the claim will be damage caused to the company (not the creditor) and thus compensation is ordered for the benefit of the company only (See Tolstov, "Tort Liability of the director to company's creditors" Dissertatioines Juridicae, University of Tartu, 2015).
[26] Ibid. at p.27.
[27] Otherwise funding creditors might settle cases for the value of their claims alone, without considering other creditors.
[28] See too Recommendation 7, below.

*E) Adding penalties*

Consider adding to the financial penalties which might be imposed on directors of a debtor where there has been a failure to comply with their duties the possibility of being disqualified from acting as directors for a period of time. This possibility would need to be part of:

- the legal consequences of failing to comply with the existing obligation to file for bankruptcy, which the courts should enforce as in other EU jurisdictions; and
- part of the new obligation under the EU Directive to take account of the interests of participants when the debtor is facing the likelihood of insolvency.

In no asset cases, responsibility for enforcing this new penalty could perhaps be part of the tasks of the Ombudsman, whose role is understood to be under consideration, or the OA mentioned above.

### 1.4. A case for a special regime for SME insolvency? Where would it fit?

In meetings with stakeholders, consideration was given to the more general question of imposing shorter time limits for certain steps to be taken in the case of SMEs.[29] Special, less-complicated regimes of that sort are increasingly found in other jurisdictions. In France, there is a fast-track liquidation procedure for small businesses, and the *mandataire ad hoc* and *conciliation* pre-bankruptcy procedures are useful for small businesses. The USA has fast-tracked special provisions for small business restructurings under Ch.11 and Ch. 15 of the US Bankruptcy Code. In Japan, the Civil Rehabilitation Act has been used to target small business reorganisations by making use of variable stays of proceedings designed on a case by case basis. And in the UK, there is a small business moratorium to permit the debtor to develop a plan (known as a Company Voluntary Arrangement) as an alternative to the much more complex procedure known as administration.[30] Such regimes typically come into effect as an exception to the "usual" procedures, and almost always include shorter timeframes, less oversight and monitoring by IPs and reduced court involvement.

As opposed to the experiences observed in these countries, there does not seem to exist a need in Estonia for any such specialist procedures because the vast majority of corporate debtors could properly be viewed as SMEs in any event. As a result, rather than viewing SMEs (and MSMEs) as the exception they should be viewed as the norm, and all of the procedures in the current RA should be examined from that perspective.

However, the task of reforming the RA so as to meet the needs of SMEs more efficiently is far from simple. This is because very little of the present RA was drafted with the limitations of SMEs in mind. This could – at least in part – explain why the take-up rate of RA restructurings has been disappointing (only 11 accepted cases in total in 2018): for many of the smaller debtors experiencing difficulties, the RA procedures are simply too costly, too lengthy and too complex.

There is therefore an argument that the coming into force of the EU Directive is an opportune moment to examine how the Estonian restructuring regime could be made more accessible to

[29] 'SME' is a term which, to have any meaning, requires a definition. This is usually done with reference to any one or more of the following attributes: number of employees, number of creditors, amount of unsecured debt and annual turnover.

[30] Other examples include India and Slovenia (expedited procedure for debtors having the status of 'micro company' under the Companies Act). Many jurisdictions have simpler procedures in place to deal with consumer bankruptcies.

SMEs. In doing so, Estonia must make a policy choice between (i) design a procedure for all incorporated entities and make the necessary changes to accommodate the needs of SMEs *within* that procedure; or (ii) treat SMEs as a different version of commercial legal entities and design a special procedure in a new law that would deal with both legal and natural persons. The EU Directive allows both approaches,[31] although it is expected that most Member States will prefer to follow the second approach and make amendments to their existing Bankruptcy laws, which in most countries apply to both legal and natural persons.[32]

Such approach implies acknowledging that the best way to approach dealing with the insolvency of small businesses is by means of a liquidation/discharge regime for natural persons and, for viable businesses, a simplified restructuring regime applicable to both natural and legal persons. Indeed, an examination of the regimes which have embraced this approach shows that the special proceedings for small businesses are essentially modified versions of arrangement proceedings for individual entrepreneurs, which recognise that the financial architecture and creditor profile of small businesses tend to resemble those of individuals rather than larger corporates (for example, multiple layers of debt, complicated operational structures and a web of contractual arrangements are rare).

However, given the unusual but well-known fiscal attractiveness of incorporation in Estonia, it may be more appropriate to follow the first approach and consider adding provisions to the RA intended to address the needs of the smaller cases of debtors in corporate form more effectively. Such approach will have the obvious limitation of leaving individual entrepreneurs[33] without access to the restructuring procedure in the RA, although this could be addressed by introducing amendments to the personal insolvency law that provide an efficient restructuring alternative. In case this approach was to be followed, the following topics (among others) need to be addressed:

- The criteria (if any) which a debtor must meet to qualify for access to a simpler, quicker and cheaper route to an approved plan. Article 1.2 of the EU Directive states that the definition of SME is a matter of national legislation, which in Estonia is provided by Article 3 of the Accounting Act. The debtor could be required to meet one or more of the existing criteria which now include number of employees, turnover and total assets;
- Vetting of a qualified debtor and its proposed plan by an independent third party such as a reorganisation adviser (or a member of the proposed Ombudsman's Office or someone who has become acquainted with the debtor's operations pursuant to the operation of any future early warning system), so as to demonstrate that the debtor is an appropriate candidate for reorganisation;
- Requiring a qualified debtor to present a plan at the same time as the application to open the restructuring proceedings;
- Requiring a plan in this context closely to follow a prescribed form, designed to be as simple as possible, so that professional advice may not be necessary for the debtor;

[31] Article 1.4 allows Member States to restrict the application of its preventive restructuring provisions to legal persons.

[32] An example of this is the proposed Dutch amendments to the Dutch Bankruptcy Act, due to come into force (if passed into law) in 2020. These amendments are intended to be fully compliant with the EU Directive.

[33] According to information received from the Commercial Registry, there may be around 30,000 individual entrepreneurs in Estonia as of July 2019.

- Not allowing the debtor any general stay of proceedings or permitting the plan to include any cross-class cramdown, so as to avoid the need to appoint any reorganisation adviser following the opening of the proceedings (See discussion below of Article 6 of the EU Directive);
- Providing to creditors the ability to apply to convert the fast-track proceedings into a full restructuring procedure by application to the court;
- Imposing abbreviated time limits for notification of the plan to creditors and voting on the plan by them, all of this to be done electronically;
- Not permitting more than one class of creditors unless there is one or more secured creditors, in which case additional classes would be allowed and the consent of secured creditors required;
- Exclusion or deemed consent of creditors not participating;
- Giving to the debtor the ability unilaterally to cancel security upon payment to the secured creditor of the market value of the asset;
- Plan to be confirmed by the court unless there are specific objections for identified forms of abuse;
- No or severely limited rights of appeal;
- Minimal levels of supervision of the performance of the plan (perhaps by an employee of the proposed Office of Ombudsman).

### 1.5. Improve the Efficiency of Reorganisation – Making Restructuring More Attractive

The timelines set out in the RA are entirely in keeping with international norms.[34] According to the text of the RA, a plan accepted by creditors is to be confirmed by the court within approximately 3 months. Equally, formal hearings are not required during the procedure unless they are necessary.[35] In addition, judges are widely regarded as competent, and they see their role as to support honest debtors in their efforts to reorganise their affairs and continue in operation. On paper, the process therefore appears to be very efficient.

Although the statistical information is confusing, the reality (and certainly the public perception) is that reorganisation procedures take too long and that the take-up rate among businesses in financial difficulty is not high enough. Previous studies of the Estonian system[36] reported that, in the period prior to 2011, it could take nearly 1.5 years from the submission of a reorganisation plan for it to be approved.[37] Less critically, the same study recorded that 90% of plans were approved within 8 months of the opening of proceedings, with 10% taking longer than 8 months. Despite these positive outcomes, the number of reorganisation procedures, when compared with the number of bankruptcy procedures, is relatively small, suggesting that there is room for improvement in the efficiency of the present reorganisation procedure. There are several points in the reorganisation process where delays can occur. These shall be considered in turn.

[34] Indeed, one commentator criticised the timelines as too short.
[35] This even applies to the hearing to confirm a plan which has been approved by creditors – see RA s.28(4).
[36] In the PWC Report (at p.9).
[37] The PWC Report also recorded that only 20 of 153 cases resulted in plans being approved.

### 1.5.1. *Improvements in the verification of claims procedure*

The first major source of delay concerns disputes over claims. RA s.13 sets out the procedure which must be followed by a creditor whose claim will be affected by the plan[38] and who does not accept the valuation of a claim put forward by the debtor under RA s.12(2)3). Although the court is required to issue its decision within two weeks from the receipt of the creditor's application from the reorganisation adviser, in practice it is understood that this rarely happens that quickly.[39] Further, an appeal is allowed from that decision. Although appeals are, according to judges, relatively rare, when they do happen the potential for delay is enormous. In the context of a reorganisation, where voting rights depend on the quantification of claims and therefore can be a crucial determinant of outcomes, there is a need to take every reasonable step to deal with such disputes quickly.

Best practice requires that disputes over claims be decided by the court. In the bankruptcy context, BA s.82(4) allows the judge participating in the general meeting to determine the number of votes to be assigned to any particular creditor. [40] In contrast, the procedure in a reorganisation is for a first instance court to deal with such disputes under RA ss. 12 and 13. A creditor whose claim is to be affected by a plan has the right to challenge the value put on its claim in the reorganisation notice by written application to the reorganisation adviser within 4 weeks after the receipt of the notification. If the reorganisation adviser does not accept the creditor's application, the reorganisation adviser must so inform the court and submit the file "promptly." The court must decide the matter within two weeks. The prescribed timeframes are well within international norms and need not be changed.

That said, if the right of appeal given to the debtor (and only to the debtor) under RA s.13(5) from the first instance court is giving rise to unacceptable delays, then this right of appeal could perhaps be reconsidered. In addition, if delays in the process of approving a plan are occurring due to disputes over claims then additional powers could be given to the reorganisation adviser to value claims ***for voting purposes only.*** In a way which is functionally similar to the existing Estonian practice in bankruptcy, in other jurisdictions,[41] where the IP is in doubt as to whether or not a claim should be admitted (in whole or in part) the IP may record that the claim is "objected to" and allow the creditor to vote as if his proof of claim had been admitted in the amount claimed. This vote can subsequently be declared invalid should the creditor's claim be reduced or eliminated as a result of the appeal process.[42] Although there will be cases where the result of a vote might depend on whether or not the votes of a creditor with a disputed claim were counted (or not), such cases will be rare, and it is not good practice to allow voting on a plan to be paralysed by disputed claims.

**Recommendation 3 – that consideration be given to the possibility of enabling a reorganisation adviser to accept claims for voting purposes even though they are subject to a dispute as to amount, and also to the possibility of eliminating appeals from decisions of a court of first instance on a disputed claim.**

[38] Unaffected creditors cannot vote on the plan: RA s.24(5).
[39] One IP said that he had only seen this happen once in nearly 10 years.
[40] This ruling is subject to appeal, however.
[41] Notably most leading Commonwealth countries.
[42] For an example of this approach, see UK Insolvency Rule 2.39.

### *1.5.2. Reducing appeals*

The second major source of delay is the possibility that there can be appeals under RA s.37 from an order confirming a plan. Judges state that in practice appeals are rare but that banks and the tax authorities will quite often do so. As a matter of practice, investors will wait for 15 days after the order confirming a plan has been made, as this is understood to be the period within which an appeal must be initiated. This is unfortunate and could jeopardise the provision of any new finance needed as part of the plan. More importantly, a practice has developed that the courts suspend the operation of the approved plan pending the resolution of the appeal. With no disrespect to the undoubtedly good intentions of the courts, this practice is contrary to both the RA and to recent Supreme Court authority. The second sentence of RA s.37(1) states that the "ruling by which the reorganisation plan is approved shall be enforced immediately." And the Supreme Court, in its ruling on 9 May 2011 in the case of the reorganisation petition of Aktsiaselts Vaatsa Agro, stated that s.37(1) means that "the filing of an appeal against a ruling of a county court or a circuit court shall not suspend compliance with the ruling."[43]

**Recommendation 4 – the courts should interpret RA s.37(1) in accordance with its terms and not suspend the enforcement of an approved plan simply on the basis that an appeal has or might be brought from the order approving the plan. If it is thought necessary to suspend the operation of an approved plan, a very high standard of proof (such as irreparable harm to the party appealing or to the integrity of the process[44]) should be required, along with, in appropriate cases, a requirement for the debtor to be secured against the consequences of an unsuccessful appeal.**

### *1.5.3. Cramming down a plan*

RA ss.29-36 set out a complicated procedure to be followed in cases where the debtor seeks to obtain court approval for a plan which has not been accepted by creditors. This is a highly unusual procedure, which has few if any counterparts in other modern insolvency regimes. It must be open to question whether or not this procedure is a useful feature of the Estonian regime. It requires the engagement of two potentially costly experts (who may of course disagree) and can take many weeks to run its course. It might also operate as a disincentive for reorganisation advisers to perform their duties to a high standard. But more importantly, since one of the fundamental assumptions of restructuring practice is that creditors may be presumed to act in accordance with their own best interests, it is not clear why the debtor should be able to second guess in this way the judgment already given by creditors.

**Recommendation 5 – That consideration be given to repealing RA ss. 29-36.**

[43] See para. 84 of the judgment. It has also been suggested that a solution to this problem is also to be found in ss.477 prim. and 378 of the Code of Civil Procedure.
[44] For example, if the appellant credibly contends that the reorganisation process has been fraudulently undertaken.

### 1.5.4. *"Pre-packaged" insolvency*

In recent years, at times with express statutory sanction and at other times as a matter of practice,[45] reorganisation plans have begun to be filed in many jurisdictions at the same time as the application to open a reorganisation proceeding. This approach is known as a "pre-packaged plan" or "pre-pack."[46]

Estonian law should now recognise that there may be cases where a debtor might, for some reason, need access to the court for the limited purpose of finalising a reorganisation plan where the debtor may not have been able to do so out-of-court. This may be because the required level of creditor support for a fully consensual plan (often unanimity) has not been forthcoming. There is broad consensus that out-of-court reorganisations may well be the best way to preserve maximum value for all participants in a debtor's financial difficulties.[47] Not only do debtors then reduce the risk of wasted effort, but they can then fully commit to a restructuring strategy on an out-of-court basis over a very extended period (certainly far longer than the time period allowed to do so after a proceeding has been commenced) in the knowledge that, even if they fail to reach the agreement they might hope for, the court process remains available.

Importantly, negotiations conducted out-of-court can be largely conducted on a confidential basis, thereby avoiding the insolvency 'stigma,' preserving brand integrity and preventing attrition of key customers, employees and strategic assets.

There is also a strong argument that to encourage pre-packs – which are the result of addressing financial and operational problems early - is consistent with the philosophy underpinning Article 5 of the EU Directive. Some pre-packs, especially in cases involving smaller debtors, could be approved by the court without the need for the appointment of an IP and without the need for a stay of proceedings or cross-class cramdown, both of which are cases where the EU Directive requires that an IP be appointed (see discussion below of EU Directive Art. 5.2). In addition, an express permission for plans to be filed along with the petition to open the proceedings would be a "measure or provision" under EU DIRECTIVE Art. 4.2 that is part of the preventive restructuring framework which takes place out-of-court.

**Recommendation 6 – That the RA be amended to permit the submission of a plan of reorganisation at the same time that a petition is submitted. If it is felt appropriate to take this approach further, in less complicated cases (for example where the total number of creditors is limited), it may be possible for the court to be satisfied that the procedural protections for creditors in the RA have already effectively been met by the debtor. In such cases it could be possible for the plan to be confirmed without the need to adhere strictly to all the time periods set out in the RA.**

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[45] Jurisdictions where the procedure is allowed include: the USA, the UK, Germany, Greece, Italy, Japan, Korea, the Netherlands, Portugal, Singapore, Slovenia, Canada, Australia and New Zealand.

[46] There are two types of pre-packs. The US type of pre-pack consists of a pre-agreed reorganisation plan, along with the necessary levels of creditor support and disclosure of relevant information. The UK/Netherlands/Poland type of pre-pack is in effect a pre-agreed sale of all or part of the assets of the business of the debtor, where all of the preparatory work for the sale takes place before the appointment of the IP and the sale is concluded immediately following his or her appointment. Each jurisdiction allowing this process can of course adapt the formal requirements to suit local needs, in whatever level of detail required. For example, in Poland the agreement must specify the terms of the sale and be accompanied by a valuation report prepared by an expert certified by the court. In all cases much time is saved as the court procedure is invoked only to implement the deal, rather than as a procedural framework for the development and approval of a plan.

[47] See, for example, the UNICTRAL Legislative Guide, Recommendations 160-168.

### 1.5.5. *Revisiting restructuring procedures in the BA*

Under the BA, there exist two other forms of reorganisation. Both of these were introduced in a different era, before the 'rescue culture' took hold in western commercial culture, and prior to the coming into force of the RA in 2008. The question to be addressed is: are these procedures still necessary in their present or in some amended form?

#### A) *Tervendamine*

The first of these is the *tervendamine,* or rehabilitation procedure, set out in BA s.129. Only the trustee has the right to make a proposal under this procedure. The proposal will be either to continue to activities of the debtor or terminate them. Should the trustee decide to continue the activities, the means to do this are to be set out in a plan to be presented to creditors at the first general meeting. The general meeting has broad powers to approve or disapprove the plan, or to direct the trustee to submit a new plan. A majority of 50% plus 1 is needed to make any of these decisions. If the decision is to terminate the activities, the trustee must submit that decision to the court for confirmation immediately, and the court must render its decision within 15 days.

This procedure is used very rarely. In other jurisdictions, the decision to continue the activities of the debtor is typically made by the bankruptcy trustee him or herself, based on a power conferred in language such as the following: "*The trustee may continue the business and activities of the debtor but only for the purposes of the beneficial winding up of the estate*." This is substantively different from what happens in a *tervendamine* procedure, which is, in effect, a form of reorganisation plan of an insolvent debtor which has been approved by a bare majority of creditors who have not been divided into classes or given the protections which normally associated with voting on formal reorganisation plans.

**Recommendation 7 – The *tervendamine* procedure in its present form should be abolished. The trustee should be given the power, exercisable without the permission of the creditors or the court, to continue the activities of a bankrupt debtor, but only insofar as this is necessary for the beneficial winding up of the debtor i.e. to maximise the value of the assets of the debtor for creditors.**

**BA s.15(4) already enables the court to postpone the making of a decision concerning the appointment of an interim trustee until a decision has been made on the approval of a reorganisation plan. This power gives sufficient protection from needless exposure to the bankruptcy process to an honest debtor whose business is viable.**

**If there is to be a procedure to permit a reorganisation to occur in a bankruptcy, or a power to convert a bankruptcy to a reorganisation, then it is important that the law allow this transition with as little disruption as possible. Reorganisation procedures, wherever they are located, should provide the same protections to creditors and other stakeholders.**

#### *B) Kompromiss*

The second procedure contained in the BA is the *kompromiss* procedure set out in BA ss.178-192. This proceeding is available after a debtor has been declared bankrupt, and is, in effect, a free-standing reorganisation procedure for insolvent debtors. It is very different from the *tervendamine* procedure under BA s.129. As such, it is in one way consistent with World Bank Principle C2, which provides that effective insolvency systems should aim to "…*strike a* *careful balance between liquidation and reorganisation, allowing for easy* ***conversion*** *of proceedings from one procedure to another (emphasis supplied).*"

But the *kompromiss* procedure does not **convert** a bankruptcy proceeding into a reorganisation proceeding. It merely permits a debtor to agree **a debt reduction or extension** with creditors despite the fact that the order of priorities among creditors is fixed under BA ss.146 and 153. The procedure contains a number of weaknesses, and does not sit comfortably alongside the reorganisation regime introduced into the Estonian legal landscape by the RA.

Modern bankruptcy regimes trigger the formation of an estate of **all** the debtor's assets, including encumbered assets and assets acquired after the commencement of the bankruptcy case.[48] Following payments to secured creditors and the costs of the bankruptcy, the proceeds available for distribution to creditors: "*…should be distributed pari passu to the remaining general unsecured creditors*"[49] unless there are compelling reasons to do otherwise. The scheme of the BA departs from this classical model in a very important way, by including in its objectives the possibility that the claims of creditors are to be satisfied "*out of the assets of the debtor…by transferring the assets of the debtor* ***or rehabilitating the undertaking thereof*** (emphasis supplied)."[50] The *kompromiss* procedure thus makes it possible for the debtor's estate to be contributed to a set of contractual rules which depart from the norms of a typical bankruptcy. Also, not all of the assets in the debtor's estate need be subject to the compromise agreement. BA s.184(2) states in part that "*Money received from the sale of assets which has not been transferred to creditors shall be transferred to the debtor*."

The procedure also presents problems in relation to the promotion of good debtor behaviour. BA s.2 provides that, upon the approval of a compromise by the court, the bankruptcy of the debtor is terminated under BA s.184, and the debtor regains complete control of its activities and assets. This is the same result that would occur if the basis for the bankruptcy (such as the insolvency of the debtor) had ceased to exist.[51] Depending on the composition of the creditor groups, a dishonest debtor who had engaged in improper transactions with insiders prior to the bankruptcy could therefore avoid sanctions by promoting a compromise with creditors. And at a later date, if a compromise is annulled, the bankruptcy proceedings are to be reopened by order of the court under BA s.190(4). The question of what happens to the running of time to challenge improper transactions is not easily answered in such circumstances. And, although BA s.184(1) states that a court ruling approving a compromise "*terminates*" a bankruptcy proceeding, BA s.188 states that a trustee has the right to recover assets for the bankruptcy estate during the term of validity of a compromise. But what powers would the trustee have to recover such assets if the bankruptcy has been terminated?

In summary, although the *kompromiss* procedure does provide a second chance at a form of debt reduction or extension to a debtor which has been found to be insolvent, it does not contain sufficient protections for the public interest in promoting good debtor behaviour.

**Recommendation 8 – given the operation of the RA (which came into effect after the BA), it is for consideration whether or not the *kompromiss* procedure outlined in BA Chapter 12 should be repealed on the basis that it is no longer a necessary or useful part of the**

[48] World Bank Principle C8.1.
[49] Ibid. Principle C12.3.
[50] BA s.1
[51] BA s.157(3).

**Estonian system of insolvency. As part of this reform, the powers of the court under BA s.14 could be expanded to include a power to refuse to accept a petition (perhaps for a limited period) where it appears to the court that there may be a basis for the filing of an application for reorganisation under the RA.**[52]

### *1.5.6. International Recognition of the RA*

At the moment, neither the reorganisation procedure nor the reorganisation adviser appointed by the court as part of that process are included in Annexes A and B to Regulation (EU) 2015/848 of the European Parliament and of the European Council of 20 May 2015 (recast) (the "Regulation").

The proceedings in Annex A are all "insolvency proceedings" under Art. 2(4) of the Regulation; the insolvency practitioners in Annex B are all "insolvency officeholders" under Art. 2(5) of the Regulation. The procedures and insolvency practitioners from other EU jurisdictions present in the Annexes share many of the attributes of the procedures provided for in the RA as well as duties similar to those of the Estonian reorganisation adviser. It is understood that one of the reasons why the *Saaneremine* procedure was not included in Annex A was due to a concern that reorganisation proceedings in Estonia are not conducted in public, whereas most of the other proceedings in Annex A are public. The fear may have been a risk that this feature of Estonian reorganisation proceedings would of necessity be lost if the procedure were added to Annex A. Whether or not this was a valid reason not to enjoy the benefits of the EU Regulation when it first came into force in 2000, there are several reasons why it is no longer the case now. First, as noted earlier in this report, given the relatively small size of the active commercial community in Estonia, it is an illusion to think that the debtor's financial problems will remain private because of the nature of a court proceeding. Secondly, Recital 10 of the latest version of the Regulation states that it is to apply to proceedings which, precisely like the Estonian RA proceedings, "*promote the rescue of an economically viable but distressed businesses...at a stage where there is only a likelihood of insolvency, and to proceedings which leave the debtor fully or partially in control of its assets and affairs*." Thirdly, any other concerns which there might be about applying to add the *Saaneremine* and the reorganisation adviser to Annexes A and B are far outweighed by the advantages of EU-wide recognition and reach which are only available to formally-annexed procedures and insolvency practitioners. The current position is therefore anomalous and should be rectified at the earliest possible date.

**Recommendation 9 – steps should be taken to add the reorganisation procedure and the reorganisation adviser to the appropriate Annex to the EU Regulation.**

[52] This would be consistent with BA s.15(4).

## PART TWO – Implementation of the EU DIRECTIVE

### 2.1. Introduction

The EU DIRECTIVE consists of an Introduction, 101 Recitals and 36 Articles. It has three main aims:

1. To ensure that member states have a preventive restructuring framework, which includes a restructuring plan;
2. To ensure that entrepreneurs have a second chance through an effective discharge mechanism; and
3. To ensure that member states put in place measures to raise the efficiency of restructuring, insolvency and discharge procedures more widely.

The objectives are to contribute to the proper functioning of the internal market and to remove obstacles to the exercise of the fundamental freedoms. In the pursuit of these objectives, it aims to ensure that viable enterprises have access to effective national restructuring regimes which enable them to continue operating.[53] Although the EU Directive does harmonise some important principles, it leaves "*sufficient flexibility for Member States to choose their approach of implementing those principles*."[54] A list of "discretionary areas" includes the following:

- The degree of control which the debtor's management should retain while subject to the preventive restructuring procedure;
- The duration of the stay;
- Whether the restriction on terminating executory contracts should be limited to 'essential contracts';
- The required majority for the approval of a plan;
- The decision whether or not to have legislative provision permitting the cram-down of shareholder claims; and
- How employees should be treated for voting purposes.

The EU Directive does not, therefore, intend to impose an EU-wide restructuring and insolvency regime but seeks to ensure coherence between Member States' regimes, which should in future be based on shared principles.[55]

Some EU jurisdictions already have or will shortly have domestic legislation which takes account of the changes proposed in the EU Directive, for example the UK and the Netherlands. In contrast, in Germany, where there is at present no pre-insolvency procedure available, the EU Directive will be a major change. In other jurisdictions, for example Spain, Croatia, Poland, Slovenia and Bulgaria, although some changes to domestic laws will be required to achieve compliance, these will not be major. Estonia is in the same category, as it already has, in the RA, a fully developed preventive restructuring law, but this will need to be amended to achieve compliance.

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[53] The impact of enhanced reorganisation procedures was clearly shown in Poland, where the number of restructuring cases following implementation of substantial reforms in 2017 was far higher than in any previous year. This was accompanied by a sharp fall in the number of liquidations. See Emerging Markets journal, Issue No.4, Fall 2017.

[54] Introduction of the EU Directive, at p.4.

[55] The EU Directive may have the potential to work more effectively than the US Chapter 11 which inspired it, especially for SMEs. The costs of a Chapter 11 can be very substantial, as many US commentators have recently noted. See the ABI Report, at note 41, above.

To the extent that the EU Directive deals with corporate debtors, after some general comments this Report will cover relevant Articles of the EU Directive in order. Consistent with the scope of this project, no consideration will be given to those Articles of the EU Directive which deal with individual entrepreneurs, or with the ways in which the EU Directive requires Member States to collect data.

## 2.2. General comments

1. It may be desirable to change the name of the RA to a name which includes "preventive" in the title – e.g. the "Prevention of Insolvency and Reorganisation Act" or some other title which gives due prominence to the overriding aim of the EU Directive to address financial problems early in order to prevent an insolvency. Although the terms "restructuring" and "reorganisation" tend to be used interchangeably, in the interests of consistency with the EU Directive it may also be sensible to use the words "restructuring," "restructure", and "restructuring plan."
2. RA s.1 should be expanded to include the objective of ensuring that viable enterprises have access to preventive restructuring measures in order to permit them to continue operating.
3. By the use of the expression "economic difficulties," RA s.2, in translation, already appears to be broad enough to cover a reorganisation intended to resolve "non-financial" difficulties. This is desirable and is referred to in Recital 28 as an option for Member States to consider.

## 2.3. Article 2 - *Definitions*

Art. 2.2 – requires that certain concepts are to be understood as they are understood under national law. Of these, the term "insolvent/cy" are already defined in BA s.1(2) and (3). The expression "likelihood of insolvency" has no exact counterpart in the RA, but the expression "likely to become insolvent in the future" in RA s.7(2)1) is substantially identical. A definition of "micro, small and medium-sized enterprises" may be required.

It would appear possible to retain the balance sheet test for insolvency contained in present BA s. 1(3) in any event.

## 2.4. Article 4 - *Availability of preventive restructuring frameworks*

Article 4.1 – uses a test of "likelihood of insolvency" as the threshold for entry into the preventive restructuring framework. The expression "likelihood of insolvency" is not used in the RA, but, as indicated above, since the words "likely to become insolvent in the future" are in RA s.7(2)1) this should suffice.

Art. 4.2 – A provision replicating this Article should be added to the list of conditions set out in RA s. 8(2).

Art. 4.3 – This Article is difficult to interpret. If the debtor has to pay for a viability test (there is no other obvious source of payment), then it is hard to see how this can be done "without detriment to the debtor's assets." There is an argument that RA s.7(2)3), combined with the obligation of the reorganisation adviser under RA s.27(2)1), amount to a requirement that the debtor **must** be viable without the imposition of a formal test. In addition, a viability test at the outset is an extra layer of procedure which may be difficult to justify in Estonia. As this is not a mandatory requirement of the EU Directive in any event, no change is required.

Art. 4.4 – RA s.8(2)3) already complies.

Art. 4.5 – an optional measure: see Recommendations 1 and 6, above, both of which are consistent with Art. 4.5.

Art. 4.6 – RA adopts this approach already. For example, there are many situations where no formal hearing is required during the process. In the Estonian context, it is probably already the case that the role of the reorganisation adviser following his or her appointment is already at a level which is properly viewed as necessary and proportionate.

Art. 4.8 – this is an optional requirement and note that the suggestions made are "subject to the agreement of the debtor." As far as creditors are concerned, RA s.7(1) could be amended to make it possible for a reorganisation application to be made by the undertaking **or** by a creditor. The same applies to workers' representatives.

It could be instructive to examine and follow the progress into law of the proposed Dutch reforms in this area, most notably s. 371 of the proposed Amendment to the Bankruptcy Act. Proposed s.371(1) provides that:

"*If it can reasonably be assumed that a debtor will be unable to continue paying his debts as they fall due, a creditor may request the debtor in writing to propose a restructuring plan….If, within one week, the debtor does not do so, or if, after having given this undertaking, one month has elapsed and no restructuring plan has yet been proposed which has a reasonable prospect of being confirmed by the court…the court may, at the creditor's request, appoint an expert who will then have the right, to the exclusion of the debtor, to propose a restructuring plan*."

There is to be no appeal from an order of the court under the above section.

This is clearly a highly innovative and unusual provision. It may be worthy of discussion.

In the current Estonia context there may be no need to differentiate them from other debtors in the way suggested in the second sentence of this Article. All of that being said, it is probably the case that neither creditors nor workers' representatives are likely to take advantage of such a provision if a decision were made to add it to the RA, and so the need for it may not be obvious.

### 2.5. Article 5 - *Debtor in possession*

Art. 5.1 – The RA leaves the debtor in control of day to day operations following the appointment of a reorganisation adviser (who is in every sense within the definition of a "practitioner in the field of insolvency" set out in Article 2.1(12)), and therefore already complies with this Article. If it is considered desirable, a new RA s.11(1)1) could be inserted to make this point expressly.

Art. 5.2 – Article 5.2 begins with the confusing words "Where necessary…." However, it is clear enough that the intention of this Article is to require that a preventive insolvency process should be available to debtors without the need for the appointment of a reorganisation adviser in cases where there will be no general stay against creditor action, and no need for a judicial or administrative authority to confirm a plan which includes cross-class cram down.

In making this a mandatory requirement, the EU Directive in effect adopts one-half of the essential features of the US chapter 11 approach. Whereas US Ch.11 grants the debtor full DIP access to US reorganisation procedures, including a stay against creditor action, the EU Directive prohibits a DIP approach in all cases where:

- the debtor requests a general stay (and the court decides under Art. 5.3(a) that a practitioner in the field of insolvency is necessary to "safeguard the interest of the parties"); or
- the plan calls for cross-class cram down;[56] or
- Where the debtor requests the appointment of an insolvency representative or a majority of creditors request it (in which case the creditors are to pay the costs of the representative).

In the case of Estonia, such a procedure would be completely new, as at present a general stay is part of every reorganisation procedure.

However, it could be argued that the EU Directive does not actually **require** the introduction of a sweeping range of new procedures in Estonia. It is relevant to consider that Recital 30 of the EU Directive states: "The appointment of a restructuring practitioner, **to supervise the actions of the debtor or take over the partial control of the daily operations**, should not be mandatory in every case, but made on a case-by-case basis depending on the circumstances of the case or on the debtor's specific needs (emphasis supplied)."[57] Taken in context, the RA is already a "light touch" debtor in possession measure because the debtor always is, as Recital 30 states, "left in control of their assets and the day-to-day operation of their business;" and, since the reorganisation adviser does not ever "supervise" the actions of the debtor or "take partial control of the debtor's daily operations," it is not the appointment of a reorganisation adviser which the policy behind the EU Directive seeks to limit, but only the appointment of a restructuring adviser whose role would be much more intensive, and thus much more costly, than that of the reorganisation adviser appointed under the RA.

That this argument can be made is a reflection of the extremely difficult debate which occurred during the development of the EU Directive, in which it was the European Council which most strongly advanced the case against the requirement for the appointment of a practitioner in all cases on grounds of cost, and the European Parliament which held out for the need for such an appointment in the cases now provided for in the EU Directive. It is clear from the extensive commentaries now appearing in relevant journals that this debate has not ended.

The difficulty with the Directive on this point has been summarised as follows:

"The fact remains that the directive cannot call for qualified practitioners in the field of restructuring…to ensure efficient procedures, on the one hand, and, on the other, make their appointment facultative in restructuring procedures in order to lower costs. Indeed, only appointed, qualified and independent practitioners can assist companies efficiently to prevent their difficulties as soon as possible, save jobs and avoid conflicts of interest."

[56] And also, in the circumstances set out in Art. 5.3.
[57] Recital 30.

The decision to make the appointment of an IP optional (depending in part on the relief sought by the debtor) was apparently based on the UK scheme of arrangement procedure, which is not an insolvency procedure and can be a very powerful tool for both solvent and insolvent entities if the necessary parties and the court approve the terms of the scheme. In that procedure, a practitioner is **not** required and there is **no stay.**[58] But there are very few other examples of such procedures in the EU. In France, for example, the *mandat ad hoc* and *conciliation* procedures, so often cited as models of preventive techniques, are based on what one commentator has described as "the systematic appointment of an insolvency practitioner by the court."[59] And even the recent Polish reforms, which added an "arrangement approval proceeding," include the appointment by the court of a licensed supervisor, who assists the debtor in a variety of ways including in the preparation of a restructuring plan, much in the same way as a reorganisation adviser appointed by the court under the RA.

Nevertheless, it is probably the case that the RA does need to be amended to permit the court to open a reorganisation procedure without the appointment of a reorganisation adviser in the circumstances set out in Art. 5.3. In reality, those circumstances are most likely to occur in smaller cases and also, potentially, if a pre-packaged plan is presented to the court for approval in circumstances where the debtor will not require a stay and the plan does not include cross-class cram-down.[60]

Art. 5.3(a) – To deal with cases where the court considers that the appointment of an insolvency representative is necessary, an addition to the opening words of RA s.15(1) could be made, such as "In order to safeguard the interest of the parties…."

Art. 5.3(b) – will be complied with (and see comments below on Article 11).

Art. 5.3(c) – not relevant as there is never a need for creditors to ask for the appointment of the reorganisation adviser in Estonia. See above comments on Article 4.8.

### 2.6. Article 6 - *Stay of individual enforcement actions*

Art. 6 – as a general comment, given the requirements of the EU Directive, the opportunity should be taken to rewrite RA s.11 completely. The present RA is complicated and difficult to understand.

Art. 6.1 – already complied with in principle, but the approach of the EU Directive is to impose a broad stay, and to permit derogations from it. Further, in order to comply more fully with the second paragraph of Art. 6.1, RA s.11(2) should be amended to permit the reorganisation adviser to assess and recommend to the court whether a stay is necessary with respect to any particular enforcement situation.

Art. 6.2 – already complied with.

Art. 6.3 – not mandatory. To incorporate them in the RA, additional amendments to s.11 would be needed. At present, it is difficult to see the need for this in Estonia.

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58 Although in many cases the scheme is proposed by a company in administration or liquidation, and in those cases, there will be a stay and an administrator or liquidator will oversee the process

59 "Technical Report," Eurofenix, Spring 2019, by Emmanuelle Inacio.

60 See recommendation below.

Art. 6.4 – not mandatory. However, given the changes which will need to be made to provide to creditors an opportunity to apply for relief from it, it may be desirable to incorporate Art. 6.4 into the RA. If it is decided to do this, a power could be given to the reorganisation adviser to inform the court of those claims which should be excluded from the scope of the stay in the circumstances set out in Art. 6.4(a) and (b); in addition, an ability to apply to the court to be excluded from the operation of the stay could be given to creditors seeking to enforce their claims on the bases set out in Art. 6.4(a) and (b).

Art. 6.5 – For the avoidance of doubt, the RA should be amended specifically to provide that the stay does not apply to workers' claims unless the exception in the second paragraph of Art. 6.5 applies.

Art. 6.6 – The maximum duration of the stay set out in the EU Directive is mandatory and therefore the stay provisions in RA s.11 will need to be amended. At present, the duration of the stay under RA s.11 is not limited to a specific time but rather to the occurrence of events within the reorganisation process. The EU Directive takes a completely different approach.

Art. 6.6 – Same comment.

Art. 6.7 – Same comment. The maximum duration of the stay, including renewals, must be set out in the RA at 12 months. Note that the present timelines in the RA require that a plan be prepared, delivered to creditors for consideration and approval and submitted to the court for confirmation in under 70 days. This time period could be modified so as to allow it to be extended for as long as the stay is in to be in place.

NOTE: The position with respect to the absence of the Estonian reorganisation procedure from Annex A to the EIR (Recast) should be rectified by taking the steps necessary to have the procedure added to that Annex.[61] The procedures in the RA clearly resemble many of those from other jurisdictions whose equivalent procedures are in Annex A. In the meantime, the RA will need to have a further provision in it in order to comply with the additional restrictions on the terms of the stay where there has been a COMI shift, as described in the second sentence of Art. 6.8.

Art. 6.9 – requires that there be provision for relief from the stay. This will require amendments to the RA, which does not at present expressly deal with this topic. Two aspects of Art. 6.9 are not mandatory. The first is that the possibility of lifting the stay of individual enforcement actions could be limited to situations where the affected creditor(s) were not heard before the stay or an extension of it came into effect. Since the stay in Estonia is automatic, this limitation is not relevant. The second optional aspect is set out in the final paragraph of Art. 9(d), which suggests that during the initial period of the stay (4 months), a Member State need not provide an opportunity for the stay to be lifted. Such an exception is not recommended: the fact that a stay is not needed could become apparent at any time, even on the first day on which it is imposed.

### 2.7. Article 7 - *Consequences of the stay of individual enforcement actions*

Art. 7.1 – the obligation of a corporate debtor to file for bankruptcy arises under the Commercial Code s.180(5) (for private companies) or s.306(3)(for public companies). That

[61] See Recommendation 9, above.

obligation arises when the insolvency of the debtor is both "evident" and "not temporary." The fact that the debtor may at that time be in reorganisation proceedings does not appear to exempt the directors of the debtor from an obligation to be aware of the insolvency of the debtor, or of their risk of potential liability for failing to act as the Commercial Code requires. This obligation does not appear to be affected by a duty imposed on the reorganisation adviser to notify the court "and the [debtor]" if "insolvency has become evident" under RA s.16(3)2). It is therefore necessary to add a provision to the RA to implement this Article 7.1 and make it clear that the debtor's obligation to file for bankruptcy is suspended while the stay is in place.

Art. 7.2 – already complied with in principle in RA s.11(1)4), but because this Article is mandatory the scope of that section should be reduced by limiting its effect to the period of the stay. At the moment it extends (like the present stay under the RA) until the occurrence of events rather than for any particular period of time.

Art. 7.3 – this Article is not mandatory. It seeks to do two things. First, it permits a derogation from the application of Articles 7.1 and 7.2 (which suspends the obligation of debtors to file for bankruptcy and the ability of creditors to file for bankruptcy for the duration of the stay) if the debtor is insolvent on a cash flow basis. Secondly, should a Member State implement this provision, it must also "ensure that a judicial or administrative authority can decide to keep in place the benefit of the stay" on the conditions specified in this Article. The derogation appears to relate only to the duration of the stay. Therefore, although it is not clear, it should be assumed that this "derogation" cannot extend beyond the maximum of 12 months specified in Art. 5.8.

Art. 7.4 – this provision is mandatory and will require amendments to be made to RA s.11(1)2) to cover more comprehensively the treatment of essential executory contracts. Note that the EU Directive would permit such amendments to include safeguards to prevent unfair prejudice, and also allow the amendments to include a wider range of executory contracts.

Art. 7.5 - This provision is mandatory and is intended to nullify the legal effect of ipso facto clauses in executory contracts. It will require a new section to be added to the RA in order to achieve compliance. That provision follows logically from others in present RA s.11.

Art. 7.6 – the carve-out from the stay for financial market contracts is not mandatory but is clearly desirable in any modern reorganisation measure and should be incorporated more fully than at present into RA s.22(2).

Art. 7.7 – A provision should be added to the RA making it clear that the expiry of the stay without the adoption of a plan having been confirmed by the court does not automatically give rise to the opening of a bankruptcy procedure unless the other conditions for such opening exist.[62]

### 2.8. Article 8 - *Content of restructuring plans*

Art. 8 – sets out a mandatory but non-exhaustive list of requirements for information to be included in a plan. The items referred to in Art. 8.1(a)-(g)(ii) are already in some respects in RA ss. 21 and 27, but in the interests of clarity one could redraft RA s.21 using all of the paragraphs of Art.8.1 et seq. as a base, and then add any aspects of present RA ss.21 and 27 which are considered useful. This will facilitate the task of compliance. Article 8.1(g)(iii) will

[62] See Recommendation 2.4, above.

clearly require the drafter to refer to national employment law principles. Art. 8.1(h) appears to have been dealt with by the reorganisation adviser's report referred to in RA s.27, but with the important difference that the opinion of the reorganisation adviser must, to comply with the EU Directive, be given to creditors at the time the report is distributed for their review prior to any vote by creditors, rather than to the court at the time of any application to the court.

Art. 8.2 – this important mandatory provision could be the subject of a separate workstream.

### 2.9. Article 9 - *Adoption of restructuring plans*

Art. 9.1 – RA s.20 needs to be amended to permit the submission of plans by creditors (and see the discussion of Art.8 above). The EU Directive allows Member States to impose "conditions" on the right of creditors to do so. One condition which might be imposed is a period of time within which the debtor alone is to have this right. In the US, this is known as the "period of exclusivity." The period selected should be relatively brief, given the other relevant time periods in the RA.

Art. 9.2 – already complied with in RA s.24(5).

Art. 9.3 – the EU Directive excludes certain persons from having a right to vote on a plan. This is not a mandatory provision. As far as shareholders are concerned, this is a policy issue, and, on balance, it is recommended that equity holders should not be able to vote in any circumstances. It would be consistent with most restructuring regimes to limit the leverage which could be exerted by equity holders by denying them the right to vote on a plan.

It is only where there is a serious issue about the possible undervaluation of the equity that this is a problem. In such a case, amendments to the RA could permit a shareholder to object on the basis of sufficient evidence that there is "value" in the equity. The downside to this approach is that delays can and do occur in large restructurings over disputes between the debtor and shareholders over this issue. On balance, in the context of Estonia, the amendments to the RA need not include such provisions.

Art. 9.3(c) – if there is a concern about voting by related parties, the EU Directive permits this concern to be addressed in Art. 9.3(c).

Art. 9.4 – RA s.21(2) is the only provision in the RA which deals with the formation of classes for voting purposes. Amendments will be needed to comply with Art. 9.4. The criteria used to identify classes must be based on what the EU Directive calls "identifiable criteria"[63] and should be set out in the RA rather than, as at present, in the plan under RA s.21(2).

It has been pointed out to us that the present legal capacity of the banks to accept shares in the debtor in exchange for debt forgiveness is may be limited due to the provisions of Estonia banking law. This constitutes a practical limit on the scope of RA s.22, dealing with the transformation of claims. This impediment could be addressed by amendments to the banking law.

[63] The proposed Dutch Bankruptcy Law (s.373) uses the following formulation: "creditors or shareholders who have interests or rights or who would receive interests or rights under the restructuring plan that are so different that they cannot be said to be in a comparable position…must be placed into different classes." Many other formulations, all intended to achieve the same objective, are possible.

The suggested treatment of workers' claims is not mandatory, as is the suggestion that SMEs may opt not to treat affected classes in separate classes.

The need to formulate classes with "a particular view to the protection of vulnerable creditors such as small suppliers" is mandatory and gives rise to policy considerations as to how to go about this. One way might be to include a power to put all creditors below a certain threshold of claim (which could be set by regulation, so as to ease the updating process) in a certain class, which could be paid more than other creditors of equal degree, or even in full. This power need not be exercised in every case (as it is the measure which the EU Directive makes mandatory, not the use of it). In practical terms, this can be a useful feature in any restructuring regime, as it enables any requirement for a majority in **number** of creditors to be achieved more readily.

Art. 9.5 – The EU Directive requires the formation of classes to be examined by the court at or earlier than the time the plan is submitted to the court for confirmation. This provision needs to be added to the RA. If the option of asking the court to decide this issue before the plan has been voted on and submitted to the court for confirmation is preferred (which seems a sensible course), then a power to ask the court to do so should be given to the debtor or any affected creditor, as disputes over class formation are not uncommon in large cases in other jurisdictions.

Art. 9.7 – already complied with under RA s.24

### 2.10. Article 10 - *Confirmation of restructuring plans*

Art. 10.1 – Art. 10.1 is mandatory. Member States must require all accepted plans which contain certain characteristics to be submitted to the court for confirmation. This is already complied with under RA s.28, as all plans must be court-confirmed.

Art. 10.2(a)(b) and (c) – already substantially complied with under RA ss. 26(3) and 28. The wording in Art.10.2(b) could be added to a new sub-paragraph in RA s.28(2) for greater clarity.

Art. 10.2(d) – the best interest of creditors' test is defined in Art. 2.1(6). This test should be incorporated into the wording of RA s. 26 or 28(5).

Art. 10.2(e) – same comment.

Art. 10.3 – already met by the combined effect of RA ss.27(2)1) and 28(5).

Art. 10.4 – already met by the combined effect of RA s.10(2)3) and the first sentence of RA s. 28(2)

### 2.11. Article 11 - *Cross-class cram-down*

Art. 11 – The EU Directive introduces the concept of cross-class cram down, which is inspired by US Ch.11. The objective is to limit the influence of "out of the money" creditors. The drafting of the necessary new provisions in RA s.28 should follow the wording of Article 11 as closely as possible.

Note that the final paragraph of Art.11 permits a Member State to increase the minimum number of affected parties which must have approved the plan before the cross-class cramdown right is triggered. Art. 11.2 also contains non-mandatory derogations from Art. 11.1(c), on certain conditions.

### 2.12. Article 12 - *Equity holders*

Art. 12 – Where shareholders are excluded from voting (as in Estonia), the EU Directive imposes a new obligation to ensure that those shareholders are not allowed “to unreasonably prevent or create obstacles” in the path of adopting and confirming a plan. It is open to Estonia to adapt what is considered to be “unreasonable” to consider those factors set out in the Article. A new provision in the RA is needed to comply with this Article.

### 2.13. Article 13 - *Workers*

Art. 13.1 – It is understood that there are currently no provisions in Estonian labour law (in particular, in the Employment Contracts Act) which would give specific protection to workers of the type mentioned in Art. 13.1. Therefore, the provisions of Art. 13.1 need to be added to the RA.

Art. 13.2 – this Article only applies “if national law or collective agreements provide for” confirmation by workers of measures leading to changes in the work organisation or in contractual relations with workers. At present, it is understood that s.101 of the Employment Contracts Act does require employees to be consulted before the cancellation of employment contracts in the case of collective termination. It would appear, therefore, that Art.13.2 does need to be incorporated into the RA.[64]

### 2.14. Article 14 - *Valuation by the judicial or administrative authority*

Art. 14 – Valuation of the debtor’s business is only to be done by the court where a plan has been challenged by a dissenting creditor on either of the two grounds set out in Art. 14. The court may enlist the support of experts to assist in this exercise (presumably at the cost of the debtor). In the Estonian context, such a measure may seem to be unnecessary, but the provision is mandatory and thus must be added to the RA. As there is already a mechanism for a creditor to challenge a plan in RA s.26, the necessary amendments could logically be incorporated into that section.

The EU Directive does not prescribe any particular method of valuation which is to be used to value the debtor’s business. If, as is believed may be the case, problems for debtors seeking to obtain confirmation of a plan arise because of Estonia court decisions prescribing that a “liquidation value” approach be taken in all cases, this could perhaps be dealt with by further amendments to the RA, but such amendments are outside the scope of the EU Directive.

[64] Although it does not need to be inserted into the RA, it is noted that employees’ pension rights cannot be compromised in a plan by virtue of the Funded Pensions Act as such rights are not assets of the employer. This is completely consistent with the EU DIRECTIVE: see Recital 20.

### 2.15. Article 15 - *Effects of restructuring plans*

Art. 15 – Already complied with in RA s.37(1). Note that the EU Directive does not specifically spell out the consequences of a plan which has been approved by the requisite majorities of affected creditors. Recital 53 states that such a plan should always be "deemed adopted."

### 2.16. Article 16 - *Appeals*

Art. 16.1/2/3 – Already dealt with in RA s.37(3). The exceptional derogation suggested in the second paragraph of Art. 16.3, by coincidence, corresponds with what is understood to be the invariable practice in Estonia (although the practice seems to contradict the second sentence of RA s.37(1), as noted earlier in this Technical Note). If it is considered appropriate to allow for the suspension of the execution of an approved plan pending an appeal, then **Recommendation 4**, above, as well as the closing words of EU Directive Art. 16.3, should be considered in deciding on the wording of the amendment to RA s.37(1).

Art. 16.4 – this Article deals with the consequences of successful appeals only. The ability of the appeal court to confirm a plan "with or without amendments" is left to national law to determine. If, as suspected, this power does not already exist in Estonia, it is recommended that it be granted not only to the court of second instance but also to the court of first instance. In either case, the limit on the power of the court to alter the plan should be limited to non-substantial amendments only. If other, more significant, changes are required to be made to the plan, it should be resubmitted to creditors for their approval.

### 2.17. Article 17 - *Protection for new financing and interim financing*

Art. 17 – As a general matter, the RA is silent as to the treatment of new financing and interim financing. Even if they did have the priority which most restructuring systems confer, providers of new or interim finance might lose that priority at present, as RA s.51(2) states that, in a subsequent bankruptcy of the debtor, the "consequences of commencement of reorganisation proceedings retroactively cease to exist." The RA will therefore need to be substantially amended to include the necessary provisions. The EU Directive requires that Member States encourage the provision of new and interim financing to support the enterprise through the reorganisation and/or to implement the plan. Importantly, one should note that the protection provided by the Directive for this sort of financing is stated to be the **minimum** acceptable. If it is sought to have a significant impact on reorganisation outcomes in Estonia, one must go beyond merely protecting such transactions from subsequent challenge and ensure that such financing is entitled to be repaid with a high level of **priority** (see comments under Art. 17.2, below).[65] It should also be noted that the EU Directive does not preclude a Member State from including provisions which deny any special treatment for new financing on grounds of fraud or bad faith or undervalue.[66]

Art. 17.1 – A new provision is needed to protect new and/or interim funding, and any security granted in respect of it, from the consequences specified in Art. 17.1(a) and (b). In drafting the provisions, it may be worth considering specifically disapplying the provisions of the BA dealing with voidable transactions (e.g. ss 109-114, inclusive). It may also be necessary to

[65] And also see Recital 68.
[66] Recital 67.

examine certain provisions of the BA, for example ss.146(1) and 153, and to make any consequential amendments needed.

Art. 17.2/3 – these provisions are not mandatory. They raise obvious and difficult issues in practice, and, subject to consideration, it may be preferable that they not be included in any new legislation in Estonia. That said, to limit the protection to relevant payments made only where the plan is confirmed by the court (as suggested in the first part of Art. 17.2) may be sensible.[67]

Art. 17.4 – It is recommended that this suggestion be adopted and incorporated into the drafting needed to comply with Art. 17.1. Since the need for fresh money is the key to virtually all successful restructurings, it is necessary to make it clear that those who are willing to provide it will have priority over other creditors of equal or even higher degree in any future bankruptcy of the debtor. In EU jurisdictions one sees a variety of different approaches to this question. In Germany, a plan can give priority to creditors who make loans or provide credit to the debtor following court-approval of the plan, or who permit existing credit lines to continue during the period of supervision. The priority given to those debts is higher than all other creditors apart from secured creditors. In the UK, an administrator (whose role is in the same category as that of a reorganisation adviser in many ways), the administrator is able to borrow on the strength of the assets of the debtor. Such borrowings have priority over unsecured creditors as they are considered to be an expense of the administration. But such loans will not take priority over the claims of pre-existing secured debt unless the security so provides. In France, during preventive insolvency proceedings the debtor may obtain new financing which will enjoy new money priority over other claims with the exception of employment claims in relation to the 60 days of work before the commencement of the proceedings, and insolvency expenses. There is clearly no "one" system for dealing with this important question.

### 2.18. Article 18 - *Protection for other restructuring related transactions*

Art. 18.1 - RA s.52 only gives some protection (but not priority) to the claims of reorganisation advisers, experts and reorganisation advisers exercising supervision functions if the plan is revoked within three months of its approval. Amendments are therefore needed to comply with this mandatory Article. Those drafting the changes might wish to incorporate the substance of the language of Art. 18.4 to facilitate their task. It is noted in passing that the 3-month time limit on treating the claims of experts and advisers under RA s.52 as "defended" seems unduly brief in any event.

Art. 18.2 – as in the case of Articles 17.2/3, these provisions are not mandatory, and could be considered and dealt with in the same way.

Art. 18.5 – As in the case of Art. 17, new drafting is required, and, again, the disapplication of BA ss.109-114 could be considered as part of this exercise. Present RA s.52 does not provide the level of protection for these sorts of transactions which the EU Directive requires.

[67] This is the practice in Italy under the Development Decree, as well as in France.

### 2.19. Article 19 - *Duties of directors where there is likelihood of insolvency*

Art.19 – This imposes explicit new duties on directors. The Introduction to the EU Directive describes the language used as "soft." These duties need to be added to the legislative framework (most appropriately to the RA or perhaps to ss.180(5) and 187 and ss.306 and 327 of the Commercial Code). The Article is poorly drafted: it is obvious, for example, that sub-paragraph (c) adds nothing to sub-paragraph (a), but for drafting purposes the wording of the Directive could largely be tracked in new Estonian legislation. The reader is also referred to the discussion preceding **Recommendation 2**, above. It is the hope of the EU Directive that directors not be dissuaded from exercising commercial judgment and taking reasonable commercial risks, particularly (as outlined in Recital 70) "where to do so would improve the chances for the restructuring of potentially viable businesses."

Articles 20-24 are beyond the scope of this Technical Note.

### 2.20. Article 25 - *Judicial and administrative authorities*

Article 25 – As the EU Directive acknowledges, the question of whether Member States have the necessary legal infrastructure in place to make a success of the EU Directive is very important. The scale of the potential challenge is evident by the need for a court to be able to determine the liquidation value of an enterprise in certain circumstances. Although the relative scale of the Estonian economy may be an advantage in this regard, it remains the case that the courts must possess the "necessary expertise" to deal with all sorts of cases "in an efficient manner, with a view to the expeditious treatment of procedures."

Although it is mainly a matter of impression, it is not considered that the judiciary in Estonia now has a sufficiently robust and regular continuing education programme in place to ensure that judges dealing with reorganisation cases have the necessary specialised expertise. There is a degree of natural specialisation of course, given the dominance of a small number of population centres, but the EU Directive requires more than that, and on a formal level. It is not necessary to commit to specialised courts in order to achieve this objective (and to do so in Estonia would not be proportionate). What is needed is a credible training and ongoing education programme for judges, tailored to the demands of the Estonian economy. In making this suggestion, no judgment is made or intended on the background or previous experience of judges at present hearing reorganisation cases in Estonia. But the recommendations in the EU Directive are forward-looking, and it is therefore a convenient moment for the judiciary to consider what might be done to improve still further the service they provide.

Apart from training, given its focus on the efficient and expeditious treatment of reorganisation procedures, the possibility of judges being able to appoint an expert to support them in cases that require specialist knowledge could also be considered. This is one of the measures now being implemented in the Netherlands, as part of their major reassessment of the Dutch Bankruptcy Law.

### 2.21. Articles 26-27 – *Supervision and Remuneration of IPs*

Art. 26/27 – General comments. The insolvency practitioner profession in Estonia is not fully developed. This is not surprising given the size and commercial context of the Estonian economy.

Some important aspects of the present system seem to work well but could be improved. For example, although the fees charged by reorganisation advisers, bankruptcy trustees and experts do not appear to cause the same level of concern often expressed in other jurisdictions,[68] the remuneration of IPs is at present the subject of a full review. This is healthy, as any functioning IP profession must be in a state of constant evolution.

In virtually all larger economies with developed insolvency regimes the IP profession has evolved in an unstructured manner until relatively recently, when formal examinations, continuing education requirements and strict disciplinary measures came into effect. This explains the vast differences in the shape of the profession from one jurisdiction to the next. It is against this backdrop that the position in Estonia should be considered.

The duties of the reorganisation adviser set out in RA s.16 are onerous. They require financial awareness, commercial judgment, negotiating experience, discretion, drafting skills and legal knowledge. In performing his or her duties, the reorganisation adviser must also take the interests of all participants in the proceedings into account. This is a challenging role. Moreover, research elsewhere suggests that the ultimate failure of businesses, particularly smaller businesses, is not primarily due to fatally flawed business models, but rather "because they were not receiving the assistance they needed in the context of a financial restructuring."[69] The early warning tools to be discussed in the second output of this project will of course be relevant here, as well as the forms of assistance mentioned in Recommendation 8, above, but since the role of the reorganisation adviser includes "assisting the [debtor] during the preparation of the reorganisation plan"[70] the need for the reorganisation advisers to be of a high calibre is undoubtedly important.[71]

It is clear that some of the features of the present profession do not inspire confidence in the public and may be contributing to a lack of efficiency in practice. Several commentators observed that the competence of some reorganisation advisers is open to question, particularly in the large, more complex cases.[72] Judges are aware of this and commented that the approved list of bankruptcy trustees maintained under BA s.59 is not a reliable guide to the quality of any individual IP, whether as potential trustee or potential reorganisation adviser. In cases where the debtor chooses or favours a reorganisation adviser who does not have the full confidence of the court, there must be an uncomfortable dynamic between the court and the reorganisation adviser.[73] Uneven quality of the assistance given by reorganisation advisers

[68] Fees in a reorganisation are usually discussed and agreed between the debtor and the reorganisation adviser in advance. The initial fee covers the deposit/filing fee and reorganisation adviser fees for period prior to court confirmation of the plan. Fees for supervision of the performance of the plan are the subject of a later agreement. The court may adjust the level of fees, even where the debtor has agreed them in advance, if the court considers that the level of fees is "clearly detrimental to the interests of creditors" under Regulations promulgated by the Ministry of Justice under RA s.18(4). Although reorganisation advisers are not generally separately advised by lawyers, bankruptcy trustees may be, in which case the fees payable to the trustee will be reduced.

[69] ABI Proposed Recommendations: Small and Medium-Sized Enterprise Cases, at p.285.

[70] RA s.16(3)3).

[71] What reorganisation advisers do in practice is often slightly less than might be expected, given the requirements of the RA. For example, there is often little discussion between debtor and reorganisation adviser about the financial condition of the debtor or about the prospects for a successful reorganisation before proceedings are opened. And after the proceedings have been opened, it is often the case that the debtor negotiates with creditors directly, either in writing or in person, without the reorganisation adviser being present or participating until it is obvious that the debtor is not achieving its objectives.

[72] See the PWC Report, at p.67

[73] Although the court appoints the reorganisation adviser under RA s.15(1) and is not required to take the opinion of the debtor into account is so doing, it is understood that the debtor's choice is often confirmed by the court. And if it were not so confirmed, the debtor might be unhappy with the choice of the court, which might not lead to a solid future working relationships between the debtor, the reorganisation adviser and the court.

manifests itself in unrealistic plans, a poor "acceptance rate" of plans by creditors and/or the court[74] and inadequate oversight of approved plans.

There is, however, an understandable reluctance to impose on Estonia an elaborate structure of rules and regulations governing the IP profession. Apart from anything else, demand for such services is low: the volume of reorganisation cases and bankruptcy cases is probably not sufficient to support a large cadre of highly-trained people, let alone cover the costs of their training and regulation. Indeed, this fact is recognised in the Bailiff's Act, which refers to the need for training programmes not to prevent any trustee "working on his or her principal job."[75] As a result, the IP profession will remain small for the foreseeable future but must nevertheless be open to new entrants or it will ossify. This creates a particularly difficult dilemma in a sophisticated but small economy in applying Principle D7 of the World Bank Principles, which presumes the existence of regulatory or supervisory bodies which should:

- Be independent of individual representatives;
- Set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency and accountability; and
- Have appropriate powers and resources to enable them to discharge their functions, duties and responsibilities effectively.

There are at present two branches of the IP profession in Estonia. On the one hand, reorganisation advisers appear to be subject to no formal regulation (other than by judges) in their capacity as reorganisation advisers; on the other hand, bankruptcy trustees must be members of the Chamber of Bailiffs and Bankruptcy Trustees, and become qualified by satisfying any one of three different sets of criteria, depending on their educational background and experience.[76] However, the present system for bankruptcy trustees is also far from perfect. Commentators have mentioned that there is little encouragement to the admission of young new members, and that the examination is itself a barrier to entry. It is important to note that those qualified as lawyers and accountants are not required to pass any separate examination or to undergo any training in order to qualify as trustees. Further, lawyers and accountants (as well as anyone with other backgrounds who may have qualified as a bankruptcy trustee) are also automatically qualified to act as a reorganisation adviser.[77] Lawyers and accountants are also exempt from any continuing education requirements under the Bailiffs Act.[78] In the modern context, this state of affairs is an anomaly.

The most proportionate approach to improving the standards of practice in the IP profession generally, and in the case of reorganisation advisers in particular, is to make better and more consistent use of the machinery already in existence for bankruptcy trustees and apply that regime to reorganisation advisers as well. This is not a perfect solution: the functions of reorganisation adviser and bankruptcy trustee are markedly different. In time, it may be necessary to revisit the recommendation which follows as the need for specialist skills becomes more apparent. Care must also be taken to encourage new entrants to the profession.

[74] See PWC Report at p.9. Prior to 2012, of 153 applications to launch a reorganisation procedure, only 20 were court-approved.
[75] Bailiffs' Act s.96(1).
[76] BA s.57.
[77] RA s.15(3).
[78] Bailiffs Act s.97(3). The continuing education requirements are not onerous and are only monitored once every 5 years.

Art. 26.1(a)(b) – in order to avoid the need to conduct a wholesale review of the IP profession, compliance with the EU Directive could be achieved by taking a number of steps which make full use of existing infrastructure. The suggested steps are as follows:

- RA s.15(3) should be rewritten completely so as to permit only those who are currently qualified as bankruptcy trustees to act as reorganisation advisers;
- The conditions for eligibility should be rationalised so as to be identical for both offices;
- the Bailiffs Act should be amended so as to require all candidates for the office of bankruptcy trustee or reorganisation adviser to undergo an initial training programme, irrespective of their educational background and experience, and also to undergo in-service training on a regular basis;
- The initial training, examination and in-service training syllabus should include topics relevant to both bankruptcy and reorganisation;
- The designation of those who are qualified and current could be "trustee in bankruptcy and reorganisation adviser," so as to permit either description to be used by the same person in any given case. This is important from an optical perspective, particularly in the context of reorganisation, where the support of participants during the process is more likely if it is known that the IP in question is a "reorganisation adviser" rather than a trustee in bankruptcy;
- A list of currently qualified bankruptcy trustees and reorganisation advisers should be reviewed at least annually, with more frequent amendments possible in case of need. Several participants have noted in strong language that the present "list system" is inadequate, and this much change. All appointments of bankruptcy trustees and reorganisation advisers must be selected from this list, whether that choice is made by a debtor or the court.

Over time, sufficient specialisation might develop or become clearly necessary so that two "branches" of the IP profession (in addition to bailiffs) might be needed. In that case, the training and qualification programme could "bifurcate" to facilitate this. But that does not appear to be necessary at this time, even though there are obvious differences in the role of reorganisation adviser and bankruptcy trustee.

The above recommendations are not free from difficulty, but the present infrastructure, as laid out in the Bailiffs Act, does seem to provide an adequate basis for it.

Art. 26.1(c) – RA s.15(1) should be amended to require the judge to consider the needs of the case, including any cross-border elements, in appointing a reorganisation adviser.

Art. 26.1(d) – already largely complied with by RA s.19(3), but s.19(1)3) should be amended so as to mention "or has a conflict of interest" as a reason for removing a reorganisation adviser.

Art. 27 – If the reorganisation of the IP profession is undertaken as suggested above, it would seem logical for the Chamber of Bailiffs and Trustees in Bankruptcy to assume responsibility for compliance with the requirements of this Article, with the support of the MOJ. As an alternative, the new Office of Ombudsman could take on this role, provided that appropriately qualified staff are in place.

## 2.22. Article 28 - *Use of electronic means of communication*

Art. 28 – Judges complain that giving notifications to creditors as required by the Code of Civil Procedure[79] can be problematic, because it is difficult for judges to be sure that notifications of any sort required under the RA have actually been received. As a result, the timelines set out in the RA (including appeals from orders made under the RA) cannot be strictly observed without a risk that some creditors do not know of events which could affect their rights. Given the provisions of s.311 of the Code of Civil Procedure, as well as Estonia's deep commitment to digital solutions nationally, it is somewhat surprising that this is a major problem: the court is allowed to "serve procedural documents" electronically through the designated information system by transmitting a notice or making the document available on the system to various possible email addresses notified to the court, registered in the information system of a register maintained in Estonia, registered to his or her legal representative entered in the population register or in the database of another state register or to the email address associated with the Estonian personal identification code. There are alternatives to these procedures where a recipient cannot be expected to be able to use the information system or if service through the information system is technically impossible. One therefore suspects that the problem is that the Code of Civil Procedure requires, in order for electronic service of a document to be proved or presumed, that the recipient take some step which demonstrates that the document has in fact been received e.g. by confirming receipt in writing, by fax or electronically.[80] And indeed this is the case. The confirmation of receipt must bear the digital signature of the sender or be transmitted in another secure manner which enables identification of the sender and establishment of the time of sending, unless the court has "no reason to doubt" that the confirmation without a signature comes from the recipient or its representative.[81] The recipient is under a mandatory obligation to send confirmation to the court "without delay", and may be fined for not doing so.[82] Very unusually, service of procedural documents in any other manner is only allowed "with good reason."[83]

The conscientious manner in which the judges administer the RA is entirely appropriate. But one can see that it is the procedural conflict between 'old' and 'new' which is the problem: "service" of a document has been understood in most systems of civil procedure as a means of delivering documents in a way which does not depend on any act of the recipient to constitute valid "service": namely, personal service by someone who can attest to that fact; or service by a form of posting (either of a notice in a specified place or via the postal service) which entitles the court to presume that actual notice of the contents of the document has been drawn to the attention of the recipient. Service electronically should be more efficient, but it may not necessarily be so (even with the added feature of an obligation on the part of the recipient to confirm receipt) as long as confirmation of receipt is required.

Section 311(8) of the Code of Civil Procedure provides as follows:

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[79] The Civil Code uses the word "notification" but does not state what it means.
[80] Code of Civil Procedure s.311(5).
[81] Ibid.
[82] Ibid.
[83] Ibid. s.311(6)

"*More detailed requirements on the electronic service of documents and making them available through the information system may be established by a regulation of the minister responsible for the area.*"

In our meetings with them, judges expressed a wish to be able to effect service of documents by sending them to the electronic address provided by or on behalf of creditors and/or their representatives, *and to dispense with any need for the recipient to confirm receipt.* Although this would be a bold step, and of course it could have ramifications in areas of the law outside that of creditor and debtor rights which would need to be thoroughly considered, but it would appear to be open to the relevant minister to permit this approach by regulation. To do so would be consistent with Estonia's approach to the digital age more generally, and in keeping with the EU Directive approach in Recital 51 that Member States should be free "to define the form and point in time of the notification [and] to identify the time when it is to be made." Whether or not such a change in the law can or ought to effectively override RA s.46 will need careful consideration.

To comply with Article 28, it is therefore suggested that consideration be given to recommending to the minister responsible to permit, by regulation made under s.311(8) of the Code of Civil Procedure, the service of documents electronically without the need for any confirmation of receipt. It may be necessary to consider the repeal of RA s.46, in order to give full effect to this recommendation.

**APPENDIX 1**

**PREPARING FOR A RESTRUCTURING: CHECKLIST FOR DEBTORS**

**NOTE: This Checklist is intended to assist a debtor in in financial difficulties to prepare for restructuring discussions with creditors, with a view to achieving a restructuring of the business and finances of the debtor so that its business can continue.**

**Not all of the questions raised will be relevant in all circumstances.**

**The aim is to help debtors to be well-prepared for discussions, and to assist them in developing a credible plan which will win the support of creditors and, if need be, the confirmation of an agreed restructuring plan by the court.**

**1. The Debtor**

1.1 Place of incorporation.

1.2 Verify all shareholdings.

1.3 Establish identity of any controlling shareholders, or of identifiable groups of shareholders (e.g. family members)

1.6 Establish if there are any associated or related companies or individuals under local law and consider the consequences of this for any future restructuring process.

1.7 Obtain up to date search information from all public registers.

1.8 Obtain copy of constitution of debtor (if a company).

**2. Business and Assets**

2.1 Identify business activities of the debtor and draft a description of these.

2.2 Establish the recent trading history of the debtor, including major changes in the business, acquisitions or disposals.

2.3 List assets which are owned outright, and list separately all assets which are charged, leased, hired, licensed, held on trust or subject to retention of title or otherwise not subject to the claims of creditors.

2.4 Obtain copies of any property, plant or other asset registers of title.

2.5 Consider obtaining independent valuations of key assets likely to be essential to enable the business to continue or likely to need to be sold to raise finance.

**3. Management**

3.1 Identify current directors.

3.2 Identify key managers and employees who are not directors.

3.3 Identify connections, if any, between management and shareholders, including family connections.

3.4 If remuneration of management is linked to performance, set out the details of the arrangement.

**4. Financial Information and Confidentiality**

4.1 Obtain copies of latest management accounts.

4.2 Obtain copies of recent audited accounts.

4.3 Obtain/produce up to date cash flow statements and forecasts.

4.4 Obtain/produce budgets, forecasts and other future financial planning information.

4.6 Consider need for confidentiality agreement for recipients of commercially sensitive information and form of any such agreement.

**5. Cash flows**

5.1 Identify all bank accounts including bank, location, currency, purpose and current balances.

5.2 Describe cash flow patterns.

5.3 Identify key cash flow dates, such as: paying wages, rent and other periodic mandatory payments.

**6. Key Contracts Review**

6.1 Locate all key contracts. If they are not in writing, then draft a description of their terms.

6.2 Establish whether valuable contracts may be terminated by counterparty or might automatically be terminated on “insolvency.” Determine whether “insolvency” includes “restructuring” and if so whether it might make a difference if the “restructuring” is completely informal or involves the court.

6.3 Establish the consequences of termination by the debtor of key contracts. Damages or contingent liabilities.

6.4 Examine contracts with customers and suppliers, service providers, IT and IP licences, property and other operating leases, and assess the consequences of a restructuring on these.

**7. Financing**

7.1 Identify all sources of financing.

7.2 Obtain copies of all bank loan documentation and identify, where applicable:

- The amount and type of facility;
- Current level of drawdown;
- Repayment profile;
- Interest rates and margins, both normal and default;
- Fees and expenses;
- Events of default and potential events of default;
- Termination rights, including acceleration;
- Financial and other covenants;
- Negative pledges;
- Governing law.

7.3 Establish if there are any existing defaults. Have any default notices been served or rights reserved? Are there any letters extending or varying facilities?

7.4 Obtain copies of documents relating to all other bank facilities, such as:

- Overdrafts;
- Letters of credit;
- Bonding;
- Acceptance credits;
- Bills of Exchange;
- Currency facilities;

7.5 Identify any foreign exchange contracts, swaps, options or other derivative contracts, and obtain copies of relevant ISDA Master Agreements and Schedules. Establish termination provisions, close-out exposures and current mark-to-market values.

7.6 Identify all bonds, notes and other debt instruments issues by the company, and obtain copies. Review these documents as loans.

7.7 Identify all finance leases and obtain copies. Review as loans.

## 8. Security and Guarantees

8.1 Identify all guarantees given by or to the debtor and note the following in each case:

- Identity of guarantor;
- Beneficiary of guarantee;
- Persons/entities guaranteed;
- Liabilities guaranteed;
- Date of guarantee;
- Purpose/benefit to guarantor in providing the guarantee;
- Consider the enforceability of the guarantee under its governing law;
- Assess the risk that payment under the guarantee will be required.

8.2 Identify all security given, including the following:

- Mortgages on land;

- Debentures;
- Charges or Pledges over shares;
- Charges by deposit of title deeds;
- Charges on bank accounts;
- Charges over movable/personal property e.g. ships, aircraft;
- Cash held as collateral, and where;
- Other collateral, type and location.

8.3 Identify all creditors who may be able to assert liens, retention of title claims, trusts or other proprietary (*in rem*) or security rights.

8.4 Check that all security requiring to be registered has been registered and assess the consequences of failing to do so.

## 9. Litigation and Litigation Risk

9.1 Obtain details of all material litigation against the company, including:

- Parties;
- Nature and amount of claim;
- Lawyers acting;
- Stage reached in the proceedings;
- Advice received on likely outcome;
- Insurance cover;
- Settlement prospects.

9.2 Obtain details of any claims or threats of litigation.

9.3 Establish if any significant arrears owed to suppliers, tax or government creditors. Has any enforcement action been threatened or commenced?

## 10. Regulation

10.1 Are the activities of the debtor subject to regulation in any way? If so, by whom?

10.2 Does the debtor hold licences which permit its activities? Could these licences be affected by a restructuring or insolvency?

10.3 Are there obligations to disclose restructuring or insolvency events to regulators? Consider how this obligation is to be discharged, and when this must/should be done;

10.4 Are any public announcements required, e.g. through a stock exchange?

## 11. Advisers

11.1 As needed, identify and list contact details for:

- Legal advisers;

- Auditors;
- Financial advisers;
- Valuations experts;
- Any relevant technical advisers.

11.2 As needed, identify and list contact details for the legal, financial and other advisers to the financial creditors.