Restructuring - screwing creditors over or an actual chance to help companies?

In December 2018, it will be 10 years since the Reorganisation Act came to force in Estonia. One of my good friends, a well-known Estonian attorney, has referred to restructuring as „screwing creditors over in three parts ". I tend to disagree. However, the first image that popped in my head years ago, when I first heard the term restructuring, was the red brick Sanitary Epidemiological Station building that I could see through my nursery school's fence.

Realisation, that restructuring may actually have some substance related to commercial law took some time. By now, I have worked as a restructuring advisor for approximately ten companies and have advised creditors several times. This article is the first one of three-part series of articles, in which we try to explain what restructuring is and whether the goal of restructuring really is to bully creditors.

The goal of Reorganisation Act was noble, and Estonia definitely needed it. It was meant to decrease bankruptcy amongst companies, preserve jobs and give the entrepreneurs a last chance for getting the company through the crisis. In an International scope, the goal was to improve the international competitiveness of Estonian companies, but most of our neighbouring countries had already passed reorganisation Acts a while before we did.

Restructuring is essentially meant to be an alternative to bankruptcy proceedings. The main idea of restructuring is simple – with restructuring proceeding the business receives a **temporary** protection from court against the creditors, but during that time the management board must put together a **restructuring plan** and get the majority of the creditors to approve it. In order to help the company form the plan and carry out the restructuring the court appoints them a restructuring adviser. The restructuring plan is a description of activities about how the management board plans to restore the company's profitability and how, and in what amount, the creditors' claims will be paid. If the company can't "sell" the restructuring plan to its creditors, the restructuring will be terminated and often the outcome is bankruptcy.

Restructuring isn't that topical at the moment, because the Estonian economy is doing well. It becomes more relevant right before an economic crisis or even during it. Maybe that is also the reason why not many people know about restructuring as a measure to help a company get through difficulties and why the general attitude towards restructuring proceedings is rather negative. Restructuring proceedings are not seen as an alternative to bankruptcy proceedings, but rather as a different form of bankruptcy proceedings. There are negative myths that follow restructuring proceedings, that install fear in entrepreneurs. It's not uncommon that the cooperation partners of a company who undergoes restructuring will distance themselves, which is why companies are too scared too even initiate the restructuring proceedings or why they start to think of restructuring too late, when the company has already used up all financial and legal resources that might help them get out of the difficult situation.

Initiating the restructuring proceedings

The right time to initiate restructuring proceedings is when first signs of financial trouble appear. I am quite certain, that if companies would consider using restructuring proceedings at the first sign of trouble, the amount of successful restructuring proceedings would be substantially higher and the reputation of those proceeding much better.

The restructuring proceedings are initiated by the court. In order for the court to be able to do so, the company has to submit a restructuring application along with other documents required by law. Every business should be able to draw up the restructuring application themselves, however, before submitting it they should answer two questions: 1) what will the money flow be like in the next two years and 2) will that be enough for both running costs and for settling old debts? If the answer to the second question is no, then it doesn't necessarily mean that the business is not a viable candidate for restructuring. It just means that they should consider what kinds of restructuring measures they should use for achieving a better result for the creditors than bankruptcy would provide. It would be wise for the company to play out the general restructuring action plan with the help of a specialist before they submit the restructuring application. That will provide better chances for a successful restructuring.

Another opportunity that businesses often miss, is that they can ask the court to appoint them the same specialist as a restructuring adviser, with whom they've already discussed the restricting plan with. Although appointing the advisor is completely up to the court, they still take your opinions into account. If the business fails to do so, the court will appoint a random person, who might not be acquainted with the specifics of the company. Companies should also consider that according to the law, the restructuring adviser can only be either an auditor, a trustee in bankruptcy or a sworn advocate (attorneys at law).

What happens to the company once the restructuring has been initiated?

The simple answer is nothing. The management board will carry on its day to day managing tasks, restructuring doesn't affect the management in any way. The appointed restructuring advisor is meant to only advise and verify. A restructuring adviser does not have the same competency as a trustee in bankruptcy in bankruptcy proceedings. The restructuring advisor has no authority to get involved with the management of the company or deny them from making any sort of payments.

Also, a restructuring advisor is not a representative of the business. They cannot make decisions for the company nor give any promises. All decisions will still be made by the management board.

What does transformation of claims mean?

During the restructuring, the creditors' claims will be transformed. To reduce and expiate the claim are two of the most common ways provided by law to transform a claim. The length of period for expiating claims and the amount they can be reduced depend on very specific facts – the size of the claim, the field the company operates in, etc. The law gives no instructions in that part.

When it comes to expiating the claims, the Supreme Court has found that fulfilling the restructuring plan can't take unreasonably long, but under extraordinary circumstances, the reasonable time may even be 10 years. The author of this article finds, that a reasonable time for expiating is up to 5 years. It's important to remember that during the expiating period companies also have to pay interest from the remaining balance of the claim.

With reducing the claim, the Supreme Court found that in restructuring proceedings the creditors shouldn't receive substantially less than they would receive during a bankruptcy proceeding. Essentially it means that companies can pay the creditors less during a restructuring proceeding than they would during bankruptcy proceedings. Of course, you can't get carried away by transformation of claims, because the creditors must approve the restructuring plan and they might not be very fond of long expiating periods or big reductions. If at all possible, the company should try and repay the debt in full - it sends a positive signal to both the court and the creditors.

Contact Veikko Toomere for more information.

VEIKKO TOOMERE
ATTORNEY AT LAW,
PARTNER

(+372) 66 76 440
VEIKKO.TOOMERE@NJORDLAW.EE