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**Transposing the Preventive Restructuring Directive:**

**Expert Views from Estonia**

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**Introduction**

The Estonian Ministry of Justice commissioned a group of insolvency experts to provide an expert opinion about the implementation of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 (“the Directive”). The expert group consisted of insolvency specialists from different occupations: attorneys-at-law, insolvency trustees, judges, academics and representatives of banking. This article summarises the aspects of the study, which might be interesting for other European countries facing similar issues in the transposition process.

**The Opinion of the Expert Group**

*1. Stay of Individual Enforcement Actions*

Unlike the Directive, whose approach is to impose a broad stay and to permit derogations from it, Estonian law regulates the suspension of enforcement measures narrowly. This approach needs to be changed, including extending the stay to various out-of-court debt recovery options. The Group’s proposal is to maintain the suspension of enforcement proceedings as an automatically applicable general measure and to leave the suspension of other measures optional. For other enforcement measures (court proceedings, out-of-court redress, non-enforcement of liens, other contractual instruments), the working group considers that a selective approach is more reasonable, i.e. they should be suspended on a case-by-case basis by a separate undertaking and against a specific creditor.

The duration of the stay under the valid Restructuring Act is not limited to a specific time, but rather to the occurrence of events within the reorganization process. The Directive takes a completely different approach and, therefore, the Group proposed setting a specific duration for the suspension of enforcement measures in the Restructuring Act in order to meet the requirements of Article 6(6) of the Directive, including the injunction that the initial duration of stay should not exceed 4 months.

As the current law does not provide for the possibility of lifting the stay, then, in order to comply with the Directive, the Group proposed that a court could decide to terminate the stay at the request of a creditor, IP or debtor, if the suspension is no longer necessary or became disproportionately burdensome for the creditor. However, the members of the Group considered it justified to use the possibility provided for in the Directive to limit the suspension of enforcement measures only to those situations, where creditors had not had the opportunity to be heard before the stay came into force or before an extension of the stay period was granted. However, the experts did not consider it justified to use the possibility provided for in the last subparagraph of Article 6(9) of the Directive to set a minimum stay period during which the suspension of enforcement measures is not allowed, since the fact that a stay is not needed could become apparent at any time during the procedure.

National legislation also needs to be amended in order to be in line with Article 7 of the Directive. The Group considers that, in order to ensure compliance with the Directive, the Restructuring Act must restrict the creditor’s right to terminate contracts, relevant to the debtor’s continuation of business, on the grounds of breach of contract before the reorganization proceedings. The restriction of the creditor’s right to withhold performance of his obligations on the basis of such breaches is also justified. However, the imposition of such restrictions must be proportionate and, as a general rule, limited to contracts critical for the continuation of the debtor’s business.

At the same time, creditors must be provided with adequate protection mechanisms. As a minimum, the creditor must be given the right to seek the court’s consent to terminate the contract or refuse to perform his obligations. The Group also suggested considering the possibility of giving priority in insolvency proceedings to claims arising from the continuation of contracts (similar to interim and new financing). Although a viable alternative, the experts did not consider it reasonable to make the continued performance of contracts conditional on the provision of a guarantee by the debtor.

*2. The Restructuring Plan*

The right to present a restructuring plan drawn up in cooperation with the restructuring advisor continues to be vested in the debtor. No separate power to present the restructuring plan was granted to the creditors or to the restructuring advisor solely. The Group recommended that national law should be amended so that the restructuring plan should correspond to the creditors’ best interest test and that workers’ claims should not be affected by restructuring proceedings.

The Group proposed that national law should be amended so that the creditors would be divided at least into four classes: (i) secured creditors; (ii) equity holders; (iii) parties related to the debtor; and (iv) unsecured creditors. When adopting the restructuring plan, the secured creditors would vote in a secured creditors’ class only to the extent where their claims have been secured. For any unsecured part of the claim, the secured creditor will have the right to vote in the unsecured creditors’ class.

The compliance of the plan with the creditors’ best interest test will be supervised by the restructuring advisor and by the judge. Although at present, there are no specialised insolvency judges in Estonia, the Group has suggested the development of a team of specialised insolvency judges to help achieve more efficient insolvency procedures. Nonetheless, the existence of quick and flexible Estonian restructuring proceedings, the lack of specialised judges and the small size of the Estonian economy are the main reasons why the Group did not support “pre-packs” or special regulation for “SMEs” at the moment. The Group suggested the formation of a new investigation and monitoring working group to analyse whether the implementation of “pre-Packs” or “SMEs” would be relevant for Estonia.

*3. Cross-Class Cram-Downs*

A novelty for Estonians is the cross-class cram-down. The Group was of the opinion that the requirements of Article 12 of the Directive could be solved by allocating equity holders into a separate class and, where they do not approve the plan, by enforcement of the cross-class cram-down under Article 11 of the Directive. For the purpose of implementing the cross-class cram-down rules, including, but not limited to the case of equity holders, the fairness test (including of course the creditors’ best interest test) and the relative priority rule should be followed. The relative priority rule was suggested, instead of the absolute priority rule, as being more flexible and efficient in dividing the surplus of the restructuring proceeding and thus make restructuring proceedings more efficient and encourage debtors to invest in restructuring efforts.

*4. Interim and New Finance*

The analysis proposes that the interim financing receives protection from claw-back actions, if the transaction complies with the criteria set for interim financing. This means that the interim financing must be new and reasonably and immediately necessary for the debtor’s business to continue operating or to preserve or enhance the value of that business (as defined in the Directive). There is no requirement for *ex-ante* control of interim financing by creditors, the court or an insolvency practitioner. By way of contrast, new financing should only receive protection from claw-back actions in cases where the court approves the plan. The terms and the amount of the new financing also have to be reflected in the restructuring plan.

Both interim and new financing should receive priority in any future bankruptcy proceeding as payments made before the creditors’ claims are satisfied according to the ranking set in the bankruptcy law. According to the bankruptcy law, before payment of money on the basis of the distribution order, payments relating to the bankruptcy proceedings shall be made out of the bankruptcy estate in the following order: (i) claims arising from the consequences of exclusion or recovery of assets; (ii) maintenance paid to the debtor and his or her dependants; (iii) consolidated obligations; and (iv) the costs of the bankruptcy proceedings.

The Group feel that interim and new financing should constitute a fifth category in that order, meaning they will be paid after the costs of the bankruptcy proceedings. It should be noted that money received from the sale of the encumbered property can be used to cover the above-mentioned claims and costs only up to 15% of the amount received from the sale of the secured object.

*5. Appeals*

The grounds of appeals may be the infringement of the procedure during the composition, adoption or confirmation of the plan, or, where a creditor, who voted against and contested the plan, was not treated in accordance with the creditors’ best interest test, unless the damage to the contesting creditor under the plan is compensated. The Group suggests that a court should be obliged to process the appeal within 30-45 days.

*6. Individual Persons*

The Group suggested treating individual entrepreneurs and other natural persons on equal terms, because an individual entrepreneur’s activity is often secured by that individual’s property. For individual persons, the Group proposed compulsory debt counselling before official court procedures. The court should take in consideration the pre-official court procedure counselling and decide, whether to direct the individual person to bankruptcy or to rehabilitation proceedings. The period prior to the fresh start is to begin from the declaration of bankruptcy of the individual person and will be shortened to three years. In case of dishonest debtors, the period before a fresh start is to be prolonged or the decision to allow a fresh start may be cancelled. There is also an opportunity for the debtor to obtain a fresh start before the period expires, where the debtor settles a goodly proportion of the claims of the creditors. The Group supports the solution that debtors should cover the expenses of the fresh start procedure, unless the covering of expenses by the state can be justified.

*Summary*

In analysing the Directive, the Group were careful to take into account the novelties presented by the text as well as institutions and procedures with which Estonian law was already familiar, but which were implemented differently to the Directive’s recommendations. Transposing the Directive will be a considerable task, but one that the Group feels will be considerably eased by this preparatory work and the solutions it proposes, with which the Group hope the legislators will be pleased to concur.