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MEMORANDUM

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REFORM OF THE FINNISH INSOLVENCY LEGISLATION

1 Background to the reform

The Finnish bankruptcy regulation has been revised recently. An overall revision of the Bankruptcy Act had been underway for decades. Finally, in December 2003, the Finnish Parliament passed the Government bill on the new Bankruptcy Act. The new Bankruptcy Act (120/2004) ("Konkurssilaki") came into force on September 1, 2004.

Although there is no unified insolvency legislation in Finland, the Bankruptcy Act plays the most central role in respect of insolvency regulation. The regulations dealing with liquidation and reorganization are to be found in different acts, i.e. the Companies Act (734/1978) and the Restructuring of Enterprises Act (47/1993).

The Commercial Bank Act (1501/2001), the Cooperative Bank Act (1504/2001), the Savings Bank Act (1502/2001) and the Insurance Companies Act (1062/1979) deal with special issues relating to winding up procedures with respect to credit institutions and insurance companies. This special regulation was amended in May 2004 by implementing the relevant EC directives[1]. No entirely new acts were established during the implementation process. The most important amendments concerned recognition of decisions taken by authorities in another Member States, lodgements of claims, priority of claims as well as certain information and publication requirements. Hence, the Finnish insolvency legislation is, invariably, undergoing revision owing to international insolvency regulation. In addition, the coming into force of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings in 2002 was an important leap towards efficient cross-border insolvency proceedings.

The former Finnish Bankruptcy Act ("Konkurssisääntö") came into force as early as in 1868. Although the former Bankruptcy Act had been amended and revised several times during its period of validity, it still comprised fundamental provisions from the original legislation. It is worth mentioning that a number of fundamental amendments were made to the former Bankruptcy Act during the 1990's. These amendments concerned, *inter alia*, the creditor's order of priority and recovery proceedings.[2] Prior to these amendments, the Finnish insolvency legislation included a multi-stage order of priority giving priority to e.g. labor costs and fiscal receivables. Today, the said order of priority is quite uncomplicated and the current system gives priority mainly to creditors with collaterals.

[1] The implemented directives were the Directive 2001/17/EC on the Reorganisation and Winding-up of Insurance Undertakings and the Directive 2001/24/EC on the Reorganisation and Winding-up of Credit Institutions.

[2] The Act on Order of Priority of Claims (1578/1992), which altered and simplified the priority structure, entered into force on Janury 1, 1993. The Act on Recovery to Bankrupt's Estate (758/1991) entered into force on January 1, 1992.

Some Finnish legal experts have pointed out that the Finnish insolvency system is, generally speaking, based on favoring the creditors (a so-called *pro creditor* principle) but the above-mentioned revisions in the early 1990's were, actually, based on a *pro debtor* principle by taking strongly into consideration the benefits of the debtor and the society as a whole.[3] In addition, it has been stated in the literature that the courts' decisions as regards recovery claims may be either pro creditor or pro debtor by nature, depending on the type of insolvency proceeding they are applied to: the Finnish courts tend to accept recovery claims more easily with respect to bankruptcy proceedings than to restructuring proceedings.[4]

The Finnish Companies Act (734/1978) currently includes provisions on mandatory liquidation. In short, this means that if the company's equity falls to below half of the share capital, the board must call a general shareholders' meeting to discuss the possibility of liquidation. If the shareholders decide not to place the company into liquidation, another general shareholders' meeting must be held within 12 months. If, at the second shareholders' meeting, the company's equity is still under half of the share capital and the shareholders refuse to commence liquidation, the Board must apply to the court for liquidation. The Companies Act is undergoing a major reform, under which the provisions on the above-mentioned mandatory liquidation are proposed to be removed.

2 Central amendments to the Bankruptcy Act

As a general rule, the new Bankruptcy Act codifies the principles set forth in the long-term Finnish legal praxis. The current new insolvency legislation retains the fundamental principles with respect to e.g. proceedings regarding groups of companies and a (conceivable) consolidation thereof, impacts on long-term agreements and possibilities regarding new financing of a bankrupt company.

However, the new Bankruptcy Act includes a number of revisions due to which the bankruptcy proceedings are expected to come off more efficiently and smoothly than before. The central amendments to the bankruptcy legislation are the following:

- The administrator appointed by the court at the opening of the bankruptcy proceedings shall no longer be replaced by another person in the middle of the proceeding. Prior to this revision, the first administrator appointed by the court to a bankruptcy estate had been a "provisional liquidator", whose term lasted only the beginning of the bankruptcy proceedings;

[3] Risto Koulu *et al.*, Insolvenssioikeus (2002), p. 51.
[4] Risto Koulu, Palautus- ja korvausvastuu konkurssitakaisinsaannissa (1999), p. 3.

- The creditors have the right to set up a special creditors' committee that acts as an advisory body in respect of the administrator. The creditor's meeting can delegate duties to the creditors' committee. The creditors' committee is obligatory in large-scale estates. According to an opinion expressed in the juridical literature, the communication with the main creditors via the creditors' committee is perhaps not any more flexible compared with direct contacts with the creditors. In addition, the use of the creditors' committee is not expected to be as common as within restructuring proceedings[5];

- If the company's assets do not cover the costs of the bankruptcy proceedings, the court may decide upon placing the debtor under a public receivership based on the Bankruptcy Ombudsman's proposition. As a consequence, the possible misconducts and defaults can be detected also as regards truly indigent companies. This new provision might also prevent misconducts within the administration of a going concern, because fraudulent conduct by an insolvent company's management would more likely be detected.

  When the court has decided to open the public receivership, the administrator no longer represents the estate. Moreover, the creditors forfeit their power of decision regarding the bankrupt's estate's matters. The Bankruptcy Ombudsman appoints a public receiver, who shall seize the assets of the bankrupt's estate. The public receiver has the same rights and obligations as the administrator would have during a normal bankruptcy proceeding. However, the public receiver is not submitted to the creditors' power of decision and is thus solely in charge of the estate. The State shall be responsible for the costs of a public receivership.

  If it is found during the public receivership that the assets of the estate will suffice to cover the expenses of the bankruptcy proceedings, the court must cease the public receivership and return the administrative power to the creditors. Such arrangement must also be regarded "well-founded" as a whole.

- The new Bankruptcy Act includes a mandatory general provision regarding the continuance of agreements bound by the debtor.

  The debtor's contractual counterparty is required to inquire the debtor's bankrupt's estate, whether it is willing to commit itself to the agreement. The counterparty is not entitled to cancel the agreement, if the bankrupt's estate notifies the counterparty within a reasonable time of its willingness to be bound by the agreement and provides security regarding the fulfillment of its obligations under the agreement;

[5] Matti Nenonen, Konkurssipesän hoitaminen (2004), p. 58.

- The credit institutions do no longer have the right to set off a claim against the debtor's assets on the debtor's bank account provided that such assets may, according to the respective account terms, be used for general payment transfers. This amendment has been made in order to strengthen the equality of creditors;

- If the creditor files his proof of claim after the deadline set by the administrator, his claim will not be finally disallowed. The creditor shall, however, be charged for this so-called subsequent proof of claim with a fee amounting to one percent of the subsequent proof of claim. The fee shall never be less than 600 euros or exceed 6,000 euros. Notwithstanding the foregoing, a subsequent proof of claim shall be disallowed after the confirmation of the proposal for the distribution of assets (Chapter 12, Section 16); and

- The administrator may take a claim into account exclusive of a proof of claim, provided that there are no unclarities regarding the grounds and the amount of the claim.

2.1 General goals of the amendment of the Bankruptcy Act

The individual amendments and the objectives thereof set aside, the revision of the bankruptcy legislation aims to update the aged linguistic form of the bankruptcy legislation. Moreover, as mentioned earlier, the idea has been to codify some of the principles originating from the legal praxis, since it is important that mandatory legal rules are to be found in the written law.[6]

According to the respective Government bill, the goal of the revision has been that the new bankruptcy legislation would be "clear and predictable". In addition, the bankruptcy proceedings are required to be efficient and flexible.[7]

The Finnish bankruptcy legislation has been codified to a large extent within the new Bankruptcy Act and the related regulation. Hence, the underlying principle of the Finnish legal system, i.e. that the effective regulation shall be found primarily in the written law and not in legal praxis or juridical literature, has now been implemented more efficiently within the bankruptcy legislation.

The above-discussed amendments to the Bankruptcy Act are, generally speaking, well founded and do not substantially alter the Finnish insolvency regulation.

[6] Government Bill (HE 26/2003), p. 16.
[7] Government Bill (HE 26/2003), p. 17.

3 Impact on international insolvency regulation

3.1 Directive 2001/17/EC and Directive 2001/24/EC

The implementation of the Directive 2001/17/EC on the Reorganisation and Winding-up of Insurance Undertakings and the Directive 2001/24/EC on the Reorganisation and Winding up of Credit Institutions in Finland had not been running to time in Finland. According to the Directives, the Directive 2001/17/EC should have been implemented in the Member States before April 20, 2003 and the Directive 2001/24/EC on May 5, 2004. However, these deadlines were not met in Finland. Especially the implementation of the Directive 2001/17/EC was clearly behind schedule. The implementation regarding Directive 2001/17/EC concerning insurance companies was completed almost a year late as the pertinent amended Finnish legislation entered into force on May 15, 2004. The national legislation based on the implementation process as regards Directive 2001/24/EC concerning credit institutions came into force two weeks later on May 31, 2004.

In a technical sense, the Directives and the implementations thereof did not significantly alter the related Finnish legislation. That is to say, no entirely new acts needed to be established on the basis of the Directives and the existing acts' structure and systematics remained the same to a large extent.

With respect to both Directives, the most central amendments to the Finnish insolvency legislation in relation to credit institutions and insurance undertakings concerned the so-called home member state principle and the recognition of decisions taken by the authorities in other member states. In addition, as regards insurance undertakings, the renunciation of the so-called special receivership was a major reform.

As mentioned above, the former legislation included a concept of special receivership. The said concept means that the assets, which cover, inter alia, the underwriting reserves and the unit-linked insurances, constitute a special receivership in winding-up proceedings. As the precedence concerns today, owing to the reform, all insurance claims and the entire assets of the insurance undertaking, this kind of special arrangements is not needed any longer. Due to the implementation process, the concept of special receivership does no longer exist. Hence, it is estimated that the administration of winding-up proceedings shall be somewhat lighter and less expensive in the future as there will be no longer two receiverships with respect to one insolvency process and one insurance company.

3.2 Council regulation (EC) No 1346/2000

From a theoretical perspective, the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings has had a major impact on the groundwork of the Finnish insolvency legislation. For example, the introduc-

tion of secondary insolvency proceedings is a central amendment to the Finnish regulation.

However, from a practical point of view, the Regulation has not yet revised the Finnish insolvency procedure praxis since the number of secondary proceedings has been extremely low.

It should be noted that the secondary proceeding could only be a bankruptcy proceeding in Finland, even if the primary proceeding would be a restructuring proceeding. This might cause inconsistency as regards the reconciliation of the primary and the secondary proceedings, because the former aims to a rehabilitation of the enterprise and latter aims to liquidate the assets at hand.

3.3 UNCITRAL Model Law on Cross-Border Insolvency

The UNCITRAL Model Law on Cross-Border Insolvency has not yet had any impact on the Finnish insolvency legislation. The Finnish insolvency legislation is based on the national legal tradition with strong influence from the Swedish legal tradition, as well as on the EU-wide insolvency regulation.

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