Economic Crisis and the Effectiveness of Insolvency Regulation

1. Introduction

In the circumstances of the economic recession, saving of money and the effective use of resources has become a highly popular subject. Also the effectiveness of legal regulation is without doubt an important part of this topic. The objective is not just the ensuring of legal regulation appropriate to the society’s level of development but the ensuring of that with the least possible expense. Insolvency law and the regulation of economic relations arising from insolvency—one of the essential elements of legal order—is also of great importance and deserves at least as much attention as the rest of the elements of legal regulation. During an economic crisis, insolvency law obtains a much more prominent place in the social consciousness than usual. This is, above all, due to the rise in the number of insolvency cases (including bankruptcies). An increasing part of the society is beginning to sense insolvency-related issues as personal problems or at least as a source of personal problems.

The author of this article has set three objectives for himself: first, to examine the statistical relationship between the state’s economic circumstances and the number of insolvency proceedings; second, to ascertain the principles according to which it is reasonable to evaluate the effectiveness of insolvency regulation, which, in turn, requires definition of the objectives of the legal regulation of insolvency; and, third, to compare different types of procedures and different regulations from the standpoint of expected effectiveness. However, the article also serves a purely practical purpose: to investigate whether the regulation in force in Estonia is sustainable in the circumstances of an economic crisis, and if not, what could be done to improve the regulation. The author has proceeded from the hypothesis that the regulation currently in force is not effective enough to handle the rising number of insolvency proceedings resulting from the economic crisis, and this is not a problem unique to Estonian regulation. Although the article mostly relies on Estonian data, most of the conclusions drawn are also applicable to other countries, with similar regulations. Because of the rising trend of insolvency proceedings, it is likely that finding ways for reducing procedure expenses—above all, for improving the effectiveness of the existing types of procedures and for using such types of procedures as involve the court and the state as little as possible—is unavoidable.
2. The relationship between the number of insolvency proceedings and change in GDP

Comparing the recent years’ dynamic of bankruptcy matters filed in Estonian courts, we will see that in 2007, there were 698 bankruptcy cases filed in courts; that is a 67.8% increase in comparison to the previous year, and the number of bankruptcy matters filed in courts in 2008 was 698, which is, in turn, 69.9% more than in the previous year. The data of 2009 are not directly comparable with those of previous years, because of a change in procedure rules, but the total number of filings for action for proceedings concerning petition and other bankruptcy matters was 2,420, which means that the number has more than doubled. Also, it cannot be claimed that the increase in bankruptcy matters has occurred proportionally to the decrease in other cases. In fact, both the total number of civil matters and the percentage of bankruptcy matters in relation to that number are on the rise. In 2007, 2008, and 2009, that percentage was 2.6%, 4.6%, and 8.2%, respectively. The facts presented speak for themselves; however, for planning of the measures necessary for updating the insolvency regulation, it is not enough to state the fact that the number of insolvency proceedings is likely to keep rising in the near future. It is important to know how much and when exactly it is going to increase. To get an overview of the situation, statistical parameters descriptive of essential relations must first be determined. Unfortunately, no statistical indicator provides a complete picture of the process. Each indicator only describes specific aspects of the reality, and making some kind of selection is unavoidable. In order to examine the statistical relations between the current economic situation and the number of bankruptcies, the author has chosen the following statistical indicators:

1. Change in gross domestic product calculated via chain-weighting method in comparison with the same period of the previous year (real GDP growth) has been used as a characteristic of the dynamic of the state’s economy. As shown by this indicator, Estonia’s economic growth was relatively stable in the years 2001–2005, was exceptionally rapid in 2005 and 2006, began to decrease in 2007, and turned negative in 2008. In 2009, the downturn became very rapid. Such a development curve coincides very well with the common understanding of the development trends of the Estonian economy.

2. The number of court-declared insolvency cases of companies—i.e., abated and declared bankruptcies—has been used as an indicator characteristic of the number of insolvency proceedings. The collected data indicated that the result does not change substantially with use of the ratio of the number of insolvency cases to 10,000 registered undertakings.

To get a good overview, it would be practical to use time-series that are as long as possible, but, unfortunately, the options are limited here. All elements of a time series must be determined on the same bases. In the years following the entry into enforcement of Estonia’s first Bankruptcy Act (hereinafter ‘BankrA’) in 1992, the number of bankruptcies was very small because the launch of the new system required some break-in time, while the number of registered companies was very large as a result of the low cost and ease of business registration proceedings. The number of companies registered in Estonia experienced a significant change in the years 1995–1997, when the principles for founding companies changed and companies were reregistered, moving from the register of enterprises, agencies, and organisations to the commercial register. Therefore, it would be misleading to compare the indicators of the years up to 1997 with those of recent years, which is why earlier years have been discarded in this study. The data, presented in table form, are the following:

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2. With the Amendment Act of the Code of Civil Procedure and the related acts (Tsiviilkohtumenetluse seadustiku ja sellega seonduvate seaduste muutmise seadus – RT I 2008, 59, 330, 284 (in Estonian)), adopted on 10 December 2008 and enforced on 1 January 2009, the initiation of bankruptcy proceedings, the declaration of bankruptcy, and the matters related to bankruptcy proceedings that cannot be settled by action were classified under matters to be settled by proceedings on petition. That also changed the way they were reflected in court statistics.


<table>
<thead>
<tr>
<th>Year</th>
<th>Number of insolvency cases*6</th>
<th>GDP*7</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>224</td>
<td>11.7</td>
</tr>
<tr>
<td>1998</td>
<td>275</td>
<td>6.7</td>
</tr>
<tr>
<td>1999</td>
<td>433</td>
<td>–0.3</td>
</tr>
<tr>
<td>2000</td>
<td>293</td>
<td>10.0</td>
</tr>
<tr>
<td>2001</td>
<td>257</td>
<td>7.5</td>
</tr>
<tr>
<td>2002</td>
<td>427</td>
<td>7.9</td>
</tr>
<tr>
<td>2003</td>
<td>459</td>
<td>7.6</td>
</tr>
<tr>
<td>2004</td>
<td>436</td>
<td>7.2</td>
</tr>
<tr>
<td>2005</td>
<td>419</td>
<td>9.4</td>
</tr>
<tr>
<td>2006</td>
<td>352</td>
<td>10.0</td>
</tr>
<tr>
<td>2007</td>
<td>202</td>
<td>7.2</td>
</tr>
<tr>
<td>2008</td>
<td>429</td>
<td>–3.6</td>
</tr>
<tr>
<td>2009</td>
<td>1055</td>
<td>–14.1</td>
</tr>
</tbody>
</table>

In order to show trends, the data have been presented in a line graph:

I will leave more precise correlation calculations to mathematicians, but it is easy to see the clear negative relation between GDP and the number of insolvency cases—the graph lines mirror each other. By examining the maximum and minimum points, one may notice that the relation occurs with a shift of about a year. This could also be formulated by saying that today’s trends of GDP change are realised as a corresponding growth or decline in the number of bankruptcies one year later. Given the duration of bankruptcy proceedings*8, the effect is likely to persist for many years. Decline in GDP therefore increases the work load of courts for more than a year.

It could be said that the author is ‘breaking through an open door’, and that such a result is entirely expected and this dependency has been noted in the professional literature before.*9 However, given the novelty of the situation for Estonia, pointing out this problem in such a way is probably necessary nevertheless. It is relevant

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* Change in chained GDP value in comparison with the same period of the previous year. Available at http://www.stat.ee/43098 (in Estonian); Press release of the Statistical Office, 11.03.2010: Mullu jäi SKP suurim langus II kvartalisse (The Biggest Decrease in GDP Occurred in the 2nd Quarter Last Year). Available at http://www.stat.ee (21.03.2010) (in Estonian).


to analyse whether and to what extent this (presumably well-known) trend has been taken into account in planning of the developments of the coming years. First and foremost, the question must be answered of whether the existing regulation is effective and inexpensive enough to be able to handle the sharp increase in the number of insolvency proceedings that is very likely to occur in the near future. Given that Estonia lacks experience with crises comparable to the current economic crisis, the study must rely mainly on the experience of other countries. As regards the economic effectiveness of the procedure, there are, however, several opportunities for drawing important conclusions from the statistics for insolvency proceedings in Estonia. Since reorganisation proceedings are still a very young type of procedure in Estonia, it is mostly the statistics pertaining to bankruptcy proceedings that can be used.

### 3. Evaluation of the effectiveness of the legal regulation of insolvency

The effectiveness of a system can be viewed as the ratio of the level of achievement of the system’s objectives (the effect gained) to the resources employed or the expenses used to achieve this. In order to evaluate a regulation’s effectiveness, the objectives of the regulation must, therefore, be determined first. Without a clear idea of the objectives, the level of their achievement cannot be evaluated. Metaphorically speaking, a ship without a target port cannot have a stern wind. By formulating the objectives, one can evaluate to what extent and with what expenses the existing regulation aids in achieving these objectives or, to put it differently, how effective the regulation is. All of the above also applies to the legal regulation of insolvency. If one is to be able to choose between alternative regulations and the different possible procedures, evaluating their effectiveness is of central importance.

Fair distribution of the debtor’s assets among the creditors has been regarded as the principal objective of bankruptcy proceedings. Such an approach shows vividly why execution proceeding for insolvent subjects must be regulated separately from the usual execution proceeding, but it fails to explicate the general objectives of insolvency regulation. If the equal treatment of creditors is considered the sole objective of bankruptcy proceedings, the objective is achieved even if the requirements are not met at all. In more general terms, ensuring fair distribution or putting the creditors in an equal position can only be one component of the objective, one part of the complete system of objectives. The author of this article believes that two sides can be distinguished in this system of objectives. Some authors highlight the component targeted at protecting public interest by claiming that the main objectives of any insolvency regulation are a foreseeable, fair, and transparent distribution of risks among business participants and the preservation and increasing of value for the benefit of all interested parties and the economy in general; whereas others emphasise the component targeted at protecting private interests by claiming that the objective is to distribute the debtor’s assets fairly among the creditors. Both sides have a sense and substance particularly in the economic context. The question of whether the regulation could also have non-economic objectives is beyond the scope of this article. In the following passages, the focus is on economic objectives.

In studies and literature on Law & Economics, the economic aspects of a regulation’s objective have been examined quite thoroughly. Using the terms of Law & Economics, one can claim that the economic objective of any insolvency proceeding (including a bankruptcy proceeding) is the maximally efficient allocation of resources after the completion of the insolvency proceeding and its achievement with minimal transaction costs. Therefore, from the perspective of Law & Economics, what matters is

- how many resources (money and time) are spent on an insolvency proceeding and how these expenses are distributed (the amount and structure of transaction costs); and
- how many resources are redistributed by means of insolvency proceedings and what the proportion (ratio) is of transaction costs and the resources to be redistributed.

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12 The general procedure of execution proceeding in force in Estonia might put creditors in unequal positions—claims are satisfied in the order of their submission for execution, and those who initiate execution proceeding earlier, gain an advantage. In a situation where the assets do not suffice to satisfy all claims, the regulator has deemed it necessary to place all creditors in an equal position.
The effectiveness of the regulation can thereby be measured in three different stages of the process:

1) *ex ante* (before the insolvency proceeding);
2) *interim* (during the proceeding); and
3) *ex post* (after the proceeding).  

In the first stage, in a situation where the particular insolvency proceeding is not yet being discussed but investments are planned, credit agreements are concluded, and decisions are made with regard to capital structure etc., the regulation is effective if it prevents the launching of unpromising business plans and creates the conditions for the emergence of as few insolvency cases as possible. A good system must eliminate the possibility of using the bankruptcy proceeding malevolently, among other things. 

Unfortunately, it is very difficult to evaluate the effectiveness of the regulation empirically *ex ante*. The views expressed in the professional literature vary greatly, and the results of comparison of different studies can be quite surprising. For instance, it has been ascertained that bankruptcies are more frequent in countries where the legal system is more developed and the rights of creditors are better protected. Several authors have concluded that the great debate of recent decades between two fundamentally different systems of insolvency law (the pro-debtor and pro-creditor system) is, at least from the economic perspective, rather immaterial—economic research shows that there is no statistically significant correlation between the effectiveness indicators of insolvency law and the pro-debtor/pro-creditor system. More important than the harshness or gentleness of the regulation towards the debtor is the efficiency of the bankruptcy proceeding. In the second stage (during the insolvency proceeding), the regulation is effective if it permits solving problems quickly and overcoming insolvency. For the most part, this involves finding a procedure that is as inexpensive and effective as possible. The central problem here is the amount of procedure expenses, but also the distribution of expenses among the various parties is very important. If the protection of private interests is considered important among the objectives of the regulation, it would be reasonable, for example, to reduce the role of courts; if the public interest is highly valued, the opportunities for extra-judicial proceedings should be reduced. These questions no doubt deserve in-depth analysis, which is also being performed quite extensively.

In the third stage, the effectiveness of the regulation can be evaluated empirically by examining, among other things, the direct costs of the process, the recovery rate, the observance of distribution rules, and the duration of the process. The direct costs of the procedure can be defined as the payments made during the procedure period in order to cover the procedure expenses. This includes the fees of administrators and other consultants as well as all other costs (including those of judicial proceedings) that are directly related to the implementation of the procedure. Recovery rate is defined as the quotient of the total amount paid to all creditors and the sum of the protected claims. In the third stage, the regulation is effective if post-procedure payments are as large and fair as possible, the costs of the process are minimal, and those involved in the procedure are satisfied with the course of events. It is this aspect of effectiveness that economists tend to study, and some authors believe that discussion around bankruptcy law is typically preoccupied with *ex post* efficiency.

Regardless of stage, the evaluation of effectiveness requires clarity with regard to the objectives of the regulation. As noted before, the objective of the insolvency regulation is a complex, multi-level, and sophisticated system, in which the particular components of the objective may contradict each other. Such complexity of objectives also necessitates a complex approach to the procedure. Many specialists believe that, when it comes to increasing both *ex ante* and *ex post* effectiveness, the keyword is diversity. The claim that the complexity of the regulation provides a relative advantage with regard to effectiveness has been confirmed by studies. In September 2003, the report *Best Project on Restructuring, Bankruptcy and a Fresh Start*, prepared by experts

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17 F. Cabrillo, B. W. F. Depoorter (Note 14), p. 264.
23 Ibid., p. 106.
working under the auspices of the European Commission, was published. 30 One of the main conclusions of the experts was that legal regulation should provide an opportunity to avoid liquidating bankruptcy proceedings in suitable cases. The possibility of using different types of insolvency proceedings and the employment of economic factors to foster optimal choice are of great importance here. The authors of a study prepared by the International Monetary Fund claim with good reason that in the development of insolvency legislation by states, the key question is how to find such a balance among the different social, political, and economic interests as would prompt all those involved in economic processes to participate actively in the system to be created. 31 In essence, this is the formulation of the objective of the legal regulation of insolvency ex ante. The ways of overcoming insolvency should be viewed as a unitary complex that enables finding an appropriate method for solving each individual case. In the event of equal efficiency, cheaper types of procedure should be favoured. It is important to ensure not only the multitude of options but also the opportunity for smooth transition from one alternative to the next. 32

The system of the objectives of the regulation cannot be viewed as a definite and unchangeable catalogue in the order of importance. In consideration of the changes in the economic situation, the different components of the objective can have different weights in different stages of development. In a situation of rapid economic development, the progress of the regulation toward greater formalisation was understandable, which also inevitably entailed an increase in the importance of courts and other institutions, whereas in the circumstances of an economic recession, the idea of saving resources dictates that attention should be focused on reducing procedure expenses and advancing informal procedures. The system should be not only complex but also dynamic. But is that idea practicable in, for example, Estonian circumstances?

Formally speaking, there are only two insolvency proceedings currently used in Estonia: the (liquidating) bankruptcy proceeding and reorganisation. From a practical standpoint, however, it would be reasonable to consider also as separate types of procedures rehabilitation under the bankruptcy proceeding, compromise both under and outside the bankruptcy proceeding, and abatement of bankruptcy. In special cases, also the establishment of creditors’ control and compulsory dissolution can be employed as ways of overcoming insolvency.

Lawyers and practitioners agree that the ineffectiveness of insolvency proceedings at a microeconomic level and ex post is mostly due to the bankruptcy being filed for too late, when the debtor is already in an irrevocably bad economic state. 33 But could this problem be eliminated by improving the regulation? Perhaps it would be possible, by legalising additional alternatives, to make the debtors assess their solvency at an earlier stage in their monetary trouble and thereby take action earlier? Given that this problem occurs in different countries to a differing extent, there is reason to assume that some relation to the regulation in force exists. In many countries, the number of types of procedure possible is much greater than in Estonia, and it is being increased even further. In France, for instance, the number of possible procedures has risen significantly in recent years. 30 Perhaps Estonia should consider this option as well.

4. Ways of overcoming insolvency in Estonia

Classical (liquidating) bankruptcy proceeding. An important step in the development of Estonian insolvency law is the amendments to the Bankruptcy Act that entered into force on 1 January 2010. 31 The amendments partially result from the need to specify the objectives of the bankruptcy proceeding and to emphasise the effect of the regulation ex ante. The authors of the amendment find, for example, that the state should ensure that insolvent legal entities do not participate in civil circulation, because that might restrict that civil circulation. The state is able to fulfil this task only if it tries to remove all associations without assets from circulation either through bankruptcy proceedings or via liquidation proceedings. 32 This wording also conceals the main shortcoming of the Estonian regulation—our regulation tends to favour ‘removal from circulation’
over transforming into solvent, and state-organised proceedings over the initiative of the concerned parties. First and foremost, an attempt should be made to overcome insolvency while maintaining the debtor, and the debtor should be removed from commerce only if there is no other option. The regulation in effect has indeed provided some opportunities for this; the use of those opportunities, however, has succeeded only in exceptional cases.

**Abatement of the bankruptcy proceeding.** Considering the very large percentage of abated bankruptcies in Estonia, this subclass of proceedings deserves special attention. The main problem of the regulation in force might well be the fact that, because of abatement of bankruptcies, liquidating bankruptcy proceedings do not usually fulfil their most direct objective, which is, pursuant to § 2 of the Bankruptcy Act as in force, the satisfaction of the creditors’ claims from the debtor’s assets. This is confirmed, for example, by the statistics concerning the abatement of bankruptcies published by the Statistical Office and the Ministry of Justice. In the years 2002–2004, bankruptcy was left undeclared on account of abatement in almost half of the insolvency cases identified by the court. Usually the reason for the abatement of proceedings was the insufficiency of the debtor’s assets even for covering the expenses of the bankruptcy proceeding, which is why all claims were left fully unsatisfied. The Statistical Office and the Ministry of Justice have not disclosed the statistics for more recent years, but, according to the data published in the one relevant study, the situation has not improved in the following years; in fact, the contrary holds true: in more recent years, the proceedings have been abated in sometimes more than half of the cases where insolvency has been identified by the court. In cases of abatement of bankruptcy proceedings, even the expected direct procedure expenses exceed the value of the resources to be distributed. The actual redistribution of resources takes place before the start of the official procedure and is verifiable only to a very limited extent and post factum. Therefore, this is an extremely ineffective procedure and the development of the regulation should be targeted at reducing the number of such proceedings.

**Rehabilitation and compromise under the bankruptcy proceeding.** The concept of rehabilitation was first explained in Estonian law with § 57 of the first Bankruptcy Act, in the formulation that entered into force on 1 February 1997: rehabilitation of a debtor that is a legal entity consists in the application of measures that enable the satisfaction of the claims of the creditors through the continuation of the debtor’s economic activity. Unfortunately, this regulation has been used in very few instances in the course of this long time span. Despite its several amendments, the Bankruptcy Act in force in Estonia still has one (perhaps formal) deficiency: in the case of a company, compromise also requires rehabilitation, since, pursuant to § 179 (1) of BankrA, the company’s rehabilitation plan is always included as an annex to the compromise proposal if the debtor is involved in economic or professional activity. Compromise aimed at saving on procedure expenses and resulting in the liquidation of the company is ruled out, at least pursuant to this provision. This fault would be easy to remove by means of a simple amendment. Also the reorganisation proceeding, whose enforcement has been welcomed by Estonian lawyers and recognised as a positive step forward by foreign experts, could do without this deficiency.

**Reorganisation.** The procedure of reorganisation has now been in use in Estonia for more than a year, and attempts to use it have been quite frequent. However, the effect of the new regulation is difficult to assess at first. Studies by researchers in field of Law & Economics have confirmed, on the basis of statistical research, that the reorganisation proceeding has high microeconomic effectiveness. According to some studies, the payments to creditors in the case of reorganisation of large public companies are almost twice as big as in the case of sale in bankruptcy going-concern sales. Researchers have also pointed out that an advantage of the reorganisation option should prompt the debtor to deal with its insolvency issue in an earlier stage. At the same time, it has been claimed that reorganisation is a suitable method for large-scale companies only, and in

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33 Bankruptcy Act provides for the opportunity of rehabilitation and compromise under the classical bankruptcy proceeding.
35 In the Bankruptcy Act in force up to 1 January 2004, the concept of abatement was broader that in the current act. The first Bankruptcy Act, in the formulation that entered into force on 1 February 1997: rehabilitation of a debtor that is a legal entity consists in the application of measures that enable the satisfaction of the claims of the creditors through the continuation of the debtor’s economic activity. Unfortunately, this regulation has been used in very few instances in the course of this long time span. Despite its several amendments, the Bankruptcy Act in force in Estonia still has one (perhaps formal) deficiency: in the case of a company, compromise also requires rehabilitation, since, pursuant to § 179 (1) of BankrA, the company’s rehabilitation plan is always included as an annex to the compromise proposal if the debtor is involved in economic or professional activity. Compromise aimed at saving on procedure expenses and resulting in the liquidation of the company is ruled out, at least pursuant to this provision. This fault would be easy to remove by means of a simple amendment. Also the reorganisation proceeding, whose enforcement has been welcomed by Estonian lawyers and recognised as a positive step forward by foreign experts, could do without this deficiency.
36 In the Bankruptcy Act in force up to 1 January 2004, the concept of abatement was broader that in the current act. See §§ 15 (1) and 93 of Bankruptcy Act.
the case of small companies, selling of the bankruptcy estate in the form of going-concern is preferable.\textsuperscript{42} It must be noted that, according to the criteria of the world economy, there are practically no large-scale companies in Estonia. Most of our companies qualify as small companies.\textsuperscript{43} The size of the companies that are winding up, in turn, is exhibiting a trend of decreasing. In the years 2002–2006, almost half of the dissolved companies had 1–4 employees. The percentage of the companies that had operated without employees during their last year of activity also grew significantly: in 2003, the percentage was 18\%, whereas by 2006, this indicator had doubled, reaching 40\%. Companies with 10 or more employees made up under four per cent of those liquidated in 2006.\textsuperscript{44}

The first steps of the reorganisation proceeding in Estonia confirm the suspicions of the sceptics. The relatively large number of reorganisation applications submitted to courts and the very low rate of their satisfaction\textsuperscript{45} show that the reorganisation proceeding is only just seeking its place among insolvency proceedings. So far, the legalisation of this proceeding has somewhat reduced the overall effectiveness of insolvency proceedings. It is becoming customary that first of all, an attempt is made to reorganise the debtor, but afterwards a bankruptcy proceeding must nevertheless be performed also. If the reorganisation proceeding turns out to be just a means for delaying the submission of a bankruptcy petition, the effect of this regulation can \textit{ex ante} be regarded, rather, as negative. One expensive proceeding is thereby replaced by two expensive proceedings instead of a cheaper one. However, these might prove to be transitional problems.

\textbf{Compromise under the law of obligations.} Considering the high costs related to bankruptcy and reorganisation proceedings, one finds it in the interests of both the creditors and the debtor to forgo proceedings. The creditors would agree (if they had enough information) to partially abandon their claim in order to hasten the recovery of money and save on procedure expenses, while the shareholders and board members of the debtor would agree to liquidate the company in order to relieve themselves of the inconveniences resulting from the bankruptcy proceeding. Pursuant to the regulation in force in Estonia, this is possible only with the consent of all creditors. The achievement of a consensus, however, is extremely difficult in practice. In order to gain the consent of all creditors, the need may arise to fully satisfy the claims of the creditors who refuse to co-operate. If a bankruptcy proceeding of the debtor must later be initiated despite the compromise, this can be regarded as unequal treatment of creditors under § 113 (1) 2) of BankrA, and the performance can be recovered. Such a regulation does not favour co-operation between creditors. The important advantages of a compromise reached in the course of a bankruptcy proceeding emerge here—the binding nature of the decision made also for those who did not support the compromise and a decision that can be used as an execution document. While making a compromise with a majority vote is probably not transferable to informal procedure, the version of the Conciliation Act that entered into force on 1 January 2010 provides a new opportunity for formalising the decision as an execution document.\textsuperscript{46} At first sight, referring the conciliation procedure to the subject of insolvency might seem artificial, but the result of conciliation activity can, among other things, also be a multilateral compromise. Pursuant to § 14 of the act, such an agreement can in some cases also be formalised as an execution document.

\textbf{Creditors’ control.} In some cases, the option of overcoming insolvency through establishment of creditors’ control—whether permanent or temporary—should be considered. The former can be done, for example, by increasing share or stock capital in a special issue to creditors. The creditors pay for the acquired holding by setting off claims. Such a procedure is enabled in Estonia by §§ 194\textsuperscript{4} and 346 of the Commercial Code.\textsuperscript{47} Temporary control is possible, for example, in the event of selling of the debtor’s shares or stocks from shareholders to creditors with the right of repurchase, as permitted under §§ 238 and 242 of the Law of Obligations Act.\textsuperscript{48} In several countries, creditors’ control as a form of procedure is relatively common. One of the best-known systems of establishing creditors’ control is the procedure developed and promoted by the Bank of England—the so-called London approach.\textsuperscript{49} The use of this procedure spread mainly in the financial sector\textsuperscript{50} and received recognition from scientists and practitioners also in other countries.\textsuperscript{51}


\textsuperscript{43} See, e.g., G. McCormak (Note 42), p. 316.


\textsuperscript{51} J. A. A. Adrianse (Note 29), p. 143; Building Effective Insolvency Systems. Available at www.wordbanjk.org/legal/insolvency inici/WG6-paper1.htm.lk (27.01.2010).
is largely based on the assumption that the majority of the claims against the debtor have converged in the hands of one creditor. Moreover, activity is governed more by custom than by law. In the presence of similar preconditions, such a procedure can also be used in Estonia. At least one such case has already been discussed in the media. Given that, from the perspective of written law, this is an informal procedure, internationally recognised practice could largely be relied on, and amendment of the existing laws is not unavoidably necessary. The designs to be used and the descriptions of working principles have been compiled and issued as recommended materials.

**Deletion from the register.** Even just a few years ago, an extremely easy and inexpensive insolvency proceeding was in use in Estonia. If a company or a commercial association lacked assets, the registrar gave a warning to the company about deletion from the register and issued a relevant notice. If the company had not submitted data on the existence of assets to the registrar within four months from the date of the warning, the registrar deleted the company from the commercial register. Presumably, this procedure was abandoned on account of its potential misuse. Unfortunately, the commercial register still contains a significant number of companies that are of no economic interest to anyone. Their voluntary liquidation at the initiative of shareholders or stockholders could be hindered for various reasons, while the completion of a classical liquidating bankruptcy proceeding can take up a disproportionately large amount of resources. It is in the public interest to, on the one hand, remove insolvent companies from circulation and ensure the conformity of the commercial register data to reality and, on the other hand, do this as cheaply as possible. To perform this task, it is reasonable to provide for procedures of differing complexity, depending on how much the society or the creditors are prepared to spend on conducting the particular procedure. In the case of a hopelessly insolvent company, using the state’s resources for the activity of the court, the temporary trustee in bankruptcy, and other participants in the procedure is reasonable only in the presence of public interest in the procedure. In the absence of such interest, this simplified deletion procedure could, in the author’s opinion, well be used with those companies. If somebody is interested in the performance of a more thorough procedure, he should certainly be guaranteed such an opportunity. Publication of a relevant notice in the media should also exclude the misuse of this simplified procedure.

As mentioned above and as the International Monetary Fund has also recommended to us, the development of insolvency law in Estonia should better facilitate the use of extra-judicial proceedings. According to the experts of the World Bank, however, all ‘semi-informal’ ways of saving the debtor must also be utilised. For that purpose, it is important to familiarise the concerned parties with the alternative methods of overcoming insolvency, including semi-formal and informal procedures that might be even more effective than formal procedures from an economic standpoint.

It would certainly increase the options if the regulator were to consider providing some safeguards to the debtor for the time during which the debtor regards the restoration of solvency as possible and is actively involved in restoring solvency or negotiating to achieve a compromise. Such an option of so-called bankruptcy protection exists in several countries, such as France. In regulation of the insolvency proceedings that take place without the direct involvement of a court, the possibility of applying four essential principles, depending on the case, should be considered:

1. the binding nature of decisions associated with an alternative procedure also for those creditors who were themselves not in favour of such a procedure;
2. the immunity of the debtor to judicial claims (including bankruptcy petitions) during the procedure;
3. increasing the options for improving the debtor’s situation, especially the opportunity for recovering assets; and
4. suspending the charging of interest on the claims against the debtor.

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57 Ibid.
In practical terms, the application of such measures would mean giving official recognition to informal restructuring. There are several objections to this, but in certain cases, especially in the circumstances of an economic crisis, this might be expedient.

5. Conclusions

The article has demonstrated, using Estonia as an example, that the number of insolvency proceedings has a negative correlation with economic growth. Moreover, the trends of GDP change are realised as a corresponding increase or decrease in the number of bankruptcies about a year later. This leads to the conclusion that the number of insolvency proceedings and that of the related court cases is going to rise in the near future. Also their proportion among all civil matters is going to increase. Stating the fact that the objective of the insolvency regulation is a complex, multi-level, and sophisticated system wherein individual components of the objective might even contradict each other to a certain extent, the article focused on examining the economic effectiveness of the complex of objectives \textit{ex post}. The author of the article is convinced (especially in view of the large percentage of abated bankruptcies) that the regulation in force in Estonia is not economical enough, in financial terms, and does not ensure maximal utilisation of resources. However, this is not a problem unique to Estonia. Presuming that there is a need to save resources in the circumstances of an economic recession, creating different opportunities and favouring procedures that involve the state and other institutions as little as possible should be given top priority in the advancement of the insolvency regulation.

The means of overcoming insolvency should be regarded as a unitary complex that enables finding an appropriate method for solving each individual case. The studies that this article refers to have come to the conclusion that the complexity of a regulation provides relative advantage in terms of effectiveness. It is important to ensure not only a multitude of options but also the opportunity for smooth transition from one alternative to the next. In the event of equal efficiency, cheaper types of procedure should be favoured. The article took a closer look at the changes in the regulation of different insolvency proceedings in the recent past and also at potential developments in the near future. In a situation of rapid economic development, the progress of the regulation toward greater formalisation was understandable, which also—inevitably—entailed an increase in the importance of courts and other institutions, whereas in the circumstances of an economic recession, the idea of saving resources dictates that attention should be focused on reducing procedure expenses and advancing informal proceedings. The system should be not only complex but also dynamic.

In addition to the enforcement of new legislation, the communication of legal and economic knowledge to all undertakings is important. Quite a few insolvency cases could be resolved more easily and inexpensively if those involved had a clear overview of the various options and were able to predict their economic efficiency. Hence, it is not only the enforcement of a complex regulation that is important but also the introduction of the opportunities of said regulation to the parties concerned.