

Podcast title: Adventures in Entrepreneurship Law

Episode: How to gently kill a company? Bankruptcy, restructuring and running down the company.

Podcast guest: Pauliina Tenhunen, Partner, Castrén & Snellman Attorneys Ltd.

Length of recording: 21 minutes and 14 seconds

Transcription notes:

N1: Narrator 1

N2: Narrator 2

N3: Narrator 3

Host 1: Petra Hietanen-Kunwald

Host 2: Kalle Airo

Episode guest: Pauliina Tenhunen

Other information about the text:

[text] = a sounds or not transcribed parts are written with square brackets e.g. [laughs] or [interview paused due to a phone call]

[recording starts]

N1: Aalto university podcast.

N2: In the adventures in entrepreneurship law podcast series Petra Hietanen-Kunwald and Kalle Airo from Aalto University, explore business law from an entrepreneurial point of view with expert guests. In some episodes, their co-host is Moritz Scherleitner. The podcast content is meant for education and is not intended to constitute legal advice.

How to gently kill a company, bankruptcy restructuring, and running down the company. Our guest is Pauliina Tenhunen partner at Castrén & Snellman Attorneys Ltd. Entrepreneurship law with Petra and Kalle.

Business does not always work out as planned. The company may get into financial difficulties or there may be other reasons for dissolving the company. In this episode, Petra and Kalle will talk with Pauliina Tenhunen about corporate insolvency, and how to deal with it. They will look into different alternatives and discuss the role and liability of the board of directors in situations of financial distress.

Petra Hietanen-Kunwald: Companies are tools in the toolkit of the entrepreneur, and cash is key. But sometimes, things don't turn out as planned. And the company faces financial difficulties. And we'll talk about this today with Pauliina Tenhunen, welcome, Pauliina.

Pauliina Tenhunen: Thank you.

Petra: So Paulina is an attorney, a partner at one of the biggest law firms in Helsinki. She has also served as the managing partner and chair of the board. She has started there 30 years ago, as the first female lawyer, which is an accomplishment and she specialized in company law and governance, and insolvency and voluntary liquidation. And she has been a longtime member of the advisory board for bankruptcy affairs. And Pauliina is also the grandmother of two little girls. So Pauliina why is entrepreneurship important to you?

Pauliina: Well, it keeps the society running, it's actually everything that is needed. It gives jobs, it gives innovation, and it's sort of oil of the whole society.

Kalle Airo: So sometimes a company runs into a situation where they don't have enough money, enough cash. So what is this insolvency?

Pauliina: Well, insolvency means that the company cannot pay its debts when they come due, that is the definition of insolvency.

Petra: So it's different from when they don't have enough equity or when they lose the share capital?

Pauliina: Yes, it's different. Actually, a company can have cash and be able to pay its debts and still lose its own equity at the same time. And then you have to either correct the situation of the own equity, or you have to register the loss of the own equity. So you still have options, and you can continue the business. So you don't have to finish and stop it at that time. Actually, it's very important nowadays, that when you can establish a company without any share capital, that you have own equity from the beginning. Because if you pay the first invoice without own equity, you have negative equity from day one. So it's very important to have, not necessarily share capital, but some sort of own capital from the beginning.

Kalle: And so the smartest students have already now understood that we are talking about limited liability companies or some form of capital companies here.

Pauliina: Yes, because it's the main structure that is used in Finland.

Kalle: What should a company do when it cannot pay its debts?

Pauliina: Well, the first thing to do is to try to negotiate with your creditors and other stakeholders and try to get new refinancing to the company of course. But if you don't succeed in that, and you really cannot pay your debts, then the bankruptcy is the only option. And it is the board of directors who will then decide to apply for the bankruptcy. Of course, you have to keep in mind that also your creditors can apply for the bankruptcy if you don't act in time. Normally in Finland, tax authorities or pension funds are active creditors, because they have to cut the increase of the debts, because it grows every month. So that is the reason why they are active. And then of course, it's advisable that you ask for advice, you can ask it from your own bookkeeper auditor, or then contact a lawyer.

Kalle: What alternatives does the company have when it actually runs out of cash or it can already know that it runs out of cash in a month or so?

Pauliina: Well, in a way, you have four options. The first one is what I said earlier, you contact your creditors and you negotiate, you contact your shareholders, ask for more equity, and capital injections, and try to sort the situation out. And then one option is restructuring where you apply for restructuring proceedings from the court. And there will be a stay when you don't pay your debts at that time when the situation is in a way cleared. But that is not possible if you don't have any money, because the proceedings cost and you have to pay all the new debts when the restructuring application is submitted. So without any cash, restructuring is not possible.

Then the third option is bankruptcy. And that is when you really don't have any money left and you sort of give up, you see that there is no viable business left. And in that situation, everything is sold and paid and then the creditors will be paid dividends out of the money that is left. And then the fourth option is liquidation. But that is possible only when the assets are bigger than the debt, so that you can pay all the debts of the company. And all those three last options restructuring bankruptcy and liquidation, there is normally a lawyer who is an administrator or liquidator in a position assisting you or the company.

Kalle: So there's like an outsider, a lawyer who's not from the company and not one of the owners, who then is kind of arbitrating so to say, that the proceedings are fair.

Pauliina: Yes, only in a liquidation situation it means this voluntary liquidation, there you can also be yourself or one of the board members can be the liquidator, but normally it's an outsider or so.

Petra: Can you still highlight the main difference between bankruptcy and restructuring? So what is the purpose of bankruptcy? And what is the purpose of restructuring?

Pauliina: So the purpose of restructuring is to be able to continue the business of the company. So if you see that the business is viable or part of it is viable, then you can choose this one but bankruptcy is the end of the story. So it's finished. And then in bankruptcy, the bankruptcy administrator can, of course, try to sell the business of the company. And it is the duty of the bankruptcy administrator to try to sell the assets at the highest price as possible to get dividends to the creditors. So it's the end of the story for the company, but the business can continue.

Kalle: Yeah, and the assets here are sometimes also kind of intangible assets as the business or the kind of customer relationship, these kinds of things.

Pauliina: Yes, actually nowadays, most of the companies don't really have real estate or that kind of assets, they are more intangible assets left.

Petra: So it might be the end of the story for the company, but is there also any risk for somebody else, is there personal liability or are their personal sanctions in these kinds of situations?

Pauliina: There might be board members and managing directors who could be at risk. And that is based on our Companies Act. So, if there has been a breach of duty of care, then it's towards bankruptcy state, this liability for damages. And the creditors and shareholders can claim damages, but only if there has been a breach of law or breach of articles of association. So it's a little bit different situation. So the liability is larger towards the company and the bankruptcy state that will come instead. Well, so if we look at what kind of cases we have had in Finland, there have been cases where the board members have faced liability because they have not registered the negative equity. So that's a very important thing to remember. Then we have had cases where the company has not paid taxes without

being insolvent, and then the board members have faced criminal sanctions and also damages. And then maybe, most in a way popular cases are where there has been distribution of funds against the company law, so-called illegal distribution of funds, and normally to the shareholders or other close mentions.

Petra: And in this case, that there is a personal liability of the board of directors?

Pauliina: Yes,

Petra: ...when they distribute equity to close friends and so on, or some favor, some creditors to the detriment of other creditors,

Pauliina: Yes, or if you have transferred funds or assets without any business reason, so breached your duty of care.

Kalle: For an individual board member or managing director are there any ways they can kind of lessen this risk or mitigate the risk?

Pauliina: Well, you have to comply with the law, of course. And then when you are doing decisions, you have to follow the business judgment rule. So you have to get enough information and make a decision based on the information you have gathered. And then you should not have any connections, your own connections with the mother, so you can objectively do the decision. And of course, then you can have and you should have an insurance covering the also the work of the board and managing director.

Kalle: So basically, as long as you make the best decisions on behalf of the company in good faith, there isn't that much risk for an individual.

Pauliina: Yes, you can say that way, and if you comply with that law and also the articles of association.

Petra: So for the entrepreneur, who is in the business, what should he or she know, what is important?

Pauliina: Well, at first, you should always follow the cash situation, the liquidity in order to budget what's coming and you have enough money to pay the invoices coming in. And as I said earlier, you should also follow the amount of equity. So that you will see when there is a risk of negative equity in the future. Then one thing that is also important is that you have to act early enough, because in Finland, in most cases, the companies, for instance, start to consider restructuring too late when you have no money to go through the proceedings, so you have to think about these things early enough.

Then in some countries, of course, now we have been discussing Finnish law. And it's different in other countries. So if you have companies also somewhere else, in some other jurisdictions, you have to find out what kind of laws there are. But in Finland, there is no such thing that you should apply for bankruptcy in certain periods of time for something that happened. For instance, in some countries, the loss of equity might mean that you have seven days, and then you have to apply for bankruptcy. But in Finland, we don't have that kind of time period.

So then one thing to remember is to treat all your creditors equally. And for instance, you cannot pay the invoices of one credit and leave others out. But you have to sort of have principles about how you are treating your creditors. And equal treatment is important when you see that there might be a risk of insolvency. And then, of course, if you see that there is a risk of bankruptcy, don't panic, don't do any unusual and unordinary transactions, because that is the sort of problem that then will be figured out later. And there will be special audits and everything will come out. So don't get panicked, get help, and don't do any sort of unordinary transactions.

Petra: So we were talking now a lot about insolvency. But what if the entrepreneur just wants to run down the business or the company?

Pauliina: We have provisions in our Companies Act about this voluntary liquidation. If you have enough assets to pay all the debts, then it's possible. If not, then the only option is bankruptcy. So voluntary liquidation is possible when all the debts can be paid, and maybe there will be some dividend also for the shareholders.

Kalle: Then as a detail, most investors want to have liquidation preferences in the shareholder agreements for exit cases and also for these kinds of cases. But we will have another discussion about these things.

Petra: If you want to file for bankruptcy, or if you file, or your creditor files for bankruptcy, what happens if you don't have any assets or don't have enough cash to pay for the proceedings, for instance?

Pauliina: even in that case, the bankruptcy will start and the administrator will be nominated. We have a law saying that the state will pay a nominal amount to the administrator. But the bankruptcy proceedings will not continue until the end, but they will lapse after there have been first investigations done. And then if there is some kind of suspicion that there have been transactions that could be recovered, or there might be some criminal inspections to come, then the state can take the whole administration and pay for that. So that is also possible. But you don't have to worry if there is no money to go through the bankruptcy proceedings.

Petra: So how can entrepreneurs manage their relationships with the stakeholders in this kind of situation, when you have an insolvency, what should they do?

Pauliina: Well, it's very important to keep the stakeholders and also shareholders informed about the situation. Communication is very, very important. And then in certain cases, it's beneficial that you have an impartial outside external adviser discussing with stakeholders because it gives some sort of meaning ... the feeling of impartiality.

Petra: What are the key takeaways you have?

Pauliina: Well, first of all, forecast and follow the cash situation and also the own equity.

Kalle: So it is of course, why is important to forecast and follow the situation, the cash situation and equity situation. But for some entrepreneurs, it actually is a surprise that some of these problems actually arise when your company grows really fast. And it is not necessarily so that your business is going down and you have a cash flow problem, but it might be that you don't have enough cash to grow.

Pauliina: Exactly. And then one thing to remember is to ask for advice early enough when you still have more options to consider.

Petra: Thank you, Paulina, for having been here.

Pauliina: Thank you very much.

[Outro music]

[Recording ends]