ALLEN & OVERY

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Restructuring Across Borders

Estonia: corporate restructuring and insolvency procedures

Contents

Introduction

The five principal restructuring and insolvency regimes for companies under Estonian law are:

- bankruptcy (*pankrotimenetlus*)
- reorganisation within bankruptcy (*tervendamine*)
- compromise (*kompromiss*)
- corporate liquidation (*äriühingu õpetamine*)
- reorganisation under the Reorganisation Act 2008 (*saneerimine*)

Bankruptcy (*pankrotimenetlus*)

The purpose of bankruptcy proceedings is for the debtor's estate to be realised and distributed to the creditors in circumstances where the debtor is insolvent. The most important principle in Estonian bankruptcy proceedings is the equal treatment of creditors. Pursuant to this principle proceedings are carried out in the interest of all creditors. A debtor is considered insolvent if it is unable to satisfy the claims of creditors and the debtor's financial situation indicates that this inability is permanent (the courts decide what is meant by permanently insolvent on a case by case basis). However, if the debtor files for its own bankruptcy, insolvency is presumed, but the court must nevertheless make adequate inquiries to verify this is the case. Bankruptcy proceedings are used as a "gateway" procedure: under the umbrella of bankruptcy, it is possible to have either reorganisation or compromise proceedings (as further described below). In practice, neither reorganisation nor compromise proceedings are common, but recent changes to the legislation have been made with a view to promoting both of these more rescue-orientated procedures.

The first stage in the opening of bankruptcy proceedings is the acceptance by the bankruptcy court of the bankruptcy petition and a decision on whether or not to appoint a temporary trustee.

Upon the filing of a bankruptcy petition by the debtor or creditor, the court will first decide whether or not to accept the bankruptcy petition. This is a procedural step. The court will only check that there are indications that the debtor is insolvent, that the petition meets the formal requirements and, if the petition was filed by a creditor, that the creditor has a *prima facie* claim against the debtor. If the court accepts the petition it will, within ten days of acceptance of the petition, decide whether to appoint a temporary trustee for the purpose of determining and preserving the debtor's assets under the supervision of the court. If the bankruptcy petition was filed by a creditor, the court will schedule a time for a preliminary hearing to decide whether or not to appoint a temporary trustee. This hearing will be held within ten days of the bankruptcy petition being filed with the court and the court must decide whether to appoint a temporary trustee within 20 days of the bankruptcy petition being filed with the court. If a reorganisation application (*saneerimisavalclus*) under the Reorganisation Act 2008 has been filed with the court, the decision as to whether to appoint a temporary trustee will be postponed until a decision is made on whether or not to approve the reorganisation plan. If a creditor has petitioned for the bankruptcy, in cases where there are insufficient assets to meet the temporary trustee's remuneration in the debtor's estate, that creditor must provide the court with a deposit for that remuneration.

The court determines the amount of the remuneration by a ruling taking into consideration the volume and complexity of the duties of the temporary trustee and his or her professional skills. The petitioning creditor may file an appeal against such ruling.

The temporary trustee's role is to assess the debtor's financial situation and to assess the prospects for a reorganisation rather than winding up of the debtor. The court may also impose specific duties on the temporary trustee depending on the particular proceedings. The temporary trustee will then submit a written report to the court, which will include his or her opinion on the causes of the debtor's financial problems. If the court finds that there are no grounds on which to commence bankruptcy proceedings, the court will not appoint a temporary trustee and the proceedings will be terminated.

If proceedings that were commenced following an application by the debtor, are terminated without declaring the debtor bankrupt (*raugemine*) and the assets of the debtor are insufficient to make required payments to the temporary trustee, the court shall order that the temporary trustee's remuneration and expenses be borne by the debtor. In certain circumstances, and subject to certain limits, the court may order that the payment be made from State funds.

Where the bankruptcy petition is filed by the debtor, the court will hear the bankruptcy petition and decide whether or not to make a bankruptcy order within ten days (or, with good reason, within 30 days) of the temporary trustee being appointed. Where the bankruptcy petition is filled by a creditor, the court will hear the bankruptcy petition and decide whether or not to make a bankruptcy order within 30 days (or, with good reason, within two months) of the temporary trustee being appointed. A court may refuse to accept a creditor's bankruptcy petition if it is based on a claim to which a reorganisation or a debt restructuring plan applies. The petitioning creditor, debtor and temporary trustee must participate in the hearing of the bankruptcy petition. Since court hearings are public, as a rule, other interested parties may also appear. At the hearing the court will either: (i) declare the debtor bankrupt, (ii) dismiss the petition, or (iii) if the debtor's assets are insufficient to cover the costs of the bankruptcy proceedings, terminate the bankruptcy proceedings regardless of the insolvency of the debtor (*raugemine*).

Bankruptcy proceedings will be commenced when the court declares the debtor bankrupt. A declaration of bankruptcy refers only to insolvency of a debtor as declared by a court ruling. A court ruling declaring the debtor bankrupt is effective and subject to execution from the date and time when the ruling is made public. A court ruling dismissing the bankruptcy petition, declining to hear the bankruptcy petition or terminating bankruptcy proceedings is effective as of entry into force of the court ruling. The enforcement of a bankruptcy ruling cannot be suspended or postponed and the manner or procedure provided by the law for the enforcement of the bankruptcy ruling cannot be altered.

In its declaration of bankruptcy, the court will set a time and place for the first general meeting of creditors. A notice of the declaration must be published in the official publication, *Ametlikud Teadaanded*.

The declaration must contain information relating to the debtor, the temporary trustee, the filing of claims (including the time period within which claims must be filed) and the date and location of the first creditors' meeting. Creditors that are already known to the temporary trustee must be sent separate written notices. If the total number of creditors exceeds 50, the publication of the bankruptcy notice is sufficient. At this first meeting, creditors must either approve the court appointed trustee or elect a new trustee whose appointment is dependent on the court's approval. At that meeting the creditors will usually also elect a creditors' committee, which will be responsible for protecting creditors' interests and supervising the trustee's activities. The number of members of the creditors' committee is decided at the first creditors' meeting, with the minimum being three and the maximum being seven members. The creditors may decide at the first meeting not to form a creditors' committee. In that case, the duties of the creditors' committee will be performed by the creditors during the creditors' general meetings. Creditors who are related to the debtor, to the judge or the trustee are prohibited from belonging to any creditors' committee.

Where relevant, the creditors' committee adopts resolutions by a simple majority. The committee is quorate if more than half its members are present. Each member of the committee has one vote, regardless of the value of its claim in the proceedings. A member of the creditors' committee, who is found to have wrongfully caused damage to the debtor or a creditor through a violation of their obligations, will be liable to pay damages.

Once the bankruptcy estate has been sold and all the proceeds from the liquidation of the debtor's estate have been distributed, the bankruptcy proceedings can be terminated by a court order. The creditors' committee is not required to approve the final report but creditors may file objections within ten days of the trustee publishing the notice in the official publication *Ametlikud Teadaanded*. The notice will set out the time and place for examining the report. The court will decide on the approval of the final report and the termination of the bankruptcy proceedings by a ruling within ten days after the expiry of the term for filing objections. However, if there are still assets left in the estate, the final report can only be submitted to the court with the consent of the creditors' committee.

Reorganisation within bankruptcy (*tervendamine*)

Reorganisation proceedings are carried out under the umbrella of bankruptcy proceedings. The aim of reorganisation within the bankruptcy proceedings is to put in place a procedure which will enable the debtor's creditors to be satisfied while the debtor continues in business.

A reorganisation may be proposed at the court hearing to decide whether or not to make an order declaring the debtor bankrupt or at the creditors' general meeting. If reorganisation is the preferred route, the trustee, in accordance with an agreed reorganisation plan, will conduct the proceedings.

Each reorganisation is unique to the company concerned, with the trustee putting together a plan for the reorganisation of the company and the discharge of its debts. Creditors (including secured creditors) and the court have to give their approval to the plan.

Creditor approval is obtained by a simple majority of votes of the creditors who are present at a creditors' general meeting (the number of votes each creditor receives is proportional to the size of that creditor's claim). Creditors may participate in a general meeting personally or through a representative.

If the creditors do not approve the reorganisation plan and decide to liquidate the debtor instead, the court may refuse to approve the creditors' decision if the procedure for organising the general meetings of creditors or for the adoption of decisions has been violated.

If a creditor is dissatisfied with the reorganisation plan, that creditor may appeal the decision of the general meeting to the court.

Reorganisation within bankruptcy should be distinguished from the reorganisation proceedings under the Reorganisation Act 2008, which are covered below.

Compromise (*kompromiss*)

Once bankruptcy is declared, the debtor may make a proposal to its creditors for the reduction of the relevant debts and/or an extension of the term for repayment. The proposal must specify as to what extent and by what date the debtor proposes to pay its debts and provide proof that the debtor has the means to comply with the proposal.

A general meeting of unsecured creditors shall vote on whether to accept or reject the proposal. The court must approve this decision.

A compromise is deemed to be made if at least one-half of the creditors who are present vote in favour and the claims of those creditors who voted in favour constitute at least two-thirds of the total amount of the claims of all creditors. If an objection has been filed against a creditor's claim (and the court proceedings concerning the acceptance of the claim have not been concluded by the time the general meeting takes place) the creditor shall participate in the voting on the compromise proposal in accordance with the number of votes assigned to the claim by a court ruling at the general meeting of the creditors.

Upon approval of the compromise by the court, the bankruptcy proceedings are terminated; however, the trustee shall exercise supervision over the performance of the compromise. No new bankruptcy proceedings may be commenced whilst the compromise remains in force and this applies with respect to any new debts incurred after the date that the compromise came into effect. However, if new funding has not been agreed as part of the compromise proposal, incurring additional financial indebtedness may cause the invalidation of the compromise and the reinstatement of bankruptcy proceedings.

Corporate liquidation (*äriühingu lõpetamine*)

Corporate liquidation proceedings are possible only if a company's assets exceed its liabilities. If the liabilities exceed the assets, bankruptcy proceedings must be commenced. Corporate liquidations are therefore limited to solvent companies and subject to the Estonian Commercial Code.

There are two ways to initiate corporate liquidation proceedings: first, by a decision of a general meeting of the company's shareholders (voluntary corporate liquidation); or secondly, by a court resolution following an application from either a member of the board of directors, supervisory council, or a shareholder (involuntary corporate liquidation). Creditors cannot initiate a corporate liquidation.

Once corporate liquidation procedures are initiated, the members of the company's board of directors will conduct them, unless a liquidator is appointed by the shareholders or the court. The liquidator has limited powers that are restricted to acts and transactions that will further the purpose of the liquidation. These include terminating the activities of the company, pursuing the company's debts, and paying creditors. The liquidator may also challenge transactions entered into by the company as provided for in the Civil Code and bring claims against the members of the management bodies

of the company in circumstances where such persons have breached their obligations.

A liquidator may be removed by a decision at a general shareholders' meeting or by the court or upon the request of an interested person (eg a creditor).

If a company is dissolved (eg during the course of bankruptcy proceedings), the company will be subject to corporate liquidation proceedings. These proceedings will be conducted by the trustee.

Reorganisation under the Reorganisation Act 2008 (*saneerimine*)

The Reorganisation Act came into force on 1 December 2008 and provides for a reorganisation procedure for companies that are likely to become insolvent in the future to enable them to resolve their financial difficulties and to ensure sustainable management going forward. Reorganisation proceedings under the Reorganisation Act are essentially a procedure for companies which are still solvent (although in financial difficulties) and should not be confused with a reorganisation within bankruptcy which is only available as an option once a company has been declared bankrupt.

In order to commence reorganisation proceedings under the Reorganisation Act, the company must file a reorganisation application with the court.
The application must contain information showing that the company is likely to become insolvent in the future, that the company requires reorganisation and that sustainable management of the company is likely after reorganisation (in other words, that the reorganisation is likely to solve the company's problems).

Reorganisation proceedings under the Reorganisation Act cannot be commenced if: (i) bankruptcy proceedings have been commenced in respect of the company and are still continuing; (ii) a court has ruled that the company should be compulsorily dissolved; or (iii) reorganisation proceedings under the Reorganisation Act were carried out in respect of the company and less than two years have passed from the conclusion of that reorganisation.

A court can refuse to accept a creditor's bankruptcy petition if it is based on a claim to which a reorganisation plan or a debt restructuring plan applies.

A court will decide whether or not to commence reorganisation proceedings under the Reorganisation Act within seven days of the receipt of the reorganisation application. If the company shows to the court that the requirements to open the proceedings are satisfied, the court must open the proceedings and appoint a reorganisation adviser. However, if the court finds that the company is insolvent it will not be able to make an order commencing reorganisation proceedings under the Reorganisation Act, but must instead open bankruptcy proceedings.

The commencement of reorganisation proceedings under the Reorganisation Act has the following consequences:

- any enforcement proceedings commenced in relation to the company's assets are suspended until a reorganisation plan is approved or the reorganisation proceedings are terminated;
- any fine or contractual penalty that increases with time will stop increasing until a reorganisation plan is approved or the reorganisation proceedings are terminated;
- on the application of the company in respect of which reorganisation proceedings have been commenced (with the approval of the reorganisation advisor to the application), court proceedings regarding a financial claim against the company

may be suspended until a reorganisation plan is approved or the reorganisation proceedings are terminated; and

- the court will suspend any decision on whether or not to make a bankruptcy order until a reorganisation plan is approved or the reorganisation proceedings are terminated.

The company with the assistance of a reorganisation advisor will prepare a reorganisation plan. Theoretically, the reorganisation plan can include any terms which are likely to improve the company's financial situation and it is possible for the reorganisation plan to affect secured creditors' rights. The main conditions likely to be included in the reorganisation plan are measures reducing or postponing the company's debts.
The reorganisation plan must be approved by creditors and will be approved if more than half of the creditors in number and two-thirds by value vote in favour of the plan. Once creditors have approved the reorganisation plan it must be submitted to the court for the court's approval. The approval of the reorganisation plan creates an assumption that, as of the moment the approval of the plan, the debtor is not insolvent. It is possible to contest this assumption at a later date by proving that the debtor was in fact insolvent at the time the plan was approved. A creditor also has the right to apply to the court to annul the reorganisation plan if the debtor does not fulfil the obligations set out in the plan on time.

The reorganisation plan will specify how long the reorganisation proceedings will last. During this period (and providing the debtor's solvency at the time the plan was approved is not successfully challenged or the reorganisation plan is not annulled on the application of a creditor) a bankruptcy petition may not be filed in relation to any claim to which the reorganisation plan applies or which existed before the approval of the reorganisation plan. However, a member of the debtor's management board always has the right to file a bankruptcy petition and if, on such petition, the court ascertains that there are grounds to declare the debtor bankrupt, the court will annul the reorganisation plan and terminate the reorganisation proceedings.

The reorganisation proceedings will also terminate: (i) on the expiry of the period set out in the reorganisation plan; (ii) on the revocation of the reorganisation plan by the court; or (iii) if the reorganisation measures contained in the reorganisation plan are completed before the expiry of the time period set out in the reorganisation plan.

A court must terminate the reorganisation proceedings under the Reorganisation Act if it becomes evident that the company is permanently insolvent. In this event bankruptcy proceedings will follow.

European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the **Recast Regulation**) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the **Original Regulation**) continues to apply to all proceedings opened before 26 June 2017. One of the key changes in the Recast Regulation is that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation. The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings - secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to terminal proceedings) in Annex B.

Of the above restructuring and insolvency regimes, bankruptcy (*pankrotimenetlus*), reorganisation within bankruptcy (*tervendamine*) and compromise (*kompromiss*) were available as main proceedings under the Original Regulation.

Bankruptcy (*pankrotimenetlus*) was also available as a secondary proceeding under the Original Regulation. Although reorganisation within bankruptcy (*pankrotimenetlus*) and compromise proceedings (*kompromiss*) are carried out under the umbrella of bankruptcy proceedings, as these are rescue style proceedings rather than winding-up proceedings, they were unlikely to be available as a secondary proceeding under the Original Regulation.

Under the Recast Regulation, bankruptcy (*pankrotimenetlus*) is listed in Annex A.

Further information

For further information on Estonian restructuring and insolvency procedures we would refer you to the Sweet & Maxwell book "European Cross Border Insolvency" edited by Allen & Overy. To purchase a copy of this book, please visit sweetandmaxwell.co.uk.

This fact sheet has been prepared with the assistance of Raidla & Partners.

Allen & Overy has launched an online service for clients focussing on debt restructurings and insolvency issues.

Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe and the U.S.

To request access for your organisation, please contact your usual Allen & Overy contact, or email rab@allenovery.com.

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