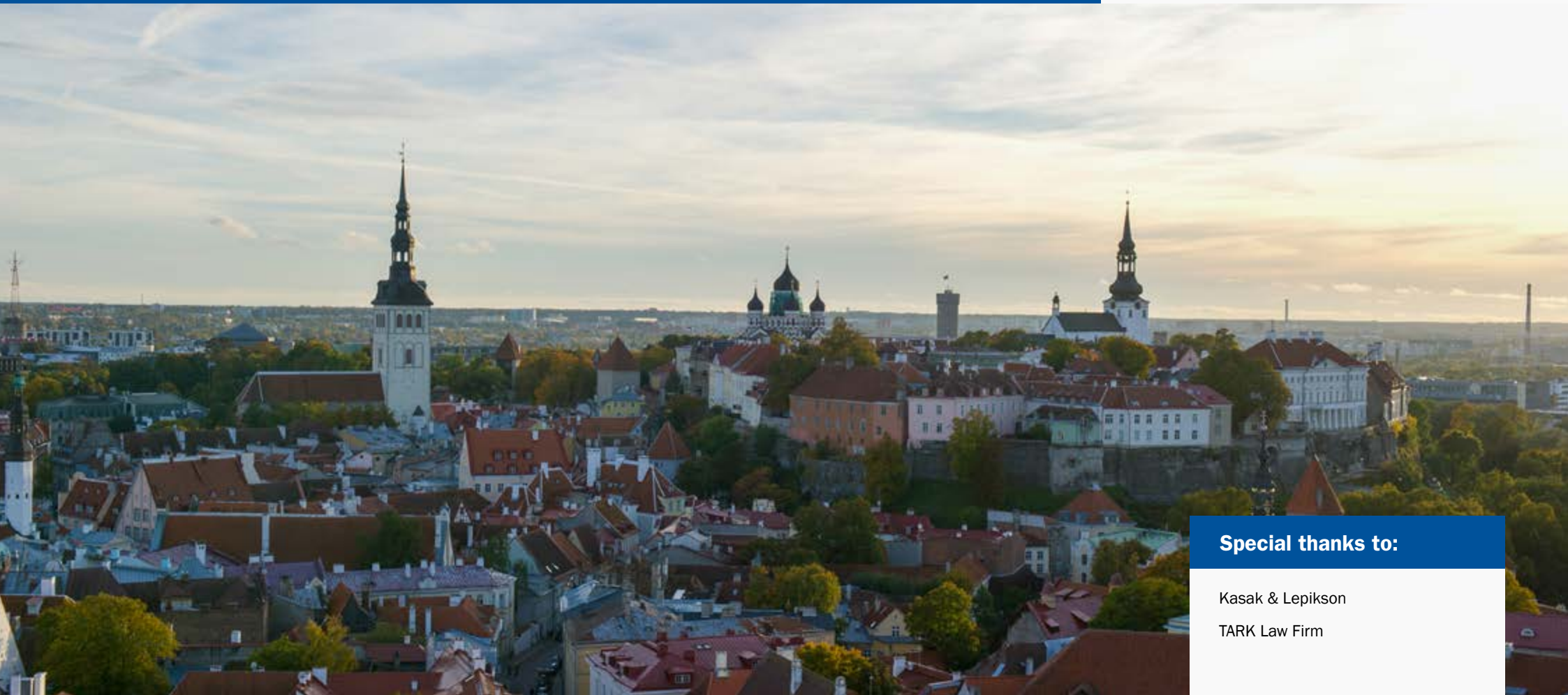
Business Reorganisation Assessment

Estonia

European Bank
for Reconstruction and Development



Special thanks to:

Kasak & Lepikson

TARK Law Firm

Part A

General Information

Macro Data

1,329	3.4%	US$ 26,470	€ Euro – EUR	20%	1.8%	7.1%
Population (million)[1]	GDP growth rate[1]	GDP per capita[1]	Currency	Corporate tax rate[2]	Inflation rate[1]	Unemployment rate[1]

Insolvency Legislation

Insolvency proceedings for non-bank legal entities and entrepreneurs (natural persons) are governed by three separate laws (jointly, the "Insolvency Framework"): the **Bankruptcy Act** (the Bankruptcy Act) (as amended) enacted on 22 January 2003 which entered into force on 1 January 2004[3], the **Reorganisation Act** (the Reorganisation Act) (as amended) enacted on 4 December 2008 which entered into force on 26 December 2008 which is only applicable to legal entities[4]; and the **Debt Restructuring and Debt Protection Act** (as amended) enacted on 17 November 2010 which entered into force on 5 April 2011 and which is only applicable to natural persons.[5] This profile will focus on the Bankruptcy Act and the Reorganisation Act. Relevant secondary legislation on insolvency includes the regulation of Ministry of Justice No 33 as of 11 October 2010 on the qualifications and knowledge of insolvency practitioners (trustees); the regulation of Ministry of Justice No 17 as of 21 May 2010 on supplementary knowledge qualifications; and the regulation of Ministry of Justice No 2 as of 1 February, 2021 about the remunerations and reimbursement of costs of the interim trustee and the trustee from State funds.

Estonia has not yet fully transposed **Directive (EU) 2019/1023** (the Restructuring Directive) on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

Insolvency Data

There is no centralised registry or website for collection of official statistical data on the opening of insolvency proceedings in Estonia. Nevertheless, analysis of public court rulings and the Companies Register reveals some information on insolvency proceedings. In 2020, 1,055 insolvency applications were submitted for natural persons and 599 insolvency applications were submitted against legal persons. In 2020, the court declared the insolvency of 635 natural persons and 150 legal persons. In 2020, 107 new cases for reorganisation proceedings were initiated before the Estonian courts.

However, the number of reorganisation plans approved by the creditors and the courts is low and there are reportedly few examples of successfully implemented reorganisation plans. Main reasons include: the reorganisation is initiated too late; the reorganisation plan is not convincing or does not take into account the depreciation in the value of money over time; and the main creditors do not vote in favour of the reorganisation plan which has a high consent threshold of creditors representing at least two thirds of reorganised debts. Furthermore, creditor claims are not always properly verified, and debtors reportedly sometimes use the restructuring procedure to avoid or deliberately postpone insolvency (bankruptcy).[6]

[1] **IMF – Source as of August 2021:** www.imf.org/en/Countries/EST

[2] **PWC – Source as of August 2021:** www.taxsummaries.pwc.com/estonia/corporate/taxes-on-corporate-income

[3] **The official English translation of the law is available at:** www.riigiteataja.ee/en/eli/521012021001/consolide

[4] **The official English translation of the law is available at:** www.riigiteataja.ee/en/eli/511012021006/consolide

[5] **The official English translation of the law is available at:** www.riigiteataja.ee/en/eli/501022021001/consolide

[6] **World Bank Group and the European Commission, 'Preventive Restructurings:** Technical Note' (July 2019), accessible at: https://advokatuur.ee/uploads/files/WB-SRSS-Preventive%20Restructuring%20Estonia-Report_0.pdf

Company Information

The Estonian company law framework is mainly governed by the **Commercial Code** enacted on 15 February 1995 and which entered into force on 1 September 1995. In Estonia information about companies is available on the website of the Companies Register, a database belonging to the state information system which collects, stores and discloses information on sole proprietorships, companies and branches of foreign companies located in Estonia. The registration department of Tartu County Court is responsible for maintaining the Companies Register. The Register does not distinguish insolvent companies from solvent companies automatically, but if the company has been declared insolvent by the court, the reference “Pankrotis”, which means ‘in bankruptcy’, is noted after the name of the company. The Register may be accessed online free of charge in Estonian **here** and in English **here**.

Insolvency Courts, Regulatory Authorities and Practitioners

Insolvency (bankruptcy) proceedings fall within the competence and exclusive jurisdiction of first instance county courts of general jurisdiction. The jurisdiction of the court is determined on the basis of the registered seat of the debtor as at the date of submission of the petition for the commencement of insolvency proceedings and in respect of the entrepreneur, the place of primary residence. The main government authority responsible for insolvency legislation is the Ministry of Justice In Estonia, insolvency regulation is also overseen by the **Estonian Chamber of Bailiffs and Trustees in Bankruptcy**, which maintains a register of insolvency practitioners. The register is available in Estonian and in English **here**.

Insolvency practitioners are required to pass a professional examination, administered by a special examination board composed of independent members of different professions and under the overall supervision of the Ministry of Justice. Trainees need to undergo training to be eligible to submit a written application to the Chamber to request the right to act as an insolvency practitioner. However, sworn advocates, sworn auditors and bailiffs complying with section 47 (1) of the Courts Act are not required to pass the examination of insolvency practitioners or undergo training in order to be granted the right to act as an insolvency practitioner.

Continue to Part B →

Part B

Business Reorganisation

Are there any incentives for extrajudicial voluntary agreements (workouts)?

No, there are no incentives for debtors and creditors to conclude an extrajudicial voluntary agreement outside of insolvency proceedings.

What is the nature and purpose of the reorganisation procedure?

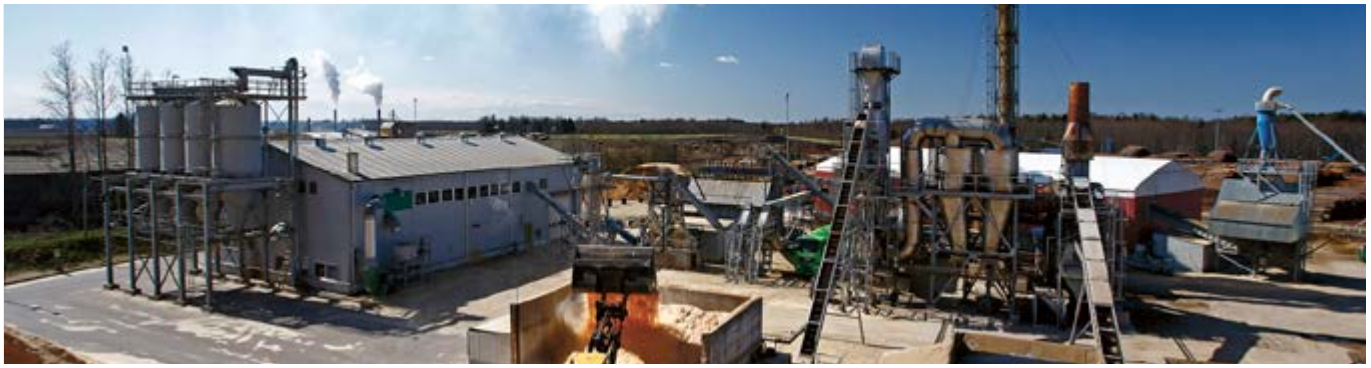
Under the Insolvency Framework there are three business reorganisation options available: the reorganisation procedure (saneerimine) regulated by the Reorganisation Act and the rehabilitation (tervendamine) and compromise (kompromiss) procedures regulated by the Bankruptcy Act. **Click here** for a high-level overview of these procedures.

Reorganisation procedure

This procedure is regulated by the Reorganisation Act. It aims to allow a debtor to negotiate a set of measures to overcome its economic difficulties, restore its liquidity, improve its profitability and ensure its sustainable management (Article 2).

Bankruptcy procedure

Under the Bankruptcy Act, there are three possible outcomes from initiation of bankruptcy proceedings with respect to an insolvent (bankrupt) debtor: approval of a rehabilitation plan; approval of a compromise, or liquidation. The aim of the rehabilitation plan is to allow the continuation of the debtor's business. The aim of the compromise is to achieve a settlement agreement between the debtor and its creditors concerning the payment of debts and reduction of the debts or extension of their payment terms. A compromise is made in bankruptcy proceedings on the proposal of the debtor or the insolvency practitioner (trustee) after the declaration of insolvency (bankruptcy) (Article 178).



Who can commence the process and what entry conditions apply?

Reorganisation procedure

The procedure can be initiated only by the debtor and is applicable only to legal entities (Articles 3 (1) and 7 (1)). The application must be accompanied by an explanation for the debtor's economic difficulties and must substantiate that: the debtor is likely to become insolvent in the future; the debtor requires reorganisation; and the sustainable management of the debtor is likely to be achieved after the reorganisation. However, reorganisation proceedings may not commence if bankruptcy proceedings have been brought against the debtor and a court ruling concerning the compulsory dissolution of the debtor has been made or liquidation is being carried out (Article 7).

Bankruptcy procedure

A bankruptcy petition may be filed by the debtor or a creditor (Article 9). The bankruptcy petition of a creditor should substantiate the debtor's insolvency and prove the existence of a claim. To initiate this procedure the debtor must be insolvent. A debtor is insolvent if it is unable to satisfy the claims of the creditors and such inability is due to the debtor's financial situation and insolvency is not temporary (Article 1 (2)).

However, if a bankruptcy petition is filed by a debtor, the court should declare the bankruptcy of the debtor if insolvency is likely to occur in the future (Article 31).

A rehabilitation plan can be proposed by the insolvency practitioner after the bankruptcy of the debtor is declared (Article 129). Alternatively, a compromise can be proposed either by the debtor or the insolvency practitioner, also after the declaration of bankruptcy (Article 178 (2)). A compromise can only be voted on and bind secured creditors with respect to any unsecured part of their debts. In the event of a dispute, the size of the secured part of the claim is determined by the insolvency practitioner. If enforcement of the secured claim is limited for more than 90 days the relevant secured creditor is granted full voting power in respect of the compromise.

References to Articles are to Articles of the Insolvency Law, unless specified otherwise. For an explanation of technical terms, please see the **Glossary of the Main Assessment Report**

Is there any court involvement?

Yes, all three procedures are fully administrated and supervised by the court.

Are there any hybrid procedures?

No, there are no hybrid reorganisation procedures involving pre-negotiation or approval of a reorganisation plan out-of-court.

Does the debtor remain in possession of and continue to manage its business?

Reorganisation procedure

Yes, the debtor remains in possession of its business. The court appoints a reorganisation advisor on commencement of the reorganisation proceedings whose duties include informing creditors and the court of the economic situation and reorganisation possibilities of the debtor and advising and assisting the debtor during the reorganisation proceedings (Articles 15 and 16).

Bankruptcy procedure

No, the debtor's right to manage its business and assets are transferred to an insolvency practitioner (trustee) (Articles 15 and 36).

Is there a need to appoint an insolvency practitioner?

Reorganisation procedure

No. The court appoints a reorganisation advisor; however, such person is not required to be an insolvency practitioner. Reorganisation advisors can be advocates, trustees in bankruptcy and auditors, as well as any natural persons who meet certain requirements set out by the law. The duties of a reorganisation adviser are detailed in the legislation and are more of a facilitating nature i.e. they do not include supervision and/or management of the debtor (Article 16).

The advisor is in charge of preparing the reorganisation plan (Article 20). If the reorganisation plan is challenged by creditors, the court may appoint at least two experts to provide an opinion on the reorganisation plan (Article 31). Implementation of the reorganisation plan is supervised by the reorganisation advisor (Article 50).

Bankruptcy procedure

Yes, after accepting a bankruptcy petition, the court appoints an interim insolvency practitioner (trustee) to assess the financial situation of the debtor and the feasibility of its rehabilitation, and to preserve the debtor's assets (Articles 15 to 22). After bankruptcy is declared, a permanent insolvency practitioner is appointed (Article 31). The insolvency practitioner manages the debtor's estate from the moment the debtor is declared bankrupt (Articles 35 and 36). Furthermore, the insolvency practitioner takes possession of the property of the debtor and commences administration of the bankruptcy estate immediately after the bankruptcy ruling is made (Article 124).

The insolvency practitioner prepares a plan for continuing the activities of the enterprise (rehabilitation plan) or makes a proposal for terminating the activities of the enterprise (Article 129). The measures required for the rehabilitation of a debtor must be prescribed in a rehabilitation plan. The rehabilitation plan must also set out whether it would be expedient to compromise creditors' claims. The insolvency practitioner presents the rehabilitation plan for approval or the proposal for terminating the activities of the enterprise to the first general meeting of creditors.

The insolvency practitioner, for the purposes of achieving a compromise agreement, may submit a proposal to the court. Should the agreement be approved by the creditors and by the court, the insolvency practitioner and the bankruptcy committee supervise the implementation of the agreement (Article 189).

Is there any applicable stay or moratorium?

Reorganisation procedure

Yes, following the commencement of reorganisation proceedings, the court suspends all enforcement proceedings regarding the assets of the debtor until the reorganisation plan is approved or the procedure is terminated, other than any proceedings in respect of an employment relationship (Article 11).

Bankruptcy procedure

Yes, the court orders a stay on compulsory execution with respect to the debtor's property at the same time as it appoints an interim insolvency practitioner (Article 17).

Is there any protection for essential contracts and from ipso facto provisions?

Reorganisation procedure

Yes, an agreement according to which a party may terminate a contract upon commencement of reorganisation proceedings or approval of a reorganisation plan is void (Article 6). However there are no specific provisions on essential contracts.

Bankruptcy procedure

There is no specific protection for essential contracts nor general protection to prevent termination by third parties on the grounds of the debtor entering insolvency (bankruptcy) proceedings. However, Articles 50 to 53 contain some protection with respect to termination of any leases in which the debtor is a lessee. In the case of the insolvency (bankruptcy) of a lessee, the lessor or commercial lessor may terminate the lease contract only pursuant to the procedure provided for in section 319 of the Law of Obligations Act.

Is new financing protected by law?

Reorganisation procedure

No, there is no specific protection for new financing required by the debtor during the proceedings or as part of the reorganisation plan.

Bankruptcy procedure

Yes, new financing is protected. An insolvency practitioner may conclude transactions with special relevance to the bankruptcy proceedings only with the consent of the bankruptcy committee. Borrowing is deemed to be a transaction of special relevance (Article 125). Therefore, under these conditions the insolvency practitioner could contract new financing and this will be protected (i.e. not challenged) and will have priority in payment before other unsecured creditors (Articles 146 to 148).

Additionally, under the compromise procedure, a compromise may prescribe that the claims of the creditors which have granted credit to the debtor to enable the debtor to continue the business activities are given priority over the claims of the other creditors in subsequent liquidation proceedings if the compromise is annulled (Article 186).

Does the law recognise separate classes of creditors for voting purposes?

Reorganisation procedure

Yes, the legislation envisages the possibility of creditors being divided into groups on the basis of a reorganisation plan for voting purposes. Creditors with the same rights form one group. The rationale for the formation of groups must be set out in the reorganisation plan (Articles 21 (2) and 24(4)). Creditors whose claim are not affected by the reorganisation plan do not participate in voting and the amount of the relevant creditors' claims is not taken into account when calculating the proportions of votes. Supreme Court practice requires that creditors are divided into at least two classes: secured and unsecured creditors for voting purposes.

Bankruptcy procedure

The formation of separate classes for voting is not required.

What are the majorities required to approve a reorganisation plan?

Reorganisation procedure

A reorganisation plan is accepted if at least half of all the creditors which hold at least two-thirds of all the votes vote in favour of the plan. The number of votes of each creditor is proportional to the amount of the creditor's principal debt claim (Article 24 (3)).

Where creditors are divided into groups on the basis of the reorganisation plan applies, the same majority requirement i.e. at least half of the creditors which hold at least two-thirds of all the votes represented in the group, applies. Creditors not affected by a reorganisation plan do not vote.

While the law does not provide for any specific veto rights, the Supreme Court has upheld that the plan cannot be confirmed and approved if the class of secured creditors is against it.

Additionally, if creditors have refused to accept a reorganisation plan, the debtor may submit an application to the court for the approval of the plan if: less than half of the creditors participate in voting held for the acceptance of the reorganisation plan or, in some groups, less than half of the creditors belonging to the group participate in voting; and at least half of all the creditors or, in a group, at least half of the creditors belonging to that group vote in favour of the reorganisation plan (Article 29). In such case, the court appoints at least two experts who will provide an opinion on the reorganisation plan (Article 31).

The plan can be approved by the court even if not accepted by creditors if the requirements under the Insolvency Law have not been violated, if according to experts the reorganisation of the business is likely to succeed, on the basis of the plan no creditor is treated substantially less favourably as compared to other creditors belonging to the same group in the case of an important business which is an important employer (Article 36).

Bankruptcy procedure

A general meeting of creditors is competent to decide on: the continuation or termination of the activities of the debtor; termination i.e. liquidation of the debtor if the debtor is a legal entity; and a compromise with the debtor (Article 77). The decisions of a general meeting of creditors are adopted by a simple majority of the votes of the creditors participating in the meeting unless otherwise provided by law. At a general meeting of creditors, the number of votes of each creditor is proportional to the amount of the creditor's claims. Secured creditors may only vote at such meeting if their claim is affected by the proposed compromise.

- **Rehabilitation plan**

The insolvency practitioner must present the rehabilitation plan for approval (where applicable) to the first general meeting of creditors. The general meeting must either approve the rehabilitation plan submitted by the insolvency practitioner or decide that the activities of the enterprise be terminated (Article 129).

The decisions of a general meeting of creditors are adopted by a simple majority of the votes of the creditors participating in the meeting. At a general meeting of creditors, the number of the votes of each creditor is proportional to the amount of the creditor's claim (Articles 81 and 82). A claim arising from a conditional transaction which is not yet fulfilled grants a voting right only if fulfilment of the condition is likely or the condition is fulfilled. If a creditor participating in a general meeting does not consent to the number of the votes assigned to the creditor by the insolvency practitioner or if the number of the votes assigned to the creditor is contested by another creditor, the number of the votes is determined by a ruling of the judge participating in the general meeting.

A general meeting of creditors is quorate regardless of the number of the votes represented if the creditors were notified of the time and place of the meeting within the specified term and in the manner specified in the legislation.

Secured creditors may only vote at such meeting if their claim is affected by the rehabilitation plan.

- **Compromise**

A compromise is made at a general meeting of creditors concerning all claims against the debtor which have been filed by the time of making the compromise. A compromise is deemed to be made if at least half of the creditors present whose claims constitute at least two-thirds of the total amount of all claims vote in favour (Article 180). A creditor whose claim is secured may vote on a compromise only if the claim is not fully secured by security, i.e. only in respect of the value of its unsecured claim. This is, however, difficult to determine in practice without sale of the underlying secured asset.

In addition, during the bankruptcy procedure, a bankruptcy committee protects the interests of all the creditors, monitors the activities of the insolvency practitioner, and performs other duties provided by law in bankruptcy proceedings. The number of the members of a bankruptcy committee is decided by a general meeting of creditors. A bankruptcy committee must have at least three and not more than seven members. A bankruptcy committee must include persons proposed by creditors with larger as well as smaller claims (Articles 73 and 74 of the Bankruptcy Act).

Who does the reorganisation plan bind?

Reorganisation procedure

A reorganisation plan approved by the court binds all the creditors that are party to the plan. If the majorities described above are reached, dissenting creditors are bound by the plan. However, a creditor can apply to court to request the refusal of the reorganisation plan if: the creditor voted against the reorganisation plan; the plan has materially violated its rights in the course of preparation of the reorganisation plan or acceptance of the reorganisation plan; or the plan has treated the creditor less favourably compared to other creditors or to creditors belonging to the same group (Article 26).

Bankruptcy procedure

The rehabilitation plan and the compromise plan bind all the creditors that are party to it. If the majorities described above are reached, any dissenting creditors are bound by the plan.

What is the timeframe for the reorganisation procedure and any moratorium?

Reorganisation procedure

The court is required to commence a reorganisation proceeding by a ruling within seven days after the receipt of the reorganisation application (Article 10). The reorganisation ruling sets out the term for acceptance of the reorganisation plan and during which the reorganisation plan must be submitted to the court for approval, which cannot exceed 60 days. Following approval of the plan by creditors, the court must approve an accepted reorganisation plan within 30 days (Article 28).

The moratorium remains in effect from the commencement of the procedure until the reorganisation plan is approved or reorganisation proceedings are terminated (Article 11).

Bankruptcy procedure

A compromise can be proposed by the debtor or the insolvency practitioner after the declaration of the debtor's bankruptcy and is decided by a general meeting of creditors. A compromise proposal may be filed prior to approval of a distribution (liquidation) proposal by the court. An insolvency practitioner must immediately submit a decision on a compromise to the court for its approval. The court must decide on approval of the compromise by a ruling within fifteen days after the date of submission (Articles 179 and 180).

A rehabilitation proposal must be filed by the insolvency practitioner for approval of the first general meeting of creditors. If bankruptcy of the debtor is declared, the court decides on the time and place of the first general meeting of creditors and the appointment of an insolvency practitioner (Article 31). The first general meeting of creditors must be held not earlier than 15 days and not later than 30 days after the declaration of bankruptcy (Article 78).

At the first general meeting of creditors, the creditors elect the bankruptcy committee and decide on the approval of the insolvency practitioner and continuation of the activities of the debtor pursuant to a rehabilitation plan or a compromise. Alternatively where the debtor is a legal entity, the creditors may decide on termination of such entity.

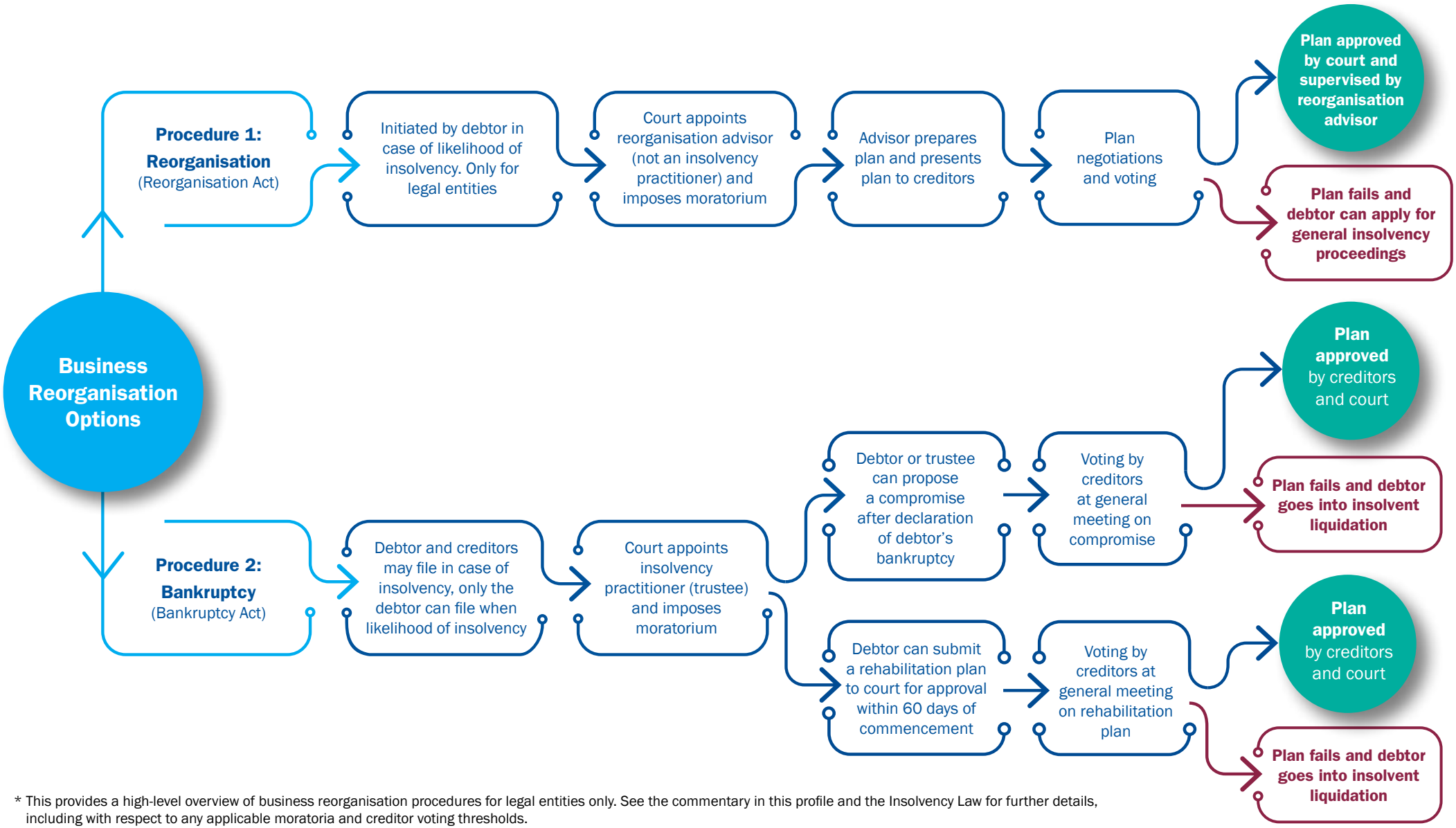
Has the UNCITRAL Model Law on Cross Border Insolvency been adopted?

No, Estonia has not adopted the UNCITRAL Model Law. However, as a member of the European Union Estonia is subject to **Regulation (EU) 2015/848** on insolvency proceedings which governs the coordination of insolvency proceedings within the EU. The reorganisation procedure does not benefit from the Regulation (EU) 2015/48 as it is not listed in Annex A to the Regulation. However, the bankruptcy procedure is included in Annex A and therefore benefits from cross-border cooperation within EU Member States.

Special features/observations:

- Interestingly, the Estonian Reorganisation Act contemplates the possibility of approval of a reorganisation plan which has not been accepted where the debtor is a large employer.
- Estonia fully transposed the EU Restructuring Directive in January 2021, ahead of many other EU member states.

Overview of Estonian Business Reorganisation Procedures*



* This provides a high-level overview of business reorganisation procedures for legal entities only. See the commentary in this profile and the Insolvency Law for further details, including with respect to any applicable moratoria and creditor voting thresholds.

Contact

Catherine Bridge Zoller
Senior Counsel
Legal Transition Team
European Bank for Reconstruction & Development
LTTRestructuring@ebrd.com

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