A&O SHEARMAN

Restructuring across borders
Estonia

CORPORATE RESTRUCTURING AND INSOLVENCY PROCEDURES | JANUARY 2024

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Introduction

There are three principal restructuring and insolvency regimes for companies under Estonian law:

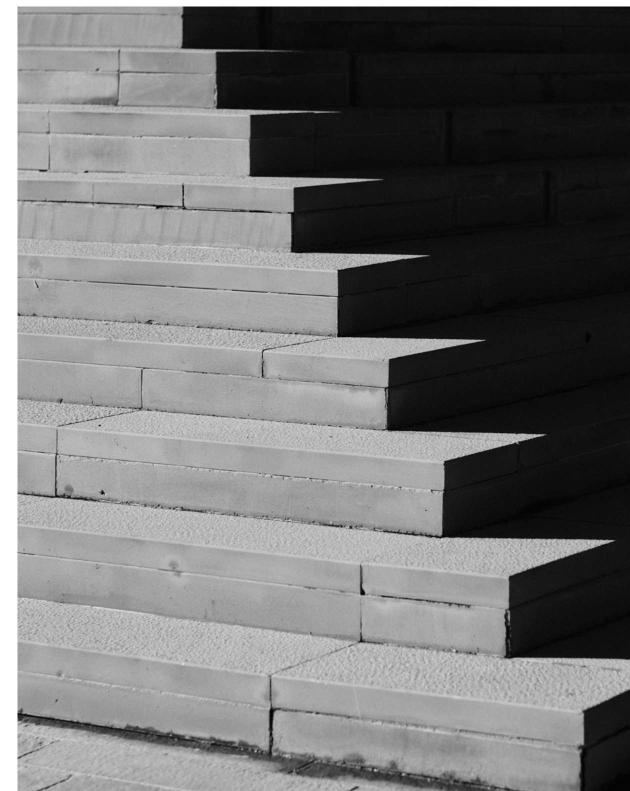
- Bankruptcy;
- Liquidation;
- Reorganisation.

The bankruptcy proceeding is unique in the way that it can be used as a "gateway" procedure with several possible outcomes: dissolution, rehabilitation, and compromise.

It should be noted that companies cannot choose freely between these regimes because the grounds for implementation differ and depend on the company's financial situation, solvency, and intentions.

The following article will give a brief overview of the regimes and their possible outcomes.

Bankruptcy



The bankruptcy procedure is regulated by the Bankruptcy Act 2004 (the **Act**). The Act has been amended and reworded throughout the years and was substantially changed in 2021 to make the proceeding faster and more effective.

The bankruptcy proceeding is suitable in circumstances where the debtor is insolvent. A debtor is considered insolvent if it is unable to satisfy the claims of creditors that have fallen due, and the debtor's financial situation indicates that this inability is not temporary. Essentially, the purpose of bankruptcy proceeding is for the debtor's estate to be realised and distributed to the creditors.

The most important principle in Estonian bankruptcy law is the equal treatment of creditors. Pursuant to this principle, proceedings are carried out in the interest of all creditors.

The bankruptcy proceeding is commenced upon the filing of a bankruptcy petition to court by the debtor or a creditor. The court can either accept or reject the petition.

The rejection of the petition is not common, since at this stage of the proceeding, the court will only assess if there are indications that the debtor is insolvent, if 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, decide whether to appoint an interim trustee or not. The court may schedule a preliminary hearing to decide that. In this stage, the court evaluates the creditor's claim and debtor's financial situation more thoroughly and may refuse to appoint an interim trustee if, *inter alia*, the debtor objects to the claim on a reasoned basis or the amount of the claim does not meet the minimum requirement set out in law (12,500EUR in the case of a public limited company and 2,500EUR in the case of a private limited company). If the court finds that there are no grounds on which to commence bankruptcy proceedings, the court will not appoint an interim trustee and the proceeding is terminated.

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 may be required to provide the court with a deposit for the remuneration. Pursuant to the latest amendments to the Act, if the deposit is not paid and the debtor is a legal person, the court shall make a proposal to the Insolvency Division (independent structural unit formed with the Competition Authority) to file an application for conducting bankruptcy proceedings by public investigation. Upon receiving the proposal, the Insolvency Division may file a reasoned application with the court if the abatement of proceedings would otherwise occur and it may be at least reasonably suspected that there is public interest in the debtor's insolvency.

The interim trustee's role is to assess the debtor's financial situation and the prospects for a rehabilitation. The court may also impose specific duties on the interim trustee depending on the particular proceedings. The interim trustee shall submit a written report to the court, which will include their opinion on the causes of the debtor's financial problems.

Bankruptcy *(cont.)*

If a debtor submits a bankruptcy petition, the debtor is presumed to be insolvent. Where the bankruptcy petition is filed by a creditor, the court will hear the bankruptcy petition and decide whether to make a bankruptcy order within 30 days (or, with good reason, within two months) of the interim trustee being appointed. The petitioning creditor, debtor and interim trustee must participate in the hearing. Since court hearings are generally public, 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.

When the court declares the debtor bankrupt, the bankruptcy proceeding is commenced. A court ruling declaring the debtor bankrupt is effective and subject to execution from the date and time the ruling is made public. Appeal against the bankruptcy ruling can be filed by the debtor or the petitioning creditor.

Upon the declaration of bankruptcy:

- the trustee in bankruptcy (trustee) is appointed;
- the assets of a debtor become the bankruptcy estate;
- the debtor's right to manage and dispose of its estate transfers to the trustee;
- all the claims against the debtor are deemed to have fallen due; and
- the courts must dismiss the proprietary claims against the debtor which were filed before the declaration of bankruptcy; the trustee may enter in lieu of the debtor the proceedings that were commenced by the debtor's action or any other petition relating to a bankruptcy estate.

A notice of the declaration of bankruptcy must be published in the official publication, *Ametlikud Teadaanded*, and contain information relating to the debtor and the trustee, a proposal for the creditors to file their claims, the term for filing the claims, and the time and place of the first general meeting of the creditors.At the first general meeting of the creditors, 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 protect the creditors' interests and supervise the trustee's activities. If the creditors decide not to form the creditors' committee, the duties of the creditors' committee will be performed by the creditors during the creditors' general meetings.

After the declaration of bankruptcy, the creditors may file their claims against the debtor only pursuant to the procedure provided for in the Bankruptcy Act. The regulation regarding the defence of claims changed notably in 2021.

All creditors are required to notify the trustee of all their claims against the debtor which arose before the declaration of bankruptcy within two months after the publication of the bankruptcy notice. A trustee must be notified by a proof of claim – a written document that sets out the content, basis, and amount of the claim and whether the claim is secured by a pledge. Within one month after the deadline for filing claims, the trustee shall prepare a preliminary list of creditors. After that, all creditors, the debtor, and the trustee may file objections to the claims together with the evidence supporting the objection. The creditor that has received the objection gets a chance to file written response to the objection. Within the following 30-day period, a trustee shall prepare the final list of creditors and submit it to the court for approval. The court shall adjudicate the list on the merits of the submitted objections, positions, requests and petitions enclosed with the list (new statements or evidence cannot generally be presented to court), determine the rankings of claims and the distribution ratios and approve the list of creditors within 30 days (or extend the term by up to 30 days).

Bankruptcy *(cont.)*

During the bankruptcy proceeding, the trustee can file for recovery of the bankruptcy estate if needed. The court shall revoke transactions which were concluded or other acts which were performed by the debtor before the declaration of bankruptcy, and which damage the interests of the creditors. Specific grounds and terms for recovery differ but, in some cases, the court may revoke transactions concluded even within five years before the appointment of an interim trustee.

The claims of the creditors shall be satisfied by the bankruptcy estate after the payments relating to the bankruptcy proceeding are made. The claims are satisfied in three rankings: (i) accepted claims secured by a pledge, (ii) other accepted claims which were filed within the specified term and, (iii) other claims which were not filed within the specified term but were accepted. Claims of a lower ranking are satisfied after the claims of the preceding ranking have been satisfied in full. If the assets subject to distribution are not sufficient for the satisfaction of all the claims with the same ranking, payments are made in proportion to the sizes of the corresponding claims.

Once the bankruptcy estate has been sold and all the proceeds from the liquidation of the debtor's estate have been distributed, the bankruptcy proceeding 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 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.

If a debtor who is a legal person is permanently insolvent, the court shall decide on the liquidation of the debtor by a ruling on termination of the proceeding. The trustee shall liquidate the debtor within two months after entry into force of the abovementioned ruling.

However, if there are still assets left in the estate, the final report may only be submitted to the court with the consent of the creditors' committee.

If a debtor who is a legal person is permanently insolvent, the court shall decide on the debtor's liquidation by a ruling on termination of the proceeding. The trustee shall liquidate the debtor within two months after entry into force of the abovementioned ruling.

Rehabilitation within bankruptcy

Rehabilitation proceedings are carried out under the umbrella of bankruptcy proceedings. Rehabilitation is an alternative way to satisfy the debtor's claims by continuing the activities of the enterprise.

An interim trustee shall first assess the financial situation and solvency, prospect of continuation of the activities, and rehabilitation, of the debtor. The rehabilitation proceeding cannot be commenced before the declaration of bankruptcy, but the interim trustee's evaluation helps the parties to understand whether it could be a possibility or not.

During the first general meeting of the creditors, the trustee shall set out the possibilities for rehabilitating the enterprise of the debtor and ascertain the opportunities for satisfying the claims of the creditors in the event of rehabilitating the enterprise. The trustee shall present the rehabilitation plan prescribing the measures required for the rehabilitation.

A general meeting shall either approve the rehabilitation plan or decide that the activities of the enterprise be terminated. 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). The general meeting may make a proposal to the trustee to submit a new rehabilitation plan.

If rehabilitation is the preferred route, the trustee, in accordance with an agreed rehabilitation plan, will conduct the proceedings. If rehabilitation is not decided on, the bankruptcy proceeding shall continue in the typical way.

Compromise within bankruptcy

Once bankruptcy is declared, the debtor or the trustee may make a proposal to the creditors for the reduction of the debts and/or the extension of the term for payment. The proposal must specify as to what extent, and by which date the debtor proposes to pay its debts and provide proof that it has the means to comply with the proposal. A compromise proposal may be filed until the approval of a list of creditors by the court.

A general meeting of creditors whose claims are not secured shall vote on whether to accept or reject the proposal.

A compromise is deemed to be made if at least one-half of the creditors present whose claims constitute at least two-thirds of the total amount of all claims vote in favour. If an objection has been filed against a creditor's claim, and the court proceeding concerning the acceptance of the claim has not been ended by the time the general meeting takes place, the creditor shall participate in the voting on the compromise proposal on the basis of the claim determined by the court in the preliminary list of creditors.

The court shall decide on the approval of the compromise by a ruling (within fifteen days after the date of submission of the compromise decision to the court). A court shall not approve a compromise if the compromise has been made in violation of the requirements provided for in the Bankruptcy Act or by fraud.

Upon approval of the compromise, the bankruptcy proceedings are terminated. However, the trustee and the bankruptcy committee shall exercise supervision over the performance of the compromise. New bankruptcy proceedings may not be commenced whilst the compromise remains in force.

A compromise can be annulled by a court at the request of the trustee or a creditor if the debtor, *inter alia*, is convicted of a bankruptcy offence, fails to perform its duties arising from the compromise or it is evident that the debtor is unable to meet the requirements of the compromise. If the compromise is annulled, the bankruptcy proceeding is reopened.

Corporate liquidation

The corporate liquidation proceeding is possible only if the 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 Commercial Code 1995.

There are two ways to initiate corporate liquidation proceedings: (i) by a decision of a general meeting of the company's shareholders (voluntary corporate liquidation) or (ii) 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 the corporate liquidation procedure is 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, selling assets, and satisfying the claims of creditors. The liquidator may also challenge transactions entered by the company and bring claims against the members of the management bodies of the company in circumstances where such persons have breached their obligations. If the assets of a private limited company being liquidated are insufficient to satisfy all claims of creditors, the liquidators shall submit a bankruptcy petition.

The liquidators shall promptly publish a notice of the liquidation proceeding in the official publication *Ametlikud Teadaanded*.
The creditors shall notify the liquidators of all their claims within four months after the publication of such a notice; nevertheless, failure to do so does not affect the validity of the claim or restrict the creditor's right to file an action with a court.

After satisfying or securing all the creditors' claims and depositing the money, the remaining assets shall be distributed among the shareholders according to the nominal values of their shares.

If liquidation is decided by the shareholders, the shareholders may, until the commencement of the distribution of assets among the shareholders, decide on the continuation of the activities of the company or a merger, division, or transformation.

The company shall be deleted from the commercial register after the conclusion of the liquidation, provided that the company is not a party to any ongoing court proceedings in Estonia (which may typically be the case when the company has not satisfied all the creditors claims).

If, after the private limited company has been deleted from the register, it becomes evident that the private limited company has assets which were not distributed and that supplementary liquidation measures are necessary, a court may, at the request of an interested person, order a supplementary liquidation and restore the rights of the former liquidators or appoint new liquidators.

Reorganisation

The reorganisation proceeding is regulated by the Reorganisation Act 2008.

The reorganisation procedure is suitable for companies that are not yet insolvent but are likely to become insolvent in the future. The reorganisation of an enterprise means the application of a set of measures to overcome the company's economic difficulties, to restore its liquidity, improve its profitability and ensure its sustainable management. Reorganisation under the Reorganisation Act should not be confused with rehabilitation within bankruptcy which is only available as an option once a company has been declared bankrupt.

To commence the reorganisation proceeding, the company or a creditor of 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 present financial problems).

Reorganisation proceedings cannot be commenced if: (i) a court has appointed an interim trustee in bankruptcy to the company; (ii) a court has ruled that the company should be compulsorily dissolved; (iii) less than two years have passed from the termination of reorganisation proceedings regarding the undertaking; or (iv) the application does not meet the aforementioned conditions.

A court will decide whether to commence the reorganisation proceeding within seven days of the receipt of the reorganisation application. If the company shows that the requirements to open the proceeding are satisfied, the court must open the proceeding and appoint a reorganisation adviser.

Upon the reorganisation ruling:

- enforcement proceedings commenced in relation to the company's assets are suspended;
- fines or contractual penalties that increase with time will stop increasing;
- court proceedings regarding a financial claim against the company may be suspended; and
- the courts will suspend deciding on the commencement of bankruptcy proceedings.

The reorganisation advisor will communicate the reorganisation notice to the creditors known to them and state the creditors claim which they believe to be correct. If the creditor does not agree with the amount of claim stated by the advisor, it shall submit the evidence certifying otherwise. If the reorganisation adviser does not agree with the objections, the court shall decide the amount of the claim within two weeks after receipt of the application.

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. The main conditions to be included in the reorganisation plan are measures reducing or postponing the company's debts.

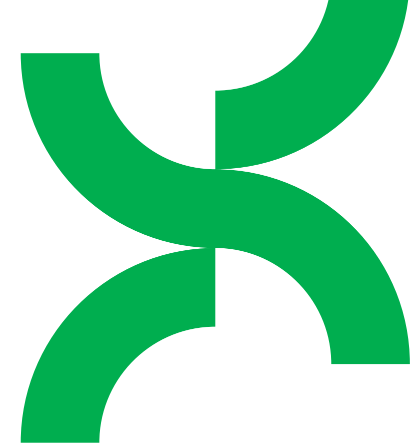
The reorganisation plan must be approved by creditors and will be approved if more than half of the creditors in number and two-thirds by value vote in favour of the plan. Once creditors have approved the reorganisation plan, it must be submitted to court for approval. In some cases, the reorganisation plan which has not been accepted by the creditors, may also be approved by the court.

Reorganisation *(cont.)*

The reorganisation plan will specify how long the reorganisation proceeding will last. During this period, a bankruptcy petition may not be filed in relation to any claim to which the reorganisation plan applies. 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 terminate upon (i) premature termination of the proceedings, (ii) revocation of the reorganisation plan, (iii) implementation of the reorganisation plan before the due date or (iv) expiry of the term for implementation of the reorganisation plan which is set out in the reorganisation plan. A court shall revoke a reorganisation plan if, *inter alia*, the company fails to perform the obligations arising from the reorganisation plan to a material extent or it is evident that that the company is unable to perform its obligations assumed in the reorganisation plan. The court must terminate the reorganisation proceedings under the Reorganisation Act if it becomes evident that the company is permanently insolvent; in this case, bankruptcy proceedings will follow. If a court terminates reorganisation proceedings prematurely, all consequences of the commencement of reorganisation proceedings retroactively cease to exist.

Upon expiry of the term for the implementation of a reorganisation plan, reorganisation proceedings shall be terminated. After that, the creditor may invoke a claim transformed by the reorganisation plan only to the extent which is agreed in the reorganisation plan and has not been fulfilled according to the reorganisation plan.



Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at A&O Shearman, or email **rab@aoshearman.com**

This fact sheet has been prepared with the assistance of Ellex Raidla. Any queries under Estonian law may be addressed to the key contacts listed below:

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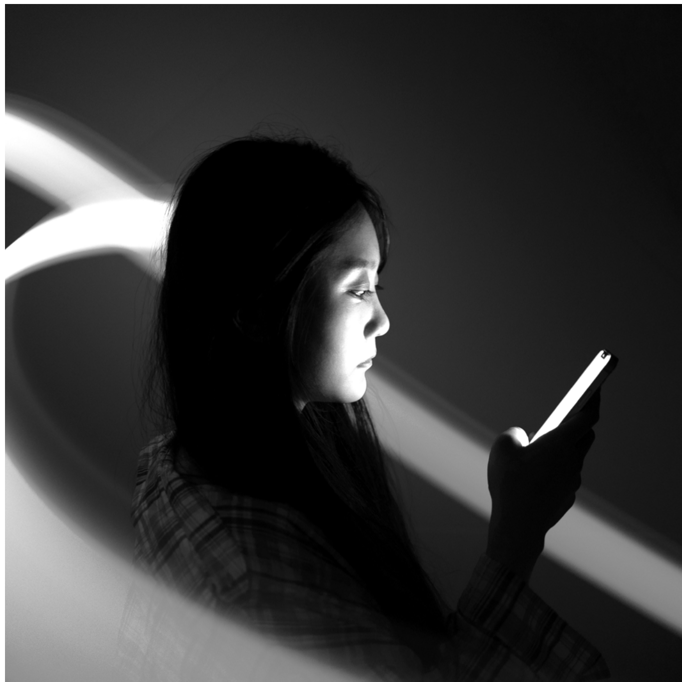
Further information

Developed by Allen & Overy Shearman market-leading Global Restructuring Group, "**Restructuring Across Borders**" is a free and easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, Asia, the Middle East and the U.S.

To access this resource, please **click here**.



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