The Insolvency Law of Central and Eastern Europe

Twelve Country Screenings of the New Member and Candidate Countries of the European Union and Russia: A Comparative Analysis

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IV. Estonia

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1. Introduction

a) Historical Background

Until the Estonian Parliament adopted on 10 June 1992 the first Bankruptcy Act[212] which entered into force on 1 September 1992, Estonia did not have a bankruptcy act of its own. In the years before 1940 bankruptcy proceedings were carried out based on Tsarist Russian legislation which was still valid then. Provisions of the Russian legislation concerning insolvency proceedings were systematized by Aleksander Puldas and published in 1934 under the name Insolvency Act.[213] This was however not an actual law act. Efforts to prepare an Estonian bankruptcy act were made but it was not yet passed as Estonia lost its independence in 1940. In the Soviet economy bankruptcy proceedings were naturally not possible. The first Bankruptcy Act has later been amended in larger scale. Major amendments were adopted by the Estonian Parliament on 18 December 1996, which entered into force as of 1 February 1997.

On 22 January 2003 the Parliament adopted the new Bankruptcy Act, hereinafter the "BA" which entered into force as of 1 January 2004.[214] The main changes concerned strengthening the position of the debtor and enabling the restructuring of the enterprises. After that the Bankruptcy Act has been amended four times, with the last amendments taking force on 1 January 2007.

b) Insolvency Practice

Between 2002 - 2004 there were on average 1,000 new bankruptcy cases filed every year. In 2005 and 2006 the number fell to about 650

[212] RT (State Gazette) 1992, 31, 403.

[213] Puldas, Aleksander. Maksuvõimetuse (konkursi-) seadus, Insolvency (Competition) Act Edited by Puldas, Aleksander, author's publication, 1934 in Varul, Paul. On the Development of Bankruptcy Law in Estonia, Juridica International, IV 1999, pp. 172-178.

[214] Estonian Bankruptcy Act, RT I 2003, 17, 95, hereinafter BA.

per year. During 2002 to 2004 on average 850 cases were concluded by the courts, in which about 320 bankruptcies were declared. In 2006 171 bankruptcies were declared. Business prohibitions were set in 21 cases. In the first half of 2007, 109 new bankruptcy proceedings have started and 94 bankruptcies have been declared. There are 171 bankruptcy trustees registered and on average there are 10 bankruptcy proceedings for each trustee. Overall as of the end of 2006, there are 1,534 pending bankruptcy cases in the proceedings.

c) Status of the Reforms

Before the adoption of the new BA there were several concerns about the efficiency of the procedure and about the protection given to the persons involved. For instance the claims could be filed to different courts thus making the administration of the proceedings and the unity of the procedure very complicated. The position of the trustee was also greatly influenced by the reforms. Most importantly supervision regarding their role and work was enhanced. One of the most criticized problems of the previous act was the lack of opportunities to rehabilitate the companies involved. The powers of the trustees concerning rehabilitation were increased also the incentives for successful rehabilitation were substantially improved.

The BA was a part of a larger reform of the civil law, wherein most legal acts in the field of civil law were redrafted to fit the new system of law and be in concert with the European level legislation. The reforms also included acts concerning procedures. As a result of the reforms the procedures were enhanced thus providing more efficiency, quicker results and larger protection. The later amendments to the legislation have been very limited and have mostly concerned procedure and the institution of the trustee in bankruptcy. The latest amendments concerned the reports drafted by the trustee. As of today there are no larger amendments planned to the legislation concerning bankruptcy.

2. Commencement of Insolvency Proceedings

Bankruptcy proceedings can be effected as judicial and extra-judicial proceedings. The BA recognizes reorganization proceedings (§129) and compromise arrangements (§§ 178-192) but these can be entered into after the bankruptcy declaration only. Voluntary (out-side bankruptcy proceedings) liquidation of legal persons, which is allowed when the assets cover obligations, is regulated by the Commercial Code (RT I 1995, 26-28, 355). But as these arrangements are based on voluntary agreements between the debtor and the creditor(s), it is not allowed to deprive a creditor from the right of invoking the claim despite of a voluntary agreement on arrangements.

a) Principles of Procedure and Legal Protection

Arising from the historical background there was an obvious need to protect the creditors' interests over the debtors' in the early 1990's as there were many uncertainties in the society which could cause great losses for the creditors. For example it was impossible for credit institutions to establish mortgages as loan securities in the early stage of land reform as the land was not in commerce yet. Basic model used in drafting the first Estonian Bankruptcy Act was the Swedish Insolvency Act. Later amendments have paid more attention to the rights of the debtor.

The main objectives of the bankruptcy proceedings are set by the BA in § 2. The claims of the creditors are satisfied out of the assets of the debtor by transferring the assets or by rehabilitating the undertaking. Natural persons are given the right to be released from his or her obligations through the bankruptcy procedure. One of the basic principles of existing Estonian bankruptcy legislation is that the bankruptcy does not commence with filing a petition but with a court order. Therefore it is up to the court to decide whether to begin bankruptcy proceeding or not.

Upon drafting the BA the following principles were considered:

- the rehabilitation of companies that could function;
- the sale of all assets together;
- transparency;

- the channeling of economic values to where they provide most efficiency.

There are no special bankruptcy courts in Estonia. The bankruptcy cases are heard by the regular courts and appeals regarding the resolutions can be presented to district courts and ultimately to the Supreme Court of the Republic of Estonia. The procedures in the bankruptcy cases are regulated by the Civil Procedure Act.

b) Scope and Applicability

Bankruptcy proceedings can be held regarding natural persons and legal persons, § 8 BA. According to the Bankruptcy Act, the state or the local governments can not be subject to bankruptcy proceedings. The debtor is insolvent if the debtor is unable to satisfy the claims of the creditors and such inability, due to the debtor's financial situation, is not temporary. A debtor who is a legal person is insolvent also if the assets of the debtor are insufficient for covering the obligations thereof and, due to the debtor's financial situation, such insufficiency is not temporary.

A debtor who is a natural person may be given the opportunity to be released from his or her obligations through bankruptcy proceedings. Nevertheless such discharge of residual debt (§§ 169 - 177 BA) is excluded if:

1) the debtor has been convicted of a bankruptcy offence or a criminal offence relating to execution procedure, a tax offence or a criminal offence;
2) during the preceding three years before the commencement of the bankruptcy proceedings or thereafter, the debtor has intentionally or through gross negligence provided incorrect or incomplete information concerning his or her financial situation in order to receive benefits or other advantages from the state, a local government or foundation or to evade payment of taxes;
3) during the preceding ten years before the commencement of the bankruptcy proceedings, the court has decided to release the debtor from his or her obligations or dismissed the debtor's petition for release from obligations due to a bankruptcy offence committed by the debtor;

4) during the preceding year before the commencement of the bankruptcy proceedings or thereafter, the debtor has intentionally or through gross negligence hindered satisfaction of the claims of the creditors by squandering assets or delaying submission of a bankruptcy petition although he or she did not have any opportunities for improving his or her financial situation;
5) the debtor has intentionally or through gross negligence submitted incorrect or incomplete information in the list of debts concerning his or her assets, income, creditors or obligations or violated his or her other obligations provided for in the Bankruptcy Act.

Together with the bankruptcy petition, which initiates the procedure, the debtor provides assurances that he or she is in no contradiction with the above conditions. The commencement of the procedure is decided by the court, upon approval of the final report. During the procedure the debtor is obliged to engage in profitable enterprises and if not then actively seek it. All income shall be given to a trustee, as shall be any inherited items. After 5 years of deciding the commencement of the procedure, the court shall conclude it and declare the person free of the obligations unfulfilled thus far.

c) Grounds for Opening Insolvency Proceedings

According to § 1 of the BA, bankruptcy is defined as debtor's insolvency which is declared by the court. A debtor is considered insolvent if the debtor is unable to satisfy the claims of creditors and this inability is not temporary when considering the financial situation of the debtor (illiquidity). A legal person is considered to be insolvent also in case where the assets do not cover the obligations and this financial situation is not temporary (over-indebtedness). Furthermore, for both legal entities and physical persons §10 II BA foresees imminent illiquidity, but only if detected in execution proceedings.

Upon submitting the bankruptcy petition the court shall not start the proceedings if it is not evident from the bankruptcy petition of the creditor that the petitioner has a claim against the debtor or the bankruptcy petition of the creditor does not substantiate the insolvency of the debtor. The law does not lay down specific criteria for calculation the

assets and the obligations of the debtors. The legislation provides requirements for proving the insolvency of the debtor. If the conditions are met the procedure can be commenced without further calculation of the assets (See under 2 d). According to §§ 176 and 301 the Estonian Commercial Code valid as of 1 September 1995, the general meeting of the company has to decide how to bring the net assets in compliance with the requirements of law, if the net assets of a private limited and public limited companies are less than half of the amount of the share or stock capital, less than the obligatory amount of share or stock capital[215] or less than some other amount set by the law. In order to do so, the general meeting of the company may decide to terminate, merge, divide or re-structure the company but they may also make a decision to file a bankruptcy petition.[216]

d) Persons Entitled and Persons Obliged to File the Petition

According to § 9 BA a bankruptcy petition can be filed by the debtor or the creditor. Every natural or a legal person may be a creditor or a debtor. The BA provides an exception only for the state and the local governments. The claim of the creditor has to have arisen before the declaration of bankruptcy. It can be prescribed by law when there is an obligation of the debtor to file a bankruptcy petition. In case of the death of the debtor, a bankruptcy petition concerning the property of the debtor, may also be filed by a successor, the executer of the will or the administrator of the estate of the debtor. The petition will in this case be handled as a petition filed by a debtor. § 9 III BA also provides others than debtors and creditors the right to file a bankruptcy petition. Such right is provided e.g. to the Financial Supervisory Authority of the Bank of Estonia according to § 123 III of the Act on Credit Institutions[217].

According to § 36 of the General Part of the Civil Code Act, members of the management board or members of a body substituting for the

[215] Private limited companies 40,000 EEK and public limited companies 400,000 EEK.

[216] RT I 1995, 26-28, 355.

[217] RT I 1999, 23, 349.

management board are obliged immediately to file a bankruptcy petition when it is obvious that the legal person is clearly permanently insolvent. §§ 306 (31) and 180 (51) Commercial Code also obliges the management of private and public limited companies to file in a petition in situations where the insolvency, due to company's financial situation obvious and not temporary.[218] §§ 187 and 315 Commercial Code and the General Part of the Civil Code Act § 37 (2) provide that members of the management board, who violated their obligations, are jointly and severally liable for the damage caused to the legal person. Also a creditor, whose claim was not satisfied because of the lacking assets, is allowed to claim for compensation of damages.[219] Members of the management board may also be held liable under the Penal Code § 380 if they fail to call a general meeting of shareholders when it is obvious that the net assets of the company are less than required or if they fail to fulfil the obligation to file a bankruptcy petition provided by law. This failure may be punished by a pecuniary punishment or by an imprisonment up to three years.[220]

Any member of the management board or the management body substituting the for the management board of a debtor, who is a legal person, may file a bankruptcy petition on behalf of the debtor even if the member does not have the right to represent the legal person alone. Since 2004 The BA also provides in § 13 (4) that a partner in general partnership or a general partner in limited partnership may file a petition even if the partner or general partner does not have the right to represent the partnership or the right to represent the partnership alone. §§ 210 and 373 of the Commercial Code provides an obligation of the liquidator(s) of private limited and public limited companies to file a bankruptcy petition if the assets do not enable the satisfaction of all claims.[221]

When the debtor files in a petition according to § 13 (2) BA, the debtor must also substantiate the insolvency by annexing an explanation about the reasons of the insolvency and the list of debts. The debtor

[218] RT I 1995, 26-28, 355.

[219] RT I 1995, 26-28, 355 ; RT I 2002, 35, 216.

[220] RT I 2001, 61, 364.

[221] RT I 1995, 26-28, 355.

shall name the creditors and mention the amount of each claim and including information about the assets. Similarly to the debtor the creditors shall be able to substantiate the insolvency of the debtor and also prove the existence of the claim. In order to substantiate the insolvency a creditor, must according to the § 10 rely on at least one of the following facts:

- the debtor has failed to perform an obligation within thirty days after the obligation has fallen due and the creditor has cautioned the debtor in writing about the intension to file a bankruptcy petition and even thereafter the debtor has failed to perform the obligation within 10 days. (Applies to creditors whose claims have fallen due.)
- it has not been possible within a period of three months to satisfy a claim in execution proceedings conducted with respect to the debtor due to the lack of assets or it has become evident in the execution proceedings that the assets of the debtor are insufficient for performing all the obligations thereof.
- the debtor has destroyed, hidden or squandered the property or made grave errors in management as a result of which the debtor has become insolvent, or has intentionally caused the insolvency of the debtor in any other matter.
- the debtor has notified the creditor, the court or the public of the inability of the debtor to perform the obligations thereof.
- the debtor has left Estonia in order to evade performance of the obligations thereof or hides with the same purpose.

3. Institutional Framework

a) Insolvency Court

Since 2004 hearings of bankruptcy matters according to § 4, declaration of bankruptcy according to § 31 and approval of cancellation of compromises according to § 178 (3) BA, are in the competence of the city

and county courts. The duty of the court is to exercise supervision over he lawfulness of bankruptcy proceeding and perform other duties provided by law.[222] The court also appoints an interim trustee (§ 22) and the trustee § 31 (5).

The court shall decide the commencement of bankruptcy proceedings within ten days after the filing of a bankruptcy petition with a ruling. If the petition has been filed by the creditor, the court will have a preliminary hearing in order to decide on the commencement of the bankruptcy proceeding. If the creditor, who filed the petition, does not appear in court, the court shall refuse, by a ruling to commence a bankruptcy proceeding but in the absence of the debtor is absent, the bankruptcy proceeding may be commenced. The court may refuse under the §§ 15 and 16 BA to commence bankruptcy proceedings if:

- the debtor objects to the claim with reason and the court finds that the dispute has to be solved outside bankruptcy proceedings;
- the claim is secured by a pledge;
- the total amount of claims which are the basis for the bankruptcy petition do not exceed 200,000 EEK for public limited companies, 40,000 EEK for private limited companies and general of limited partnerships and 10,000 EEK for other legal persons and private persons;
- the creditor has failed to sufficiently substantiate the petition or prove the existence of the claim;
- the creditor has failed to pay the deposit for remuneration of an interim trustee if the court demanded it before commencement of the proceedings;
- the debtor or a third person has before commencement of the bankruptcy proceeding performed the obligation on which the bankruptcy petition is based on or provided sufficient security for performance of the obligation.

If the debtor's assets are not sufficient for covering the costs of the bankruptcy proceedings and it is impossible to recover or reclaim assets,

[222] Additionally about the supervision of the court in Juridica IX 2005 pp. 655-666: Kersti Kersna-Vaks. Supervision of the Court and Its Relation to the Objectives of the Bankruptcy Proceedings. (Kohtulik järelvalve ja selle seos pankrotimenetluse eesmärkidega).

the court shall terminate the proceedings by abatement without declaring bankruptcy under § 29 BA.

b) Interim Trustee and Trustee

Since 2004 natural persons to whom the examination board for trustees in bankruptcy formed by the Minister of Justice has granted the right to act as trustees or sworn advocates and senior clerks of sworn advocates may act as bankruptcy trustees. § 56 BA also provides a set of requirements which bankruptcy trustee shall meet. Persons holding a right to act as trustees shall be entered in the register of trustees provided by § 59. This does not concern the sworn advocates and their senior clerks. Trustees perform their obligations personally but on their request the bankruptcy committee may appoint an assistant to the trustee for performance of specific duties according to § 62. It is obligatory for trustees to have a liability insurance as provided by § 64. A trustee who violates his or her obligations and thereby wrongfully causes damage to the debtor, a creditor or persons who may claim performances of a consolidated obligation, shall under § 63 compensate for the damage. The limitation period for a claim for compensation is three years as of the date the victim became aware of the damage arising from the violation of the obligation of the trustee and circumstances on which the liability of the trustee is based but not more than three years as of the release of the trustee.

Creditors and the debtor may under § 67 file complaints against the activities of the trustee to the bankruptcy committee, the general meeting of creditors, the court or the Ministry of Justice. Supervision over the activities of the trustee is exercised by courts and state supervision by the Ministry of Justice. If the trustee has violated his or her obligations and the court has warned the trustee that a fine may be imposed, impose a fine amounting up to EEK 100,000 (ca. 6,390 EUR). The Ministry of Justice may also on certain reasons deprive the trustee of the right to act as a trustee for a period up to five years as provided by § 69. On a written the request of the trustee presented thirty days in advance the court shall release him or her from the duties. The court may also release the trustee on its own initiative or at the request of the bankruptcy committee, the debtor or the Ministry of Justice if the trustee fails to

perform his or her duties or performs them inadequately as provided by § 68 BA.

Upon commencement of bankruptcy proceedings, the court shall appoint an interim trustee by a court ruling as required by § 22 BA. Requirements for an interim trustee are similar to requirements for a trustee. Main tasks of the interim trustee are:

- to determine the assets and obligations and to control whether the debtor's assets cover the costs of the bankruptcy proceeding;
- to assess the financial situation and solvency of the debtor and the prospect of continuation of the activities of the enterprise and if the debtor is a legal person , of the rehabilitation of the debtor;
- ensure preservation of the debtor's assets;
- give or refuse consent to the disposal of the debtor's assets if the court has prohibited the debtor from disposing of the assets thereof without consent of the interim trustee;
- perform other duties, which the court assigns to him of her during the bankruptcy proceedings.

The interim trustee shall also present a written report on the performance of the duties and an opinion on the causes of the insolvency of the debtor to the court. The report shall include a note, whether the insolvency was caused by an act with criminal elements, a grave error in management or other reasons. An interim trustee is liable for damage wrongfully caused to a debtor or creditor through violations of his or her obligations under § 24. A claim against an interim trustee may on these grounds be filed within three years after the date of termination his or her activities.

If bankruptcy is declared, the court shall decide on the appointment of a trustee. Approval of the trustee appointed by bankruptcy order shall also be decided by the first general meeting of creditors. As a consequence of the bankruptcy declaration, the right to administer the debtor's assets and the right to be participant in court proceedings on behalf of the debtor with regard to a dispute relating to the bankruptcy estate or the assets which may be included in the bankruptcy estate is transferred to the trustee. According to § 54 BA, the trustee is a legal representative of the debtor. If the debtor is a legal person, the trustee may represent the debtor in all transactions and legal acts but if the debtor is a natural person, the trustee may perform only such transactions and legal acts,

which are necessary for achieving the objectives of the bankruptcy proceedings and performing the duties of the trustee.

The principal duties of the trustee are to defend the rights and interests of all the creditors and of the debtor and to ensure a lawful, prompt and financially reasonable bankruptcy procedure. The trustee shall perform his of her obligations with the diligence expected from an accurate and honest trustee and take into consideration the interests of all the creditors and the debtor. The trustee shall:

- determine the claims of the creditors, administer the bankruptcy estate, organise its formation and sale and satisfaction of the claims of the creditors out of the bankruptcy estate;
- organise continuation of the business activities of the debtor if necessary;
- if the debtor is a legal person, conduct liquidation of the debtor if necessary;
- provide information to the creditors and the debtor in the cases prescribed by law;
- report on his or her activities and provide information to the court, the supervisory official and bankruptcy committee and
- perform other obligations set by law.

Remuneration of the trustee is in general decided by the court upon approval of the final report after hearing the opinions of the trustee, the debtor and the bankruptcy committee. The minimum and maximum amounts of remuneration of interim trustees and the procedure for calculation of the expenses subject to reimbursement are established by a regulation given Minister of Justice.[223] According to § 23 BA[224], the interim trustee has the right to receive remuneration and reimbursement of the necessary expenses in the amount determined by the court.. The remuneration of a trustee shall be calculated on the basis of the money which has been received and included in the bankruptcy estate as a

[223] Maximum Charges and Procedure for Calculating the Reimbursed Expenses of the Trustees and Interin Trustee. (Pankrotihalduri ja ajutise halduri tasude piirmäärad ja hüvitamisel kuuluvate kulutuste arvestamise kord) Regulation of the Minister of Justice no. 71, RTL 2003,131, 2107.

[224] According to § 2 of the cited Regulation the remuneration is related to the time used, which the interim trustee shall present to the court.

result of the sale and recovery of the bankruptcy estate and other activities of the trustee. When deciding the amount of remuneration the court shall evaluate the amount of work, the difficulty and the professional skills of the (interim) trustee. Court may also make a reference to the business activities of the debtor and to the type of bankruptcy estate. The maximum fee of an interim trustee is 800 EEK (ca. 51 EUR) per hour but it may not be less than one month's minimum salary.[225] A debtor, the petitioning creditor and the interim trustee may file an appeal against a court ruling on the remuneration of the interim trustee and reimbursement of his or her expenses.

The court shall among other things consider the amount type of the bankruptcy estate, business activity of the debtor, number of creditors and the proportion of the bankruptcy proceedings. If additional money is received or included in a bankruptcy estate after termination of the bankruptcy proceedings, the court shall prescribe additional remuneration for the trustee at the request of the trustee. If a compromise is reached or the bankruptcy proceedings are terminated without termination of the debtor who is a legal person, the court shall determine the remuneration of the trustee taking into account the volume and complexity of the duties of the trustee and his or her professional skills. If a debtor who is a legal person is terminated regardless of rehabilitation carried out in the course of the bankruptcy proceedings, the activities of the trustee in the rehabilitation of the debtor shall also be taken into consideration in determining the remuneration of the trustee. If a court finds upon approval of a final report that the trustee has incurred unnecessary expenses out of the bankruptcy estate in performing his or her duties, the court shall deduct such expenses from the remuneration of the trustee. If the trustee had the consent of the bankruptcy committee for incurring the unnecessary expenses, the trustee has the right of recourse against the members of the bankruptcy committee who voted in favour of granting the consent.

The minimum amount of remuneration of the trustee for an estate that is up to 100,000 EEK (ca. 6,391 EUR) is 20 % of the value of the estate. If the value of the bankruptcy estate exceeds 100,000 EEK, the minimum charge is according to the regulation follows:

[225] Currently 2690 EEK (172 EUR).

value of the estate	general amount of remuneration	remuneration for the amount exceeding the minimum value of the estate
100,001 - 200,000	25	15%
200,001 - 500,000	40	11%
500,001 - 1,000,000	73	10%
1,000,001 - 2,000,000	123	7%
2,000,001 - 5,000,000	193	3,5%
5,000,001 - 10,000,000	298	2,25%

The maximum amount of remuneration of the trustee for an estate that is up to 100,000 EEK (ca. 6,391 EUR) is 35% of the value of the estate. If the value of the bankruptcy estate exceeds 100,000 EEK, the maximum charge is according to the regulation follows:

value of the estate	general amount of remuneration	remuneration for the amount exceeding the minimum value of the estate
100,001 - 200,000	40	18%
200,001 - 500,000	58	12,5%
500,001 - 1,000,000	95,5	11%
1,000,001 - 2,000,000	150,5	7,5%
2,000,001 - 5,000,000	225,5	4%
5,000,001 - 10,000,000	345,5	2,6%

The maximum amount of an estate which value exceeds 10,000,001 EEK (639,116.55 EUR) is up to 5% of the value of the estate. However the remuneration cannot be less than 1% of the value of the amounts that the trustee received to estate. As a rule the remuneration is paid according to the minimum and payment according to the maximum has

to be justified. § 5 of the regulation provides some cases such as when the trustee is not using out-side legal assistance and represents the debtor personally in court, when maximum payment is justified. The regulation sets some special rules for cases where the debtor is continuing its business activities. Here the court shall also consider the amount of effort of the trustee. The remuneration is based on the profit but if no profit is gained then on the turn over. In case of a compromise, the trustee shall be remunerated according to the amount set in the compromise decision.[226]

c) General Meeting of Creditors and Bankruptcy Committee

As provided in § 78 BA the first meeting of creditors shall take place not earlier than 15 days and not later than 30 days after the declaration of bankruptcy. At their first meeting the creditors nominate the bankruptcy committee and approve the trustee. They also should decide about the continuation of the debtor's undertaking as well as termination of the debtor in case the debtor is a legal person. The general meeting is according to § 77 competent in addition to the above mentioned issues to:

- decide on a compromise;
- decide, to the extent provided by law, on issues relating to the sale of the bankruptcy estate;
- defend claims;
- resolve complaints against the activities of the trustee;
- decide the remuneration of the members of the bankruptcy committee;
- resolve other issues which are within the competence of the general meeting pursuant to law.

[226] More detailed reading about the remuneration and taxation of the trustee and the interim trustee can be found in Juridica V 2005, pp. 351-358: Merike Varusk. Taxation of the Remuneration of the Trustee, Interim Trustee and the Members of Bankruptcy Committee in Bankruptcy Proceedings (Pankrotihalduri, ajutise halduri ja pankrotitoimkonna liikme tasu maksustamine pankrotimenetluses).

According to § 79 the general meeting is called by the trustee either by his or her own initiative or in cases set by law. The trustee will publish the call for the meeting in Estonian official publications (Ametlikud Teadaanded). The notice shall be published no later than five days before the scheduled meeting unless otherwise provided by law. If the call has been delivered to all he creditors in some other manner, publication of the call is not necessary. The meeting shall be called within fourteen days if such request is made by the bankruptcy committee or by at least five creditors, whose claims together constitute at least one- fifth of the total amount of the claims or by one or more creditors whose claims added together constitute at least two-fifths of the total amount of the claims. If the trustee does not call a meeting within the mentioned time-limit, the general meeting may be called by the bankruptcy committee or the creditors by whom the request was made. On the other hand, if the call for the first general meeting has been made pursuant to the procedure but none of the creditors appear, the trustee is given the right to make decisions concerning issues that should be decided at the first meeting but naturally not the approval of him or herself.

General meetings of the creditors are chaired by the trustee. The judge will always participate in the first meeting and in later meetings, when there is a reason to believe that a dispute concerning the number of votes may arise. All creditors either in person or through a representative, the debtor and other persons, who have been given the right to participate by the court or by the trustee, have the right to be present. Decisions are adopted by a simply majority of the votes of the creditors present as provided in § 81. According to § 82 the number of creditors' votes are proportional to the amount of their claim. Until the defence of the claims, the number of votes of each creditor is determined by the trustee according to the documents which are at his or her disposal. The creditor shall hand over such documents to the trustee no later than three days before the meeting. A claim arising from a conditional transaction the suspensive condition has not yet fulfilled, grants a voting right only if fulfilment of the condition is likely or the condition is fulfilled. The number of above mentioned votes shall be approved by the ruling of a judge, on whose ruling appeals may be filed. If a creditor does not agree with the number of votes given by the trustee or if another creditor does not consent with the amount of votes issued to some other creditor, the amount of votes will be determined by a ruling of the judge. If new

circumstances become later evident, votes can be distributed differently during following meetings.

Decisions of the general meeting may be revoked, as provided in § 83, by the court on the request of the debtor, the creditors or the trustee, if the decision is not in conformity with the law or it was made in violation of the procedure provided by law or if the right to contest a decision is directly provided by law as well as in case the decision damages common interests of the creditors. The request for revocation has to be filed within ten days after the adoption. The court will hear the request within ten days as of the submission of the request. The trustee, the person, who submitted the request and the chairman of the bankruptcy committee or a person chosen by the general meeting will participate at the hearing but their presence is not a prerequisite. Contesting of decisions is not possible if the approval of the decisions is within the competence of the court. The creditor may however submit objections to the trustee, who then forwards them together with the decision to the court.

The bankruptcy committee (§§ 73- 76) is elected by the general meeting of creditors. In case there are less than five creditors, the general meeting may decide not to form a committee. In that case duties of the committee are performed by the general meeting. The committee has to have at least three but not more than seven members. Members of the committee shall represent both creditors with larger and smaller claims. The exact number of members is decided by the general meeting as well. The main task of the bankruptcy committee is to protect the interests of all the creditors, monitor activities of a trustee and perform other duties provided by law. Members of a bankruptcy committee who have wrongfully caused damage to the debtor, a creditor or a creditor with a consolidated claim through violation of their obligations shall be solidarily liable for the damage caused. Members of the bankruptcy committee have a right to a reasonable remuneration whereas the amount and payment procedure are decided by the general meeting of the creditors.

4. Insolvency Proceedings

a) Bankruptcy Declaration and Effect of the Decision

The court shall within ten days and with good reason within 20 days after the commencement of the bankruptcy proceeding, hear the bankruptcy petition filed by a debtor. If the petition is filed by a creditor the time limits for a hearing are 30 and respectively 60 days under § 27 BA. If the debtor is insolvent and there are no reasons mentioned by the BA for refusal, the court shall declare bankruptcy by a bankruptcy order. If the bankruptcy petition was filed by the debtor, the court shall declare bankruptcy also where it is likely that the debtor will become insolvent in the future. A bankruptcy order is subject to immediate execution according to § 31. The court shall immediately according to § 33 publish a notice concerning the decision in the official publication Ametlikud Teadaanded. A debtor and a petitioning creditor may appeal against the order. In this case under § 32 the appointed trustee shall not represent the debtor.

As a consequence of the bankruptcy declaration:

- assets of the debtor become bankruptcy estate;
- the right to administer the assets of the debtor and the right to be a participant in court proceedings on behalf of the debtor with regard to a dispute relating to the bankruptcy estate or to the assets which may be included in the bankruptcy estate is transferred to the trustee;
- a debtor, who is a natural person is deprived the right to enter into transactions relating to the bankruptcy estate;
- a debtor being a legal person is deprived the right to enter into any transactions;
- calculation of interest and fines of delay on claims against the debtor shall be terminated;
- other rights of the debtor (e.g. leaving the country without a consent of the court and without taken an oath (§ 88); prohibition on business (§ 91) are restricted (§ 35).

b) Reorganisation

In rehabilitation the aim of the arrangement is to satisfy all claims of all the creditors by the continuation of the activities of the debtor. The trustee may start with rehabilitation immediately after the declaration of bankruptcy. If the bankruptcy estate includes an enterprise, the trustee shall according to § 129 BA prepare a rehabilitation plan for continuation the activities the enterprise. The trustee may of course also make a proposal to terminate the activities. The rehabilitation plan shall include a notice whether it would be appropriate to make a compromise as well. The rehabilitation plan shall be presented to the first general meeting of the creditors, which may decide to approve the plan with simple majority (§ 81 BA) requirement in the vote or decide to terminate the activities. The meeting may also make a proposal to the trustee to draft a plan of rehabilitation if the trustee proposed termination of the activities. The general meeting is given the right to decide, in case it finds that despite of the rehabilitation plan, the rehabilitation has not been successful, to terminate the activities of the enterprise. Such decision has to be immediately presented to the court for approval. The general meeting may also decide upon the liquidation of the legal person in connection to the termination of the activities of an enterprise. If it is more expedient to sell the enterprise as a set of assets, the general meeting may allow on the proposal of the trustee to continue the activities until the sale.

There are several incentives for the trustee to rehabilitate the debtors. The remuneration of the trustee is noticeably higher upon rehabilitation. There are also incentives for creditors, for example loans given to the debtor to continue the economic activities can be satisfied before other claims from the bankruptcy estate. It is also provided that in the event the rehabilitation process is selected, then assets necessary for the continuation cannot be sold. Rehabilitation can also be a part of a compromise, wherein the extent of satisfaction of the claims and the deadline for doing so are provided. Upon confirming the compromise the rehabilitation plan is also reviewed.

c) Rescission and Invalidity of Pre-Petition Transactions

For recovery of assets the trustee files a claim on behalf of the debtor to the court. Claims for recovery may be filed within three years as of the

declaration of bankruptcy as provided in § 118 BA. Assets can be recovered also during the compromise period. As a general rule such transactions that damage the interest of creditors are recoverable. If a transaction subject to recovery has been concluded after commencement of bankruptcy proceedings but before declaration of bankruptcy, such transaction is deemed to harm the interest of the creditors. The court shall revoke transactions which:

- were concluded during the period from commencement of the bankruptcy proceedings until the declaration of bankruptcy;
- were concluded within one year before the commencement of the bankruptcy proceedings if the other party knew or should have known that the transaction damages interests of the creditors;
- were concluded within three years before the commencement of the bankruptcy proceedings and the debtor intentionally damaged the interests of the creditors by the transaction and the other party to the transaction knew or should have known that the debtor damaged the interests of the creditors;
- were concluded within five years before the commencement of the bankruptcy proceedings if the debtor intentionally damaged the interests of the creditors by the transaction and the other party to the transaction was a person connected with the debtor and knew or should have known of the damages.

If the transaction was concluded within six months before the commencement of bankruptcy proceedings, it is presumed that the other party knew that the transaction damaged the interest of the creditors. Persons connected[227] to the debtor are presumed to have known that the debtor intentionally damaged the creditors' interests as set in § 110 (2) BA.

The BA also acknowledge special rules for recovery of gifts, performance of financial obligations and securities. The court shall revoke a

[227] Connected persons of the debtor are defined in the Bankruptcy Act (RT I 2003, 17, 95) § 117. Such persons are among others spouses, ascendants and descendants and their spouses etc. when the debtor is a natural person. Connected persons of a legal person are e.g. shareholders with more than 1/10 of the votes, members of the management bodies etc.

performance of financial obligation to a creditor under § 113 BA if the obligation was performed:

- during the period from commencement of the bankruptcy proceedings until the declaration of bankruptcy;
- within three months before the commencement of bankruptcy procedure, if the obligation was performed by unusual means of payment or before due date for performance or in preference of one creditor to another or if the debtor was insolvent at the time of performance and the creditor was or should have been aware of the insolvency;
- (since 2004) within two years before the commencement of the bankruptcy proceedings to the benefit of a person connected to the debtor unless the person or the debtor proves that the debtor was solvent at time of the performance and did not become insolvent due to it.

Grants of security shall be revoked by the court if the security was granted:

- during the period from commencement of the bankruptcy proceedings until the declaration of bankruptcy;
- within six months before the commencement of the bankruptcy proceedings if the debtor was not required to grant such security at the time when the obligation rose or if the debtor was insolvent at that time and the person in whose favor the security was granted should have been aware of the insolvency;
- within two years before the commencement of the bankruptcy proceedings if the security was granted in favor of a person connected with the debtor unless the debtor or the person proves that that the debtor was solvent at that time.

It is not allowed to recover a grant of security if it was granted for security of a loan or other credit agreement and the debtor received a corresponding amount of money. This prohibition does not apply in cases where the security was granted to a person is connected to the debtor. It also not allowed to recover transactions concerning exercising of rights and performance of obligations related to pledges (§ 114 BA). If a transaction is revoked by the court, the proceeds of the transaction together with the fruits and other gain has to be returned to the bankruptcy estate. The other party that was aware of the circumstances which were the basis for recovery shall compensate for the gain which could

have been received for the recovered items in adherence to the rules of regular management. If he other party to the transaction knew or should have known at the time of entry into the transaction that it damages the interests of other creditors, the other party may demand compensation for that which was transferred to the debtor only as a creditor in the bankruptcy proceedings (§ 119 BA).

d) Compromise Arrangements

A compromise means according to § 178 BA an agreement between the debtor and the creditors concerning payment of debts and involves reduction of the debts or extension of their term of payment. Proposal for compromise can be made by the debtor or the trustee. Also the general meeting of creditors or the bankruptcy committee may ask the trustee to prepare a compromise proposal. When a compromise proposal is made, it shall include information to which extent and by what date the debtor is able to pay the debts. The proposal shall include proof about the debtor's ability to pay according to the proposal. If the debtor is engaged in business or professional activities, the plans for continuation of business or professional activities and the rehabilitation plan has to be annexed to the proposal as provided in § 179.

According to § 180 a compromise decision is made by the general meeting of creditors after verification of claims. The decision is adopted if at least one-half of the creditors are present at the meeting, they represent at least two-thirds of the total amount of all claims and vote in favour. A secured creditor may vote only if the claim is not fully secured by a pledge. If invocation of a claim arising from a the right of security of creditor, who is the pledge is requested to be precluded for more than ninety days by a compromise proposal, the claim of the creditor who is the pledgee shall be fully taken into account in voting. The BA also provides restrictions to the rights of a pledgee in order to enable continuation of the activities of debtor's enterprise (§§ 181-182). In addition the decision shall also be approved by the court within 15 days after the date it was presented to the court. The court will refuse to approve the compromise if the compromise has been made in violation BA or by fraud. The notice about approval of the compromise shall be published

in the official publication Ametlikud Teadaanded by the trustee as provided in § 183 (5) BA.

As a consequence of approving the compromise (§ 184 BA):

- the bankruptcy proceedings are terminated;
- the debtor recovers the right to administer his or her assets;
- the sale of assets is terminated and money received from sold assets and which has not been transferred to the creditors will returned to the debtor;
- obligation to perform consolidated obligations and pay costs of the bankruptcy proceedings are transferred to the debtor;
- the compromise is an execution document with regard to accepted claims. If the compromise includes decision concerning extension of payment terms of debts, claims concerned may not invoked during the period of compromise.
- during the period of compromise it is not allowed under § 191 BA to file bankruptcy petitions on the basis of claims to which compromise applies.

In order to secure persons who have granted credit to the debtor for continuation of business, it is possible to agree in the compromise that these persons are given a priority over the claims of other creditors in bankruptcy proceeding conducted if the compromise is annulled. This kind of an agreement requires that the debtor and the new creditor have agreed on the issue to which extent the principal claim, interests and collateral claims are to be satisfied and the trustee has given a written consent. In case the claims of new creditors prevail secured creditors, the secured creditors shall be given the right to vote on the compromise proposal as provided by § 187. Preferential rights are also applied to new creditors, whose claims have arisen from an agreement during the period of compromise. The trustee and the bankruptcy committee are supervising the performance of the compromise and the trustee shall issues an annual report to the court and the bankruptcy committee on his or her activities and concerning the performance of the compromise according to § 189.

Bankruptcy proceedings are reopened if the compromise is annulled. The court shall annul the compromise on the request of the trustee or a creditor to whom the compromise applies in case:

- the debtor is convicted of bankruptcy offence or a criminal offence related to execution procedure;
- the debtor fails to perform the duties arising from the compromise;
- upon expiry of at least one-half of the term of validity of the compromise, it is evident that the debtor is unable to meet the requirements of the compromise.

The court shall publish a notice in official publication Ametlikud Teadaanded about the annulment of the compromise and reopening of the bankruptcy proceeding as set in § 191 BA. Creditors, to whose claims the compromise applied but which were not satisfied during the period of compromise may invoke their claims after the expiry of the compromise term to the extent that was agreed in the compromise. After the term of compromise has expired, the court shall release the trustee and the bankruptcy committee and all notations on restraints in registers concerning disposition shall be erased (§ 192 BA).

e) Status of Secured Creditors

When a bankruptcy declaration has been made, the court shall publish an announcement in the official publication Ametlikud Teadaanded, which among other things shall include a proposal for the creditors to file their claims and the due date to do that. § 33 BA also requires that the notice shall also note the consequences of the failure to file a claim by the set date. In addition the trustee shall give a notice of the bankruptcy order to all known creditors stating the consequences of failure to submit claims by the specified date and the time and place of the first general meeting of creditors. If there are more than one hundred creditors the publication of bankruptcy notice is sufficient. Regardless of the number of secured creditors, including those creditors, who pursuant to the land or ship register, commercial pledge register or Estonian Central Register of Securities may have financial claims against the debtor and other known creditors holding a right of security with regard to the debtor's assets, shall be notified personally. Also known creditors, whose place of residence is outside Estonia, but within the European Union, shall be separately notified as set in § 34 BA.

The creditors are supposed to notify the trustee under § 94 and 95 in writing within two months as of the date of the publication of the first notice published in the official publication. They shall make their notification despite of the basis and the due dates of the claims. The consequence for a secured creditor for the failure to file claims within the specified term where the term for filing the claims was not extended is rather severe as stated in § 95. If the creditor received a proper written notice as mentioned above, the right of security held by the creditor is deemed to have extinguished. However, if the creditor files the claim after the due date, the claim will be satisfied if the claim is successfully defended, according to § 153 (1) 3 BA in the last ranking.

Payments relating to bankruptcy proceedings are to be performed from the bankruptcy estate before claims of the creditors. Such payments are (in order of performance):

- claims arising from the consequences of exclusion or recovery of assets;
- the maintenance support paid to the debtor and his or her dependants;
- consolidated obligations;
- the costs of bankruptcy proceedings.

§ 146 BA provides that in case the assets are not sufficient to perform all payments with the same ranking, payments are to be made in proportion to the sizes of the corresponding claims. After the obligations related to bankruptcy proceedings are satisfied, the claims of the creditors' shall be satisfied in the following order:

- accepted claims secured by a pledge, filed by the due date;
- other accepted claims which were filed by the due date;
- claims which were not filed by the due date but which were accepted.

Claims secured by pledges shall be satisfied from the sale of the pledged object. From the money received from the sale of the pledged object, amount necessary to cover payments relating to bankruptcy proceedings is deducted in proportion to the ratio of the amount of money received from the sale of pledged object to the total amount of money received from the sale of bankruptcy estate but not more than 15/100 of the amount received from the sale of the pledged object (§ 146 BA). If the pledged object is encumbered with several pledges the

claims shall be satisfied according to the ranking of the rights of security. Claims of lower rankings are satisfied only after the claims of higher rankings are fully satisfied. If the estate is not sufficient to satisfy all the claims of the same ranking, the claims are satisfied according to the proportion of the claims as provided in § 153 BA.

In the event of reorganisation, if the debtor engages in business or professional activity and according to the compromise the pledged object is necessary for continuing the activities, the claim secured by the pledge can not be invoked during the term determined in the compromise, which can not exceed one year if the pledgee voted against the compromise (§ 182 BA). Also if there is credit given for the continuation of business, then such credit have priority over claims that are protected with pledges (§ 186 BA).

f) Realisation of Debtor's Property

As the bankruptcy proceedings are commenced the trustee shall conduct the sale of the bankruptcy estate according to § 133 and 134 after the first meeting of creditors unless otherwise agreed at the meeting. If the debtor has appealed against the bankruptcy order, the assets may not be sold without the consent of the debtor before the hearing of appeal. These restrictions do not apply to highly perishable assets or assets which are of rapidly depreciating value or highly expensive to store. It is not allowed to sell assets, if it hinders the continuation of the activities of the debtor's enterprise. In case of a compromise proposal, assets can not be sold before compromise has been made unless the meeting of creditors has decided otherwise.

As a general rule, the trustee will sell the bankruptcy estate in accordance with the Code of Enforcement Procedure.[228] With the consent of the trustee a natural person may sell movables or rights belonging to the bankruptcy estate. The order in which assets are sold shall be determined by the trustee as provided by § 135 (3) BA. In general, unless otherwise provided in the BA, the bankruptcy estate is sold at auctions

[228] RT I 1993, 49, 693.

(§§ 136-137). Bankruptcy estate may also be sold without auction in more profitable way under the provisions set in the BA.

The pledgee may sell the object of a security over movables. By sell of such movable, the right of security terminates according to § 138 BA. When an immovable is sold at an auction, only such real rights encumbering the immovable which have a ranking higher than the real right which was entered first in the land register and according to which forced sale of immovable may be demanded, remain in force. Other real rights are deemed to be extinguished. If the immovable is not sold by auction, the real rights encumbering the immovable shall be deleted with the consent of the holders of the real rights (§ 139 BA). If such holder refuses to give a consent, the holder will lose the right to demand satisfaction of a claim in the bankruptcy proceeding to the part secured by the mortgage or real encumbrance.
§ 141 BA provides that an enterprise or an organisationally independent part of an enterprise can be sold with the consent of the bankruptcy committee and in certain cases with the consent of the general meeting of the creditors only.

Insolvencies of legal persons are in Estonia mainly solved by liquidation in bankruptcy proceedings where the trustee acts as liquidator. If the general meeting of creditors decides to terminate the activities of an enterprise of the debtor, who is a legal person, the meeting shall also decide on the termination of the legal person. The legal person is not terminated, despite of a possible decision to do so if:

- the bankruptcy proceedings have been terminated due to a compromise (proposed by the trustee);
- the bankruptcy proceedings have been terminated after the basis for bankruptcy has ceased to exist or the creditors have given their consent to terminate the consent (proposed by the debtor);
- after the all the claims are satisfied and the debtor retains sufficient assets to continue activities as a legal person (proposed by the trustee).

The decisions not to terminate the legal person shall be made by a court ruling. In reference to § 130 BA, a legal person has to be liquidated by the end of bankruptcy proceedings or within two months after the ruling of termination of the proceeding, if the proceeding was terminated because of the abatement.

g) International Insolvency Law

Apart from the applicable legislation of the European Communities Estonia has also entered into agreements concerning among other things recognition and enforcement of judgements made by foreign courts with Russia[229], Latvia[230], Lithuania[231], Ukraine[232] and Poland[233]. In addition Estonia has ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[234]

h) Criminal offences in Connection with Bankruptcy

If it becomes evident in bankruptcy proceedings that the debtor has committed an act with criminal elements due to becoming insolvent, the court shall give notification thereof to the prosecutor or the police to decide whether to commence criminal proceedings under § 28 (1) BA. As above mentioned, members of management boards can be held liable under the Penal Code § 380 for failure to perform their obligation to submit a bankruptcy petition and punished by a pecuniary punishment or up to three years' imprisonment.[235]

The Penal Code defines causing insolvency as punishable. A person, who materially reduces the solvency of the person or causes the insolvency of the person through destroying, damaging, squandering or unjustified grant or assignment of assets or investment thereof in a foreign state or assumption of unjustified obligations or grant of unjustified benefits, or a debtor who prefers one creditor to another while being aware that due to the existing or expected economic difficulties the acts of the debtor may violate the interests of the creditor, shall be

229 RT II 16, 27.

230 RT II 1993, 5.

231 RT II 1993, 5.

232 RT II 1995, 63.

233 RT II 1999, 4, 22.

234 RT II 1993, 21/22, 51

235 RT I 2001, 61, 364.

punished by a pecuniary punishment or up to 3 years' imprisonment. The mentioned acts are punishable only if the court has declared the bankruptcy of the offender or terminated the bankruptcy proceedings by abatement since the assets of the debtor are insufficient to cover the costs of the bankruptcy proceeding and it is impossible to recover or reclaim the assets. In addition a debtor who in bankruptcy or enforcement proceedings conceals the assets or debts of the debtor or submits incorrect information concerning the assets or debts or other facts which are significant for a creditor shall be punished by a pecuniary punishment or up to one year of imprisonment or if the acts involve perjury the imprisonment may be up to two years (Penal Code §§ 384-385).[236]

The Penal Code does not mention anything about the liability of the trustees or bankruptcy trustees as such.

5. Conclusions

Main aim of development of the BA was to bring insolvency legislation into conformity with the results of the reform in civil law. The World Bank Insolvency Initiative[237] and the Draft Legislative Guide on Insolvency Law of UNCITRAL working group[238] where referred to during the process of preparing the draft law. Objectives of the amendments where to speed up the insolvency processes in favor of both the debtor and the creditor and to bring all action under one court. In order to guarantee the effectiveness of the process, among other things, time-limits of proceedings, possibilities to appeal and alternatives for sale of bankruptcy estate were revised. Another important feature in drafting the

[236] RT I 2001, 61, 364.

[237] See http://www4.worldbank.org/legal/insolvency_ini.html.

[238] See http://www.uncitral.org/en-index.htm.

currently valid act was to improve the supervision over the trustees.
The number of rankings of claim was decreased as the Unemployment Insurance Act took force. According to this act salary claims of employees are now mainly paid by the Estonian Unemployment Insurance Fund. Also tax claims of the state were moved to the same ranking together with other claims. Certain improvement of possession of secured creditors is provided as well and special clauses for the insolvency proceedings of natural persons, that previously did not exist, were brought in to the current act. E.g. release from unsatisfied claims was taken into account as suggested by the UNCITRAL insolvency working group.