

GETTING THE DEAL THROUGH

Real Estate

in 30 jurisdictions worldwide

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ACQUISITION OF REAL ESTATE

Legal system

1 How would you explain your jurisdiction's legal system to an investor?

Estonia has a civil law system. Court practice does not place the same value on precedents as in the common law system, although in fact Supreme Court resolutions have considerable effect on the application and interpretation of law by lower courts.

Estonian civil law has mainly been codified in five pieces of legislation: the General Part of the Civil Code Act, the Property Law Act, the Inheritance Act, the Law of Obligations Act and the Family Act. In addition the Commercial Code has significance in the civil circulation of assets.

As a general rule, unless otherwise set forth in the law or agreement, transactions do not have to have a specific form, ie, oral contracts can also be concluded. In the real estate sector, however, particularly with the transfer of real estate, the transfer agreements, encumbrance agreements, etc, need to be signed before a notary.

Similarly in civil court procedure, in a case pursuant to law or based on an agreement between the parties, a fact must be proved by evidence of a certain type or form.

Civil court procedure also foresees a possibility of securing a court action, where possible means could be, inter alia:

- the seizure of the defendant's property (which is in the possession of the defendant or another person), including making a notation in a property register concerning a prohibition on disposal of property;
- a prohibition on the defendant from entering into certain transactions or performing certain acts, including imposition of a restraining order; or
- a prohibition on other persons from transferring property to the defendant or performing other obligations with regard to the defendant, which may include an obligation to transfer property to a bailiff or to pay money in a bank account prescribed by the court.

Recording conveyance documents

2 What are the legal requirements for recording conveyance documents?

In order for the real estate to participate in civil circulation (ie, be subject to transfers, encumbrances etc) the real estate is required to be registered in the Land Register. The Land Registers are maintained by the courts; thereby the state guarantees and secures the procedure of maintenance of Land Register. The Land Register is public and everyone with legitimate interest is entitled to access the registered information. The Land Register is maintained on the principle that each entry in said register is

presumed to be correct, valid for a third party acting in good faith and no one may be excused by being unaware of information in the land register.

According to the Law of Property Act, all real rights (including ownership) relating to an immovable are entered in the Land Register. Therefore, as all above real rights arise with the registration in the land register, until these rights are registered they are not binding on third parties.

As a result, for a transfer of immovable property ownership a notarised agreement between the entitled party and the other party (a real right contract) is required and a corresponding entry shall be made in the land register.

An application for the transfer of a registered immovable shall be reviewed not later than within one month after the date of receipt of such application and after review of a registration application the assistant judge shall make a registration order. An entry is made in a register on the basis of a registration order.

The main costs involved in the real estate transaction (other than the payments to lawyers, surveyors, agents, etc, if applicable) are the notary's fee and the state duty. The notary's fee is fixed by the Notary's Fee Act and is therefore non-negotiable. The amount of the notary's fee depends on the transaction value (eg, the purchase price) and may range from 0.3 to 10 per cent of the transaction value. Notary's fees are capped at 160,000 Estonian krooni (EEK) (approximately €10,000), which corresponds to a transaction with a transaction value of EEK100 million (€6.4 million). VAT at 18 per cent is added to these fees.

The applicable amount of the state duty also depends on the transaction value and normally is within a range of 0.1 to 0.16 per cent of the transaction value. State duty is capped at EEK40,000 (€2,500).

Foreign investors

3 What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are practically no restrictions for foreign investors in Estonia, in particular with respect to those which jurisdiction is in any European Union country.

In particular with respect to real estate, Estonian law establishes limited restrictions on ownership of the real estate to foreign investors. On the basis of the Restrictions on Acquisition of Immoveables Act these limitations apply:

- to acquiring 10 or more hectares of agricultural or forestry land (unless a person falls under the categories set forth in the law, he or she may acquire a real estate that includes 10 hectares or more of agricultural or forest land only with the authorisation of the local county governor).

- to acquiring real estate in regions where national defence considerations prevail (ie, a person who is not an Estonian citizen or the citizen of a contracting state of the EEA Agreement is prohibited from acquiring real estate in certain countries near the Estonian border) and on islands (other than the largest islands Saaremaa, Hiiumaa, Muhu and Vormsi).

Exchange control

- 4 If a non-resident invests in a property in your jurisdiction, are there exchange control issues? What about return of capital?

There is no foreign exchange control in Estonia. Similarly, no restrictions on return of capital, other than respective application of taxation laws.

Legal liability

- 5 What types of liability does an owner of real estate face? Is there a standard of strict liability and can there be liability to subsequent owners? What about tort liability?

With respect to contractual liability, the general principle is that the seller is liable for any lack of conformity of a property that exists at the time when the risk of accidental loss of or damage to the property passes to the purchaser, even if the lack of conformity becomes apparent after that time. The seller is also liable for any lack of conformity of a property that becomes apparent after the risk of accidental loss of or damage to the property passes to the purchaser, if the lack of conformity of the property arises from a violation of obligations by the seller.

Also the purchaser may rely on the lack of conformity regardless of the purchaser’s failure to examine the property or give notification of the lack of conformity of the property on time if:

- the lack of conformity of the property has been caused by the intent or gross negligence of the seller; or
- the seller is aware or ought to be aware of the lack of conformity of the property or the circumstances related thereto and does not disclose such information to the purchaser.

The seller is not liable for any lack of conformity of a property if the purchaser was or ought to have been aware of the lack of conformity of the property upon entry into the contract.

The general principle of tort liability set forth in the Law of Obligations Act is that a person (tortfeasor) who unlawfully causes damage to another person (victim) shall compensate for the damage if the tortfeasor is culpable of causing the damage or is liable for causing the damage pursuant to law.

Protection against liability

- 6 How can an owner protect itself from liability and what types of insurance can they obtain?

As a general note with respect to the limitation of liability, the principle set forth in the Law of Obligations Act is that an agreement that precludes or restricts liability for damage caused unlawfully or intentionally is void.

Insurance is indeed the main vehicle for the owner to mitigate its risks arising from the ownership or operation of the real estate. The type of insurance that is suitable for a specific real estate of course depends on the specifics of the case, but, for example, general third-party civil liability insurance can be issued by local insurance companies.

Choice of law

- 7 How is the governing law of a transaction involving properties in two jurisdictions, one outside of your jurisdiction, chosen? What are the conflict of laws rules in your jurisdiction?

Contracts shall be governed by the law of the state agreed upon by the parties. The parties may choose the law applicable to the whole contract or to a part thereof if the contract is divisible in such manner. Law also sets forth that the fact that the parties have chosen a foreign law to govern the contract, whether or not accompanied by the choice of foreign jurisdiction, shall not, where all the elements relevant to the contract at the time of the choice are connected with one state only, prejudice application of such rules of the law of the state that cannot be derogated from by contract (mandatory rules).

If the law applicable to a contract has not been chosen by the parties to the contract, the contract shall be governed by the law of the state with which the contract is most closely connected. A contract is presumed to be most closely connected with the state where the residence or the seat of the directing body of the party who is to perform the obligation characteristic of the contract is situated at the time of entry into the contract. If a contract is entered into in the course of the economic or professional activity of the party who is to perform the obligation characteristic of the contract, the contract is presumed to be most closely connected with the state where the principal place of business of such party is situated.

If the object of a contract is a real right in immoveable property or a right to use immoveable property, the contract is presumed to be most closely connected with the state where the immoveable property is situated.

As regards the real rights (eg, ownership), the law sets forth that the creation and extinguishment of a real right shall be determined pursuant to the law of the state in which the thing was situated at the time of creation or extinguishment of the real right. Specific rules exist with respect to ships, aeroplanes and railway vehicles.

Subject-matter jurisdiction

- 8 Does subject-matter jurisdiction exist? Who are necessary parties? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The Estonian legal system foresees general subject-matter jurisdiction: disputes are deliberated in civil, administrative or criminal courts or court of constitutional review depending on the subject matter of the dispute. Within the civil court system there is no further differentiation, so we do not have separate bankruptcy courts, employment courts (although in the field of employment, parties can have recourse before court proceedings to Employment Dispute Commission), etc. The party does not have to be registered or similar in order to enforce remedies in Estonia.

Investment entities

- 9 What entities does your jurisdiction recognise? What are pass-through entities for tax purposes and what entities best shield ultimate owners from liability?

The Commercial Code recognises following investment entities – general partnership, limited partnership, private limited company, public limited company or commercial association.

Considering that the private limited company and public limited company are investment entities with strict shareholder

limited liability, then in vast majority of cases these investment entities are selected for a market entry by foreign investors. On some occasions foreign investors have also entered into Estonian market using branch offices registered in the Estonian commercial register. The branch office does not have a separate legal capacity, but acts as the representative of the foreign company.

US investors

10 What form of entities do US investors customarily use in your jurisdiction?

As a rule the choice for the US investor contemplating investing into Estonia is between whether to use any of the limited liability vehicles such as private limited company or public limited company or whether the market entry shall be done using the branch office of a foreign company or directly from a foreign entity. In principle the main difference between the company and the branch office is that the branch office does not have a legal capacity, but is the representation office of the foreign company. Therefore any action undertaken by the branch office is binding upon the foreign company. Other than that the branch office may enter into transactions (on behalf of the foreign company), is subject to reporting and taxation requirements, and so on.

Organisational formalities

11 What are the organisational formalities of creating the above entities? What requirements does your jurisdiction impose on a foreign entity? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The foundation of limited liability companies can be divided into two stages: entering into notarised foundation agreement (or foundation resolution in case of one founder) and registration of the company in the commercial register. As a rule the foundation process take one to two weeks to be completed.

The main difference between the limited liability companies consists in the level of statutory requirements. For example, for the public limited company the Commercial Code requires a tenfold minimum capital, the existence of a supervisory board and an annual audit report. Also the shares of the public limited company must be registered in the Estonian Central Register of Securities, whereas with private limited companies, such registration is voluntary. Unless the shares of the private limited company are registered in the Estonian Central Register of Securities, the share transfer needs to be notarised.

There are no other material differences between these types of companies. Both may enter into agreements and assume obligations, both may purchase property in Estonia and abroad, their treatment under relevant tax laws is the same.

Documentation

12 Does your jurisdiction or customs recognise a non-binding form of agreement? Is there a form of non-binding agreement before a contract? Is it customary to take the property off the market while negotiation of a contract is ongoing?

Estonian law does recognise non-binding form of agreement as a way to formalise pre-contract negotiations, such as letter of intent, heads of terms etc. Law of Obligation Act refers to such agreement as ‘pre-agreement’, an agreement under which the parties undertake to enter into a contract in the future under the terms agreed upon in the preliminary agreement. It is important to note with respect to real estate that the law also prescribes that if, pursuant to law, an agreement is to be entered into in a spe-

cific format, the preliminary agreement shall also be entered into in the same format. Therefore as the law prescribes a notarised format for real estate transactions, any pre-agreement involving real estate needs to be in notarised format as well.

As regards to ensuring exclusivity during contract negotiations, then with respect to any normal day-to-day real estate transaction, it is not common that the property is taken off the market during the negotiations of the contract. Larger, more complicated transactions involving in particular commercial real estate shall involve usually exclusivity clauses.

Contract of sale

13 What are typical provisions in a contract of sale?

A customary real estate sale agreement includes sections on the parties, sale object (including existence of any encumbrances), representations and warranties as regards the sale object, purchase price and payment thereof, law of property agreement whereby the parties agree, inter alia, to make certain changes in the land register, dates for transfer of possession.

With respect to evidencing good title to the real estate being transferred, then it should be repeated that all real estate must be entered in the Land Register, which is maintained on the principle that each entry is presumed to be correct and valid for a third parties acting in good faith and that no one may be excused by being unaware of information in the Land Register. Therefore, if a person in good faith acquired real estate relying on information in the Land Register, his or her rights and ownership are protected and can not be challenged. Also the Land Register is public and maintained electronically so that anyone can access it through the internet.

Typical general representations and warranties issued by the seller are that:

- the seller has the ownership over the real estate;
- the real estate is duly owned by the seller and, prior to entering into contract, said real estate has not been transferred or encumbered by such restricted real rights that are not indicated in the contract;
- no claim arisen out of the real estate and no disposal prohibition or seizure is currently effective; and
- there are no such circumstances that may restrict or preclude the right of the seller to enter into the contract and the seller has not entered and hereby undertakes not to enter into such agreements that may result in whatsoever rights by third parties or any other agreement that may prevent or delay entering of the ownership in the Land Register in favour of purchaser.

Environmental clean-up

14 Who takes responsibility for a future environmental clean-up? By representation with survival provisions? What are typical general covenants? What remedies do the seller and buyer have for breach?

The ‘polluter pays’ principle applies with respect to the environmental clean-up. However, should the state supervisory authorities be unable to ascertain the identity of the polluter, the obligation for the environmental clean-up shall rest with the owner of the real estate.

Leases

15 What are typical representations and covenants regarding leases? Do they cover brokerage agreements and do they survive closing? Are estoppel certificates customarily required and can estoppel certificates substitute for representations?

Typical covenants and agreements contained in the lease agreement are as follows:

- length of term – there are lease contracts with specified term and unspecified term. It is common for the marketplace to conclude mainly short-term leases (six months to three years);
- tenant’s right to sell or sublease – a lessee may, with the consent of the lessor, transfer the use of a property fully or partially to a third party (sublessee), particularly to sublet the property. The lessor’s right to refuse approval is limited by law;
- transfer of lease as a result of a corporate restructuring (eg merger) – upon change of ownership of leased immovable, the lease contract shall transfer to the buyer. The buyer may terminate the lease with three months’ notice, unless the lease agreement has been registered in the Land Register; and
- repairs:
 - improvements and alterations made to property by lessor – a lessor may make improvements and alterations to a property and the lessee shall tolerate the works and other effects on the property related to the improvements and alterations, unless the work and effects are unfairly burdensome to the lessee; and
 - improvements and alterations made to property by lessee – a lessee may make improvements and alterations to a leased property only with the lessor’s consent, which is submitted in a format which can be reproduced in writing.

Estoppel certificates are not common in Estonian legal practice.

Leases and mortgages

16 Is a lease generally subordinate to a mortgage pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a mortgage upon foreclosure? Do lenders typically require subordination and non-disturbance agreements?

According to the Enforcement Act, if mortgaged real estate is sold in the course of enforcement proceedings, the new owner may terminate the lease with three months’ prior notice. The new owner can not terminate the agreement in case a registration has been made as regards the lease agreement in the land register.

It is customary for the lenders to foresee in the agreement the obligation of the borrower to ensure that the value of the mortgaged real estate is maintained and that no encumbrances are established on the real estate, including lease agreements.

In the foreclosure proceedings the claim of the lender or mortgage creditor also extends to the lease payments.

Delivery of security deposits

17 What steps are taken to ensure delivery of security deposits to a buyer? How common is it to get a security deposit under a lease? Do leases customarily have periodic rent resets?

It is quite customary to agree to security deposits in the lease agreement. In case of dwelling leases the individuals customarily use the principle set forth in the Law of Obligations Act, whereby

a residential lease contract may prescribe that the lessee pays a deposit in the amount of up to three months’ rent to the lessor in order to secure claims arising from the contract. The lessee may pay the deposit within three months in equal instalments. The deposit shall be kept by the lessor in a credit institution separately from the assets of the lessor and at least at the local average interest rate. The interest belongs to the lessee and increases the deposit.

As regards the rent resets, the law stipulates the limits on the rent increase only in case of dwelling lease contracts. In case of lease contracts of business premises the basis for the rent increase is an agreement of both parties. In case of lease contract for unspecified term that does not involve the agreement for increase in rent it is presumed by law that the lessor may raise the rent as follows: upon the lease of immovables, ships entered in the ship register and aircraft entered in the Estonian aircraft register, after each six months as of entry into the contract; or upon the lease of furnished rooms or separately leased parking places, places in garages and the like, each month as of entry into the contract. Normally in case of commercial leases the payable rent is indexed on the basis of the change in consumer price index.

Due diligence

18 What is the typical method of a title search and is it customary to order searches? Is there something akin to title insurance and opinion letters? Does your jurisdiction provide statutory priority for recorded instruments?

As noted in previous questions, in Estonia all real estate is required to be registered in the Land Register and the land register is maintained on the principle that each entry in the land register is presumed to be correct, valid for a third persons acting in good faith and no one may be excused by being unaware of information in the land register. Also, as the access to this information is very simple (ie, a simple search at the respective internet website), it is customary to carry out title searches upon entering into lease agreements.

Reviews

19 Is it customary to arrange an engineering or an environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is not customary to arrange for an engineering or environmental review before an acquisition of a real estate. However depending on circumstances, in particular if the property subject to acquisition is connected with the provision of services to customers, engineering or environmental review is carried out.

Usually risks involving environmental liabilities are mitigated through respective contractual representations and indemnities.

Review of leases

20 Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

As regards the dwelling leases, it is not so customary that a lease agreement is submitted for the review to a lawyer, but lease agreements for industry or business purposes are often reverted to lawyers. If an agreement is submitted for lawyer’s review, he or she will most likely concentrate on issues that are subject to scrutiny in most other jurisdictions, for example, on the situation of the leased property, ownership issues, maintenance obligations, rent increases, collateral, termination clauses etc.

One specific issue set forth in the Law of Obligations Act is

the possibility to make a registration with respect to the lease in the land register. This is necessary to ensure that upon change of ownership of the leased object, the lease agreement can not be terminated by the new owner. Otherwise the general principle applies, whereby the new owner may terminate the lease with three months' prior notice.

Other agreements

21 What other agreements does a lawyer customarily review?

In case a lawyer is employed in connection with the real estate transaction, then it is customary that the lawyer reviews all documentation in connection with the transaction, starting from the brokerage agreement to the financing agreements, purchase agreement etc until the closing of the transaction.

Closing

22 What does a lawyer customarily prepare for a closing?

Lawyers normally prepare the documentation for the closing: mainly any documents relating to the conveyance of the real estate, eg, documents evidencing the status of the real estate, in particular, in case of lease agreements, information of respective indicating meters (water, electricity etc).

As the title to the real estate is transferred with the registration in the land register, there are no conveyance documents as such entered into and delivered upon closing of the real estate transaction; however, notarised transfer agreements are normally reviewed.

FINANCING

Form of lien

23 What is the method of creating and perfecting liens?

In general the following securities are available in Estonia:

- possessory pledge – a moveable may be encumbered with a pledge such that the pledged thing is transferred into the possession of the pledgee and the establishment of a possessory pledge is agreed upon. A thing may also be encumbered by a pledge so that the thing is transferred to a third person and the pledgee obtains indirect possession of the pledged thing;
- register pledge – a patent, trademark, industrial design, utility model, variety, layout design of an integrated circuit, motor vehicle or aircraft that is entered in a register the data of which are public and maintenance of which is regulated pursuant to procedure provided by law may be encumbered with a registered security over moveables in such a way that the person in whose benefit the registered security over moveables is established has the right to satisfaction of the claim secured by the pledge out of the pledged object;
- pledge of securities (rights) – a proprietary right may be the object of a pledge if it is transferable;
- commercial pledge – specific type of floating charge covering moveables of the pledgor, save cash on bank accounts, moveables subject to registration, securities, real estate; and
- mortgage – an immoveable may be encumbered with a mortgage such that the person for whose benefit the mortgage is established (mortgagee) has the right to satisfaction of a claim secured by the mortgage out of the pledged immoveable.

Normally most of the real estate lending is secured by a mortgage. Following from the Bankruptcy Act, mortgages and other

type of pledges have priority over any claims of other creditors. Second, as the mortgage is created by registration in the land register and earlier registrations have priority over the later, the real estate lender is protected from competition with other secured creditors.

Legal requirements

24 What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

The main issue for a lender from a foreign jurisdiction is related to the enforcement of court decisions. Assuming that in the foreclosure situation the consent of the debtor is not forthcoming for initiation of the enforcement proceedings, the lender would need a court decision ascertaining the claim of the lender. This may be a decision obtained in Estonian court, in an arbitration court (Estonia is a party to the 1929 New York Convention) or in a foreign court. Foreign court decisions are enforced only where Estonia has concluded a relevant international treaty (eg, all court resolutions adopted in any EU jurisdiction are recognised through application of Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters); in addition respective legal assistance treaties have been concluded with Russian Federation and Ukraine.

Mortgages are subject to notarisation and registration in the land register. Similar to the transfer of real estates, notary's fee and state duty are payable, whereas the amounts of these are in the same region as those payable in connection with the transfer (see question 2).

Interest

25 Is interest charged on a spread over LIBOR, EuribOR or relevant equivalent? What rate of interest is usurious in your jurisdiction and what are the consequences if a loan exceeds the usury rate?

It is customary for an Estonian credit institution to issue loans in EuribOR, most common is the six-month EuribOR interest plus agreed margin.

As regards the usury interest, there is no specific provision or court practice on what level an interest would be regarded as usury. In such cases the courts have followed a principle set forth in the General Principles of the Civil Code Act, whereby in case a transaction is entered into under the influence of a relevant mistake, fraud, threat, violence or gross disparity may be cancelled pursuant to the procedure provided by law. On the basis of this concept, the courts have used the gross disparity principle to tackle usury interest in loan agreements. If a transaction is cancelled pursuant to the procedure provided by law, the transaction is invalid from inception.

Enforcement

26 How are remedies enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding?

In order to initiate enforcement proceedings, including sale of the mortgaged real estate, a court decision is necessary. It is also possible (and is customary in particular in case of bank lending) for the debtor to agree in the mortgage agreement to subject himself or herself to compulsory enforcement proceeding in case

the claim secured by mortgage is not duly paid. In such case the court resolution is not needed for the commencement of the enforcement proceedings, but a notarised agreement to that effect shall suffice.

Protection of collateral

27 What actions can a lender take to protect its collateral until it has possession of the property?

If the value of encumbered immovable decreases as a result of the activities of the owner, the mortgagee has the right to demand that the owner of the immovable terminates further harmful activity. A mortgagee may perform acts necessary for prevention of a decrease in value of an encumbered immovable pursuant to a court judgment. The mortgagee may also perform such acts without a court judgment if a delay would significantly reduce the value of the encumbered immovable and shall have the right to demand reimbursement of expenses relating to these acts.

If a decrease in value of an encumbered immovable can be presumed or if it has already occurred, the mortgagee may demand restoration of the former state or additional security from the owner of the immovable. If the owner of an immovable does not restore the former state or give additional security on the demand of the mortgagee, the mortgagee may demand satisfaction of a claim secured by the mortgage to the extent by which the value of the encumbered immovable has decreased. If the value of encumbered immovable decreases by no fault of the owner, the mortgagee may demand additional security or partial payment of the debt to the extent the owner of the immovable is compensated for the decrease in value.

Recourse

28 Do the security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy filing?

In case of an enforcement of the security, then indeed the security documents provide recourse to only with respect to the secured assets. This of course does not preclude the lender who is not satisfied from the secured assets, to apply for enforcement procedures vis-a-vis the other unsecured property of the debtor.

With respect to the bankruptcy proceedings, the claims of creditors are satisfied out of the assets of the debtor pursuant to following ranking order:

- accepted claims secured by a pledge which were filed within the specified term. The payments relating to the bankruptcy proceedings (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 and the costs of the bankruptcy proceedings) shall be deducted from these payments, but not more than 15 per cent of the sale receipts;
- other accepted claims which were filed within the specified term;
- claims which were not filed within the specified term but were accepted.

Cash management systems

29 Is it typical to require a cash management system and do lenders typically take reserves?

It is not that customary in bank lending to require cash management systems and lenders do not often take respective reserves.

In practice these issues mainly come in case of major syndicated loan agreements or similar procedures.

Credit enhancements

30 What other types of credit enhancements are common? What about forms of guarantee?

In an average bank lending arrangements, the credit enhancements are used extremely rarely. In case however a need arises for such an enhancement, Estonian law does not preclude parties agreeing on it and the law foresees a possibility for agreeing on letters of credit, bank guarantees, including payment guarantees. Also the law allows for issuing sureties, among others.

Covenants

31 What are commonly used covenants in loan documents? What is the difference depending on asset classes?

Covenants used in Estonian financing arrangements are standard and there are not that many differences compared for example to the Loan Market Association standard formats. Usually the covenants are issued as regards the compliance with the laws (in particular environmental laws), restrictions on disposals, insurances, negative pledges, restriction on affiliate agreements, no borrowing etc.

Financial covenants

32 What are typical financial covenants?

Most common financial covenants used in Estonian financing arrangements are minimum EBITDA, debt service coverage Ratio, capital ratio requirements. The vast majority of bank lending agreements foresee financial reporting requirements, such as 90 days from the end of the financial year, 30 days from the end of the respective quarter, etc.

Bankruptcy

33 Describe the bankruptcy system in your jurisdiction.

Under Estonian law bankruptcy is defined as insolvency of a debtor declared by a court judgment. A person is insolvent if: the person is unable to satisfy the claims of the creditors; and such inability is not temporary.

A bankruptcy petition may be filed by the debtor or a creditor on the basis of which the court commences bankruptcy proceedings and appoints an interim trustee. Bankruptcy proceedings shall not be initiated in case the total amount of the claims which are the basis for the bankruptcy petition of the creditor does not exceed EEK200,000 (approximately €12,800) in the case of a public limited company; EEK40,000 (€2,600) in the case of a private limited company, general partnership or limited partnership; or EEK10,000 (€640) in the case of other legal persons or a natural person.

If the debtor is found insolvent the court declares bankruptcy.

Main consequences of declaration of bankruptcy are following: the debtor's assets become the bankruptcy estate, it is important to note that the estate is not a separate legal person but a pool of assets; the right to administer the debtor's assets is transferred to the trustee; and if the debtor is a natural person, he or she is deprived of the right to enter into transactions relating to the bankruptcy estate; if the debtor is a legal person, the debtor is deprived of the right to enter into any transactions.

Creditors are required to notify the trustee of all their claims against the debtor which arose before the declaration of bankruptcy not later than within two months as of the date of publication of the bankruptcy notice.

Courts exercise supervision over the lawfulness of bankruptcy proceedings and perform other duties provided by law. Yet in general the role of court in the procedure is of lesser importance in comparison with that of the general meeting of the creditors that has the right to decide upon all important matters concerning the bankruptcy procedure.

In case of legal persons, bankruptcy proceedings usually conclude with the liquidation of the company. Yet the law offers also alternatives like compromise (agreement between a debtor and the creditors concerning payment of debts and involves reduction of the debts or extension of their terms of payment) or rehabilitation (application of measures which enable satisfaction of the claims of the creditors through continuation of the business activities) of the debtor.

Lockboxes

- 34 What are the requirements of creation and perfection? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Lockboxes are not common in relation to Estonian financing arrangements.

Single purpose entity (SPE)

- 35 Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy filing, has the concept been upheld?

It is not that common for the lender to require a SPE to be founded and maintained for the purpose of bank lending. This is sometimes done in case financing is needed for management buy-outs, but these requirements are usually dependant on respective case and specifics of the borrower. There are no specific corporate rules for the creation and maintaining of the SPE, therefore it shall be treated as any other limited liability company created and maintained under Estonian law.

The concept of an independent director is not common to the Estonian corporate system.

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