



Possibility to use and enforce lender's step-in rights in Baltic PPP projects: part one — Estonia

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As the possibility to use and enforce lender's step-in rights is of crucial importance for the financing of public-private partnerships (PPP) projects, this series provides an overview of the relevant legal requirements in Estonia, Latvia and Lithuania. Step-in rights are particularly important for lenders as they give lenders control over a project's cash-flow, which is the most important security for lenders. Where a lender has been granted step-in rights, the lender has a chance to cure the breach and thereby avoid termination of the contract and related cash-flow. In international practice, step-in rights may take the following two main forms:

1. Right to replace the defaulting private partner with another private partner (i.e., transfer of contracts from the defaulting private partner to a new private partner suggested by the lender).
2. Right to take control of the performance of the defaulting private partner by acquiring shares of the private partner.

The main issues with using and enforcing lender's step-in rights in Estonian, Latvian and Lithuanian PPP projects arise in the context of public procurement, although contractual, corporate and insolvency law are also relevant when using and enforcing step-in rights. Each summary provides an insight into the different PPP regulatory landscapes of the three Baltic states and a summary of which issues relating to step-in rights are common for all three jurisdictions, and which are not.

Although financing infrastructure objects through PPP projects is an increasing trend in Estonia, the relevant legislation is still in the development phase. Unlike neighbouring state Latvia, Estonia does not have specific legislation for PPPs and, therefore, PPP projects are subject to the general legislative framework. Competitive dialogue and concessions that favour the use of PPP, however, are regulated in Estonian law.

Public procurement issues

On January 1, 2011 amendments to the Public Procurement Act defining PPP for public procurement purposes and regulating step-in rights in PPP projects came into force. The amendments to the law were made to enable implementation of PPP projects more in accordance with international practices. The Public Procurement Act now lists the circumstances where the contracting authority (public partner) may consent to replace the private partner in PPP projects. Such consent to replace a private partner may be granted only if all following conditions are met simultaneously:

- The existing private partner has significantly breached the obligations deriving from the public contract and as a result of such breach the public partner is entitled to terminate the contract.
- The new private partner does not meet any criteria under the Public Procurement Act which would require exclusion of a tenderer from procurement proceedings.
- The economic and financial standing and technical and professional competence of the new private partner complies with the qualification conditions provided in the contract notice.

A definition of PPP has existed in Estonian law for public procurement purposes since January 1, 2011. PPP has been defined in the law as performance of construction works or provision of services under a public contract concluded by means of public procurement proceedings or public works or services concession, provided that all the following conditions are met simultaneously:

- The purpose of the partnership is to execute construction works or provide services within public interests.
- The partnership lasts for at least 20 years.
- The contracting authority and the tenderer jointly use the means necessary for the partnership, such as money, know-how and experience.
- The contracting authority and the tenderer share the responsibility and risks derived from the partnership.

PPP was defined for the purpose of introducing step-in rights regulation into Estonian law. Under those new amendments to Estonian law, replacement of the defaulting private partner with another private partner (i.e., transfer of contracts from the defaulting private partner to a new private partner suggested by the lender) has become possible.

As to the second form of step-in rights, Estonian law does not restrict changing the shareholder of a defaulting private partner. Although changing a public contract is restricted under Estonian law, a change in shareholders of a private partner would probably not be regarded as an amendment to the public contract. A European Court of Justice ruling has supported this opinion, indicating that any changes to the composition of the shareholders in a contractual partner would not, as a rule, result in a material contractual amendment. Using step-in rights in the form of taking control of the performance of the defaulting private partner by acquiring shares of the private partner is, therefore, also permitted in Estonia.

Contractual law issues

Contractual law issues become relevant in cases where the lender wishes to use step-in rights to replace the defaulting private partner in contracts with another private partner. Estonian contract law does not hinder the use and enforcement of step-in rights. To transfer contracts from the defaulting private partner to another private partner, consent of the other party to the contract (public partner) is required. In the case of transferring contracts, risk of transfer of enterprise arises. Under Estonian law, by taking over the things and rights that belong to an enterprise, all transferor's obligations related to the enterprise also transfer automatically to the transferee. The economic substance of the transfer of enterprise would, therefore, be comparable to the transfer of shares of a private partner.

Corporate law issues

Corporate law issues become relevant in cases where the lender wishes to use step-in rights to take control of the performance of the defaulting private partner by acquiring the private partner's shares. Estonian corporate law does not hinder the use and enforcement of such step-in rights. Some formal requirements should, however, be taken into account when exercising step-in rights for the acquisition of the private partner's shares from the sponsor.

Assuming that the share(s) of the private partner are registered with the Estonian Central Register of Securities (ECRS), transfer of ownership must be registered in the ECRS to be valid with regard to third persons. To register transfer of shares in the ECRS, the lender or its nominee must have a securities account open in the ECRS. If the private partner's share(s) are not registered in the ECRS, the share transfer agreement must be concluded in notarised form.

It is also possible that the sponsor may not own the majority of the private partner's shares, but exercises control over the private partner on the basis of a shareholder's agreement. In such cases, in addition to the private partner's shares, the shareholder's agreement should be transferred to the lender so that it can acquire control of the private partner.

Insolvency law issues

If an Estonian private partner is declared bankrupt, the bankruptcy trustee, who is an independent official appointed by the court, would gain control of the property and the affairs of the insolvent private partner. If the private partner also has other creditors, lenders under the PPP project would not have the ability to direct the bankruptcy trustee fully to their desired course of action, since the bankruptcy trustee must act for the benefit of all creditors.

As there is a risk that a lender's right to enforce its step-in rights in the form of the transfer of contracts from the defaulting private partner may be restricted in bankruptcy proceedings, the solution for the lender would be to exercise its step-in rights prior to the declaration of bankruptcy. The other option for the lender would be to purchase or satisfy claims of other creditors before the declaration of bankruptcy and thereby avoid the private partner's bankruptcy proceedings.



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