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ESTONIA LATVIA LITHUANIA BELARUS

M&A AND PRIVATE EQUITY

BALTIC TRANSACTION GUIDE 2011


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Introduction to M&A and private equity developments in the Baltics

General

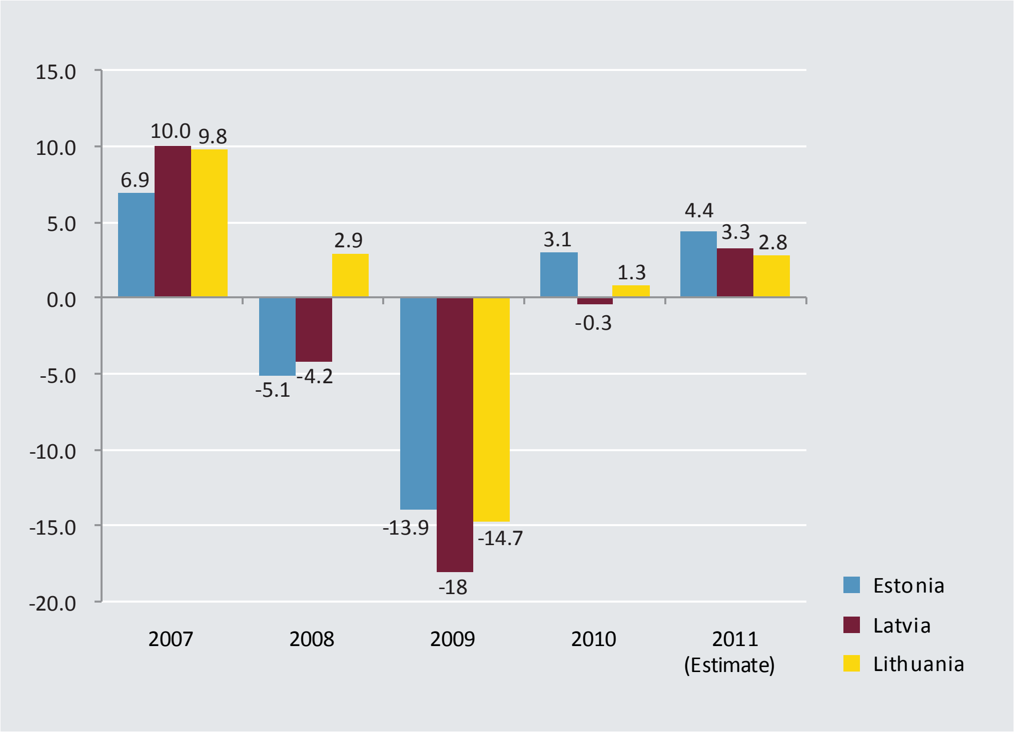
Estonia, Latvia and Lithuania, the three Baltic States, cover an area of more than 170,000 km^2 along the Baltic Sea with a combined population of more than seven million people.

According to Eurostat, the combined GDP of the three Baltic States at market prices was approx EUR 64.8 billion in 2007, while the figure peaked in 2008 at approx EUR 71.2 billion.[1] In 2007 Estonia, Latvia and Lithuania enjoyed a real GDP growth rate of 6.9%, 10% and 9.8% respectively. GDP growth weakened in the region during 2008, growing 2.9% in Lithuania, while declining -5.1% in Estonia and -4.2% in Latvia. In 2009 the Baltics suffered a steep negative decline in GDP growth of -13.9% in Estonia, -18% in Latvia and -14.7% in Lithuania.

In 2010, negative growth in the Baltic States was slowing down, with Estonia returning to a positive GDP growth rate of up to 3.1%. Estonia was followed by Lithuania, which reached a GPD growth rate of up to 1.3%, while in Latvia continuing negative growth reached a level of -0.3%. The positive news is that in January 2011 Estonia joined the Eurozone and continued to lead growth in the Baltics with an estimated GDP growth rate reaching 4.4% in 2011. The euro is likely to encourage foreign investment. Latvia and Lithuania are also heading for recovery and are supposed to reach a GDP growth rate of up to 3.3% and 2.8% respectively in 2011. Lithuanian industry has grown for the third quarter in a row, while exports remain the main driving force of economic growth. The Baltic economies have finally emerged from severe recession in 2009 and the rates in 2011 seem promising. Rising external demand, boosted mainly by favourable economic conditions in Europe's major economies, had a positive impact on economic indicators in the Baltic region. As a result, transaction activity in the region appears to be reviving.

1 http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home

Real year-on-year GDP growth (%)



Source of data: http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home

Historical and analytical perspective

Mergers & acquisitions (M&A) emerged in the Baltic States in the early 1990s with privatisation of state-owned businesses. Since that time the Baltic M&A market has developed considerably to its current state where legislation as well as practice is comparable to other developed markets. Foreign investors can engage in business in the Baltic States with relative ease by establishing branches or local companies, although establishment procedures differ in each country. In addition, repatriation of profits is possible from all three countries. According to the World Bank's 2011 Ease of Doing Business Index, Estonia, Lithuania and Latvia rank second, third and fourth respectively among East European and Central Asian jurisdictions as to ease of doing business. As members of the European Union (EU), all three Baltic States are also members of the World Trade Organisation and have ratified most international economic treaties. As of 2010, Estonia is also a member of the OECD. Additional funds for investment in the region have been provided by institutions such as the International Monetary Fund and the European Bank for Reconstruction and Development and EU Structural Funds. With positive signs of stabilisation, anticipated growth and news of Estonia having joined the Eurozone, we are seeing signs of increased activity in the Baltic M&A market with several large deals already closed in 2010.

SORAINEN is happy to note that its lawyers have participated in the majority of the biggest M&A deals in the Baltic States. Below is a table listing the TOP 10 BALTIC DEALS[2] for the period January 2006 to January 2011.

No	Deal	Deal value (EUR million)	SORAINEN's role
1.	Formation of **LEO LT** (the Lithuania-based holding company) through merger of interests in Lithuanian electricity companies **Lietuvos energija**, **VST** and **RST**	2,155	Adviser to HSBC and the Lithuanian Government
2.	Sale by **Yukos International UK** and the **Lithuanian Government** of 84.36% stake in **Mažeikių nafta** (the listed Lithuania-based oil refinery) to **PKN Orlen**	1,476	Adviser to the buyer
3.	Sale of **BITĖ Group** (the Lithuania-based telecommunications company) by **TDC**	450	Adviser to short-listed bidder
4.	Acquisition by **Coopernic Alliance** (the European alliance of independent retailers, consisting of REWE Group, E. Leclerc, Coop, Conad and Colruyt) of an 80% stake in **Palink** (the Lithuania-based food retailer) from **Citigroup Venture Capital International** and **Baltisches Haus**	300	Adviser to the buyers
5.	Sale by the **Lithuanian Government** of a 9.88% stake in **Mažeikių nafta** to **PKN Orlen**	210	Adviser to the buyer
6.	Acquisition by the **Lithuanian Government** of a 38.3% stake in **LEO LT** (the Lithuania-based holding company for electricity transmission and distribution companies in Lithuania) from **NDX energija**	197	-
7.	Acquisition by **ICA** (the Swedish food retailer) of a 50% stake in joint venture **Rimi Baltic** (the major pan-Baltic food retailer) from **Ruokakesko**	190	-
8.	Acquisition by the **Estonian Government** of a 66% stake in **Eesti Raudtee** (the Estonian state railway) from **Baltic Rail Services** (BRS)	150	Adviser to one of the parties in relation to completing the transaction
9.	Acquisition by **Vitol** (the Switzerland-based oil products group) of a 34.5% stake in **Ventspils nafta** (the listed Latvian oil terminal operator) from the **Latvian Government**	96	-
10.	Acquisition by **Inchcape** of **Baltic Motors Corporation** and **BM Auto** (Latvian distributors and retailers of vehicles) from **MVC Capital**	89	-

The Baltic region, with its beneficial tax system among other factors, has been attractive to foreign investors. Historically, strategic investors, especially those from the Nordic countries, have been the most active investors in the three Baltic States. However, investment trends have started to change recently in two respects. First, private equity funds and venture capitalists are becoming more active in the Baltic countries. Secondly, certain changes have occurred in the direction of investments. In Lithuania for example, from 2008 investors from Poland outrivaled Nordic investors, which were historically the biggest and most active in the country. For instance, Polish investors made four of the five largest acquisitions of Lithuanian companies in 2010.

[2] The table lists the largest announced deals (according to value) closed during the period 1 January 2006 to 1 January 2011, and covers national and pan-Baltic acquisition deals where the target relates to Estonia, Latvia or Lithuania. Multi-national deals where Estonia, Latvia or Lithuania formed only part of the deal, as well as public offer deals were not included. Source: www.mergermarket.com

In general, the private equity industry in the Baltics, though rather young and still developing, appears to be recovering following trends across Europe. The JEREMIE[3] initiative in Lithuania and Latvia has recently resulted in creation of six new venture capital funds which, together with other private equity players, are expected to reenergise M&A activities in the region.

M&A deals usually involve a high value and a high level of risk, so it is vital to keep in mind both the legal framework and market developments that impact each transaction. Thus, it is important to seek advice from your local financial, legal and business advisors when contemplating entering, expanding or otherwise investing in the Baltic markets.

■ Overview of the regulatory framework in the Baltic States

After joining the EU on 1 May 2004, Estonia, Latvia and Lithuania quickly transposed all principal European Community (EC) legislation into national law, including M&A related legislation, such as the Takeover Directive, the Second Company Law Directive, Directive 2006/68/EC amending the Second Company Law Directive, and the Cross-Border Mergers Directive. The Baltic States have also liberalised investment policies, freely allowing for foreign investments without burdensome restrictions.

While EC legislation applies in all three Baltic States, it is important to note that each jurisdiction has its own distinct legal system and laws applicable to M&A activities. The considerably modern legal systems of the Baltic States have certain peculiarities, eg the unique tax system and liberal labour laws in Estonia and the employee-protective labour laws in Lithuania.

The following chapters provide an overview of some of the main legal issues to consider when conducting M&A transactions in the Baltics. Because of its generality, the information in this brochure may not apply in all situations and should not be acted upon without specific legal advice based on the particular circumstances.

[3] Joint European Resources for Micro to Medium Enterprises

2 TYPES OF ACQUISITION

In practice, M&A transactions are rarely implemented by way of merger in the Baltic States due to complex regulations and time-consuming procedures necessary to achieve a merger. Thus, acquisitions are typically carried out by way of share or asset deals.

The main types of M&A transaction include the following:

Type of acquisition	Description
Acquisition of shares	Shares in public or private limited companies are purchased by the buyer from the shareholder(s) of those companies.
Acquisition of assets (business) as a going concern	An economic unit (business consisting of assets, rights and liabilities) or a part of it which is an organisational whole is transferred to the buyer by the target company.
Merger	One company is absorbed by another company or two or more companies merge to form a new company.
Demerger / Spin-off	A company ceases to exist and two or more new entities are created, or a company is divided into two or more parts to be transferred to existing companies.

A number of variations may implement a specific type of business acquisition, including:

- directed share issue;
- management buyout (MBO) / leveraged buyout (LBO);
- acquisition of strategic assets;
- takeover of a significant stake of shares in capital markets; and
- joint venture.

The choice of acquisition type and its exact variation depends on numerous factors, such as the intentions and structure of the parties, taxation, legal restrictions, payment and financing terms and business risks. Prior to starting an acquisition, it is highly recommended to structure the acquisition scheme with your financial, legal and business advisors.

Share vs asset transactions

	Acquisition of shares	Acquisition of assets
Seller	Shareholder(s) of the target company.	Target company.
Purchase object	Shares.	Assets and goodwill.
Ability to pick and choose assets	Purchase of shares generally does not affect the assets of the target company. In order to avoid purchase of certain assets of the business, the target company needs to transfer those assets out.	The parties are generally free to pick and choose assets to be acquired.
Ability to pick and choose liabilities	Purchase of shares does not generally affect the liabilities of the target company.	All liabilities related to the assets (business) are considered transferred to the buyer (unless creditors consent otherwise).
Form	Generally simple written form.	Generally simple written form.
Transfer of title	In the case of registered shares a securities transaction should be carried out. In the case of non-registered shares under the agreement between seller and buyer.	The parties may freely agree on the title transfer date. In the case of registered assets, entries should be applied for in the relevant registers.

In Estonia, shares which are not registered in the Central Registry of Securities must be transferred by notarised agreement.

In Estonia and Latvia, the form of agreement for acquisition of assets depends on whether the transfer of a particular asset requires notarisation, eg for registration of transfer of immovables.

In Latvia, a business is an organisational whole and can only be transferred as such, so the ability to freely pick assets might not always be possible.

In Lithuania, a share deal does not require notarised form, whereas the form of asset transfer agreement depends on the transferred property (eg transfer of immovables usually requires a notarised agreement). The Civil Code provides for a complex procedure of sale-purchase of an enterprise, which also involves a notarised agreement.

Main steps and legal documents

Every acquisition usually goes through three main stages. It starts with preliminary negotiations followed by due diligence performed by the buyer (and in some cases by the seller), and, if the first two stages have been satisfactory to the buyer, results in the signing of a share purchase agreement or asset transfer agreement depending on the transaction structure.

Legal documentation

The main legal documents and steps of a typical M&A transaction in the Baltic States can be described as follows:

Letter of Intent	Drawn up at an early stage of negotiations. Includes the main points of agreement and serves as the basis for proceeding with the transaction. Typically includes an exclusivity clause to exclude negotiations with other potential buyers and a strong confidentiality clause to protect information disclosed during due diligence and negotiations.
Legal due diligence	Assessment of the target company being sold from a legal point of view. Financial due diligence is also often conducted by the buyer simultaneously with legal due diligence. Some acquisition processes also include tax, environmental, technical and other types of due diligence.
Transaction documents: – share purchase or asset transfer agreement; – shareholders agreement; – articles of association.	Transfer of ownership either of the shares or the assets (business) being sold. Regulation of further relations between the parties.
Regulatory approvals and notifications	Merger control and other regulatory filings are generally carried out prior to closing and are included as conditions precedent in the transaction documents. Stock exchange and other regulatory notifications regarding changes in shareholdings or control for certain listed or regulated companies are generally made shortly after completion of the transaction, if not otherwise required beforehand.
Post-completion actions	If filings are required to be made to the commercial or real estate registers in order to transfer ownership or change other company data.

Non-binding Letters of Intent are generally regulated by the rules applicable to precontractual negotiations under which the negotiations must be carried out in good faith. However, these rules do not foresee an obligation on the parties to conclude an agreement.

As a general rule, the parties must follow certain pre-contractual obligations during preliminary negotiations. Those obligations are aimed at maintaining fair business conduct and protecting business secrets. The goal is to enable disclosure of as much information on the target company as possible to the potential buyer while protecting the business secrets of the target company should negotiations fail. The primary obligations include the following:

- disclosure of information;
- maintenance of confidentiality of information;
- negotiating in good faith.

In Latvia no statutory confidentiality obligation exists.

Due diligence in Baltic practice

To reduce the risks of an unpleasant surprise, the market practice is to conduct a legal due diligence review of the target company prior to closing the acquisition. In addition to share transactions, this is also relevant in asset transactions where all liabilities related to the assets (business) may transfer to the buyer automatically (depending on jurisdiction).

A vendor due diligence (VDD) of the company is also sometimes performed by the seller. This aims at providing the seller with a better picture of what it is selling and to facilitate the sale of the company to third parties. If presented to potential buyers, the VDD report may serve as a reliable source of information and provide potential buyers with a fair and adequate view of the company on sale.

The VDD also serves to identify potential liability areas for the vendor and its management (the "know-what-you-sell" principle), thus increasing their bargaining power in relation to the buyer who conducts its own legal due diligence, and often speeds up the negotiation process. Indemnities for damages in relation to any defects in the VDD report might be recoverable when a buyer is intended to rely upon the VDD report directly without conducting its own due diligence of the target company.

Several provisions in the law may require the management of the buyer to conduct at least a limited due diligence on the target business or company. According to these general principles, members of the managing body must perform their obligations diligently, and act in the most economically purposeful manner, ie in the best interests of the company. Lithuanian court practice even suggests that a reasonable and prudent buyer should perform due diligence of a company before acquiring it. Thus, it is highly recommended that the board of the buyer conduct a LDD review of the target company to ensure it meets its fiduciary duties.

Warranties and indemnities

Issues related to representations and warranties are in general regulated by law.

Statutory warranties require the object of a sale to comply with certain requirements, depending on the object sold, with regard to:

- quality;
- quantity;
- agreed features, or fitness for the object's purpose.

Statutory warranties mainly protect the buyer against defects of a purchased item and are formulated in general terms, ie the purchased item does not meet the agreed quantity or quality or does not have the agreed features and, absent an agreement concerning the latter, it is not fit for the purpose for which the buyer intended to acquire the item and of which the seller was or should have been aware at the time of entering into the agreement.

Thus, the parties should expressly agree on the particular qualities and features that the target company or business should correspond to. Indeed, a major part of the acquisition agreement usually consists of representations and warranties by the seller in favour of the buyer concerning among others the following:

- shares and corporate standing (in the case of share transfer);
- business;
- financial statements;
- assets;
- employees;
- relations with authorities;
- disputes and litigation;
- intellectual property rights;
- IT solutions;
- other matters relevant to a particular type of business the company is involved with (eg compliance with personal data protection rules in insurance companies, environmental issues in manufacturing companies).

Breach of a representation or warranty is generally considered a breach of contract, entitling the buyer to remedies available under the law (eg specific performance, damages, price reduction, withdrawal from the agreement, late payment interest) and set forth in the acquisition agreement. The extent of statutory warranties and the remedies provided by law are typically not sufficient for the parties to a business acquisition agreement, and therefore should be accounted for in the transaction documents.

According to court practice in Lithuania, statutory quality warranties apply to the shares as an object but not to the company acquired.

It is recommended that the parties design and adjust remedies for their own specific purposes, eg by limiting the use of some remedies, defining possible losses, defining principles for calculating liquidated damages, prescribing contractual penalties, prescribing limitation periods, limiting the liability of the parties. Furthermore, it is typically important for the buyer to obtain specific indemnities from the seller for tax, environmental or employment issues, among others. Indemnities provide an added recourse for the buyer to claim compensation directly from the seller or the target company for third party claims covered.

Key features of share transactions

- Pre-emptive rights

As a rule applicability of pre-emptive rights on transfer of shares is regulated differently for public and private limited companies. This is due to their different nature. In general, private limited companies are meant for a “closed” circle of shareholders, while public limited companies are meant to attract a larger number of shareholders and capital from outside. Regulation on pre-emptive rights in limited liability companies supports this basic distinction.

In the case of private limited companies, the pre-emptive right of other shareholders upon transfer of shares is provided by law. However, it is generally possible to deviate to a certain extent from this requirement in the articles of association.

In Lithuania this rule applies only to sale of shares. Therefore, pre-emptive rights do not apply in the case of a swap (trade) agreement.

In Latvia this rule applies only to sale of shares. For other transactions on share disposals consent by the shareholders meeting is necessary.

In Estonia this rule applies only to transfer of shares for cash contribution. Therefore, pre-emptive rights do not apply in the case of gifts or transfer of shares to the share capital of the company as a non-cash contribution.

In the case of public limited companies, the presumption is reversed. The law does not provide for a pre-emptive right on transfer of shares, but the articles of association may so provide. Thus, it is left to the shareholders to decide whether they wish to control entry to the shareholders circle.

In general the term for exercising pre-emptive rights varies between one and two months.

In Estonia the pre-emptive right applies only in case of transfer of shares to third persons.

In Latvia and Lithuania the pre-emptive right also applies upon transfer to other shareholders.

In Lithuania restricting transfer of shares in public limited companies by introducing pre-emptive right is prohibited (it may be agreed between the shareholders but this is not valid with regard to third parties).

In the case of private limited companies a statutory right of pre-emption exists from which one can deviate only in exceptional cases.

In addition to statutory right of pre-emption, parties often agree to establish contractual pre-emptive rights, tag along and drag along rights.

Key features of asset transactions

- Purchase of a business as a going concern

Acquisition of a business as a going concern can be achieved through acquisition of all or part of the assets of the target company without acquiring the underlying legal entity. The legal entity, eg, a limited liability company, remains behind and its shares are not transferred. The attraction of an asset deal is that the parties can usually choose which assets are transferred and which remain with the seller. However, on transfer of the assets of a company, the obligations connected to the assets sold are generally also transferred to the buyer. Thus, the buyer and seller are jointly and severally liable for obligations related to the business transferred which were created before the transfer took place. Agreements between the buyer and the seller that deviate from this rule are valid towards third parties only after the third party has so agreed in writing.

In Lithuania, regulation of sale of business establishes a specific mechanism aimed at protecting interests of creditors.

- Transfer of contracts and permits

While generally the consent of a creditor is needed for assignment of a contract, consent is not expressly required in the case of transfer of an enterprise. However, the purchaser must immediately notify creditors about acquisition of obligations and the seller must immediately notify debtors about transfer of claims.

Permits or licenses held by the seller may only be transferred to the purchaser on acquisition of the underlying assets if the right of transfer is established by the permit or license itself or is otherwise permitted by law.

In Latvia, the law provides very little guidance with respect to business transfers so that regulation on transfer of agreements is not entirely clear. As a practical matter we recommend concluding separate novation agreements with respect to third party agreements most valuable to the business, to provide additional certainty with respect to these transfers.

In Estonia, permits and licenses held by the seller are not usually automatically transferred to the purchaser in the case of transfer of business as a going concern. A separate process of applying for permits and licenses should be initiated by the purchaser.

- Transfer of employees

Employment agreements are deemed transferred to a new employer on transfer of all or part of an enterprise, provided that the same or similar activities are continued. Note that transfer of a business does not serve as a basis for terminating employment agreements. The same applies to collective agreements.

In Lithuania, regulation is different. National legislation does not expressly provide for transfer of employees on sale of business. Thus in practice, transfer of employees should be agreed between the current and new employer separately and consents for the transfer of any individual employee have to be received from each employee.

In Latvia amending the collective agreement within one year of an acquisition by a new employer is prohibited if the amendments would harm employee interests.

Although employment agreements are transferred automatically, it is important to note that employment laws prescribe for certain information and consultation obligations of the current and new employers towards employees. The seller and buyer of a business should submit the relevant information in writing to employee representatives (or employees directly in case no employee representatives exist) at least one month before transferring the business (in Latvia, one month before the transfer starts affecting employees' employment terms or working conditions). If the seller or buyer intends to implement changes affecting employees, a consultation procedure should be followed.

3 REGULATORY REQUIREMENTS

Approvals, notifications and restrictions

In addition to concentration control discussed below, acquisition may require approval by, or notification of, other public authorities.

For example, acquisitions of shares in banks, investment companies, fund management companies, pension funds and insurance companies may require consent from the respective local financial supervision authority.

Typically, consent from a supervisory authority must be applied for if the buyer intends to acquire a qualified holding in the company or intends to increase its qualified holding so that the proportion of the share capital or votes in the company exceeds certain legal thresholds.

Persons intending to engage in certain regulated activities, such as activities in the insurance, financial services, and energy sectors, should apply for the necessary operating licences.

Competition law

Competition law rules aim to protect, maintain and develop free, honest and equal competition in the best interests of consumers.

As of 1 May 2004, all the EU competition rules apply in the Baltic States and prevail over national legislation that may contradict them.

The EC competition rules apply on a mandatory basis whenever a specific agreement, decision or practice may affect trade between member states. Therefore, not only the EC, but also national competition authorities are responsible for enforcing EC competition rules.

Merger control

Transactions recognised as mergers under competition laws include the following:

- Mergers of two or more market participants with the aim of establishing a single entity.
- Incorporation of one market participant into another.
- Arrangements where a market participant gains a decisive influence over another market participant, or where a person already enjoying a decisive influence over one market participant acquires a decisive influence over another.

A joint venture between several market participants can be seen as either an agreement between those undertakings or as a merger. Under longstanding EU law and practice the latter option will prevail if the joint venture performs economic activity independently on a lasting basis and creates permanent structural changes in its “parent undertakings”.

The respective competition board may impose restrictions or conditions on clearance of a merger in order to prevent creation or strengthening of a dominant position or to achieve some improvement in competition. For example, the competition authority may order divestment if this appears to be necessary.

The objective of merger control is to prevent creation or strengthening of a dominant position, or reduction of competition in the relevant market, and to enable competition in the local Baltic economies. However, even in cases when a dominant position of an enterprise is established or strengthened as a result of a merger, the competition authority will assess efficiencies yielded by the merger, for instance, an offer of new services to consumers.

- Merger control notification thresholds

The intended concentration (whether concerning acquisition of shares or assets) must be notified to the respective competition board if the aggregate turnover of the undertakings participating in the concentration is higher than the applicable thresholds.

In Estonia, the notification threshold is triggered if the aggregate turnover of the parties to a concentration exceeds approx EUR 6.4 million for the financial year preceding concentration and the Estonian aggregate turnover of each of at least two parties to the concentration exceeds approx EUR 1.9 million for the financial year preceding concentration.

In Latvia, the notification threshold is triggered if the aggregate turnover of the parties to the concentration exceeds LVL 25 million (approx EUR 35.4 million) for the financial year preceding the concentration or if the combined market share of the parties to the concentration in the relevant market exceeds 40%.

In Lithuania, the notification threshold is triggered if the combined aggregate income of the parties to the concentration exceeds LTL 30 million (approx EUR 8.7 million) for the financial year preceding concentration and the aggregate income of each of at least two undertakings concerned exceeds LTL 5 million (approx EUR 1.4 million) for the financial year preceding concentration.

Generally, the net turnover of a market participant is the income from activities, sale of goods and supply of services of the respective market participants in the territory in question during the previous financial year, less any applicable sales and other discounts, as well as value added tax and other taxes directly related to turnover.

Only a few exceptions apply when a concentration notice does not have to be filed.

- Notification

Notification must be filed before the transaction is completed. In practice, notification is filed after signing of the purchase agreement but before closing of the transaction (ie before change of control occurs). If change of control takes place without prior approval from the competition board the transaction will be considered illegal and the parties can also be fined for each day of delay in filing notification.

The concentration is generally approved within 45 days as of filing full notification if the concentration participants do not receive a decision of the competition authority stipulating conditional approval, prohibition of the concentration or a decision to proceed with a second-phase investigation.

The second phase can generally last up to three months. The concentration is considered approved if the second phase investigation does not result in a decision stipulating conditional approval or prohibition of the concentration.

Generally, the parties will include competition authority clearance as a condition precedent to closing the transaction. In addition, the parties will often include a long-stop date by which if competition clearance is not received then one or both parties may decide not to proceed with the transaction without penalty.

Non-competition, non-solicitation and similar undertakings

Generally, non-competition and non-solicitation agreements are enforceable. However, careful attention should be paid to ensuring that the terms of such agreements are reasonably drawn and do not unduly restrict trade.

Typically, covering the general geographic scope of the target company's business in the non-competition agreement is acceptable provided the term of prohibition is reasonable. However, expanding the geographic scope too broadly may be seen as placing a restriction on competition. Similar analysis is applied to non-solicitation and other similar agreements as a test to whether such agreements hinder competition. Thus, such agreements should be carefully considered and should avoid unduly restricting competition or granting one party sufficient control so that it obtains a dominant position in the relevant market.

4 KEY ISSUES IN PRIVATE EQUITY TRANSACTIONS

Significant regulatory reform of the private equity (PE) industry in Lithuania has been proposed in 2010-2011. The proposed reform is generally aimed at liberalising the PE industry through creating a more competitive, more favourable regulatory and tax environment for one of the activities of PE market players – collective investment undertakings intended for informed investors (CIUIIs) – and bringing it into line with best international practice in this particular field. Proposals include empowering collective investment undertakings to act through a wider range of corporate forms (including an investment fund managed by a management company or an investment company established in a form of a public company, private limited liability company or partnership). Management companies will enjoy reduced capital requirements for setting up, as well as simplified regulation for investment portfolio diversification. Ongoing discussions over optimising the tax regime include the following proposals: (a) establishing a "full exemption" regime for collective investment undertakings (ie investment gains would only be taxed if distributed to investors), and (b) exempting gains/dividends received by foreign investors from collective investment undertakings from taxation in Lithuania: these gains/dividends would be taxed only in the investor's country of residence.

One objective of the changes is to promote foreign PE investments in Lithuania and to increase Lithuania's attractiveness as a promising jurisdiction for PE funds. These legislative proposals are expected to be considered in the Lithuanian Parliament by mid 2011.

■ Financial assistance

Generally, public limited liability companies may not advance funds, make loans, or provide security with a view to acquisition of its shares by a third party. This prohibition applies broadly to both public and private limited liability companies in the Baltic States.

Latvian law does not explicitly apply the financial assistance prohibition to private limited liability companies (SIA company form).

Management incentives

Typically, stock option plans are not common in the Baltic States due to less than favourable tax treatment. However, in certain cases management are still granted stock options as an incentive and to help align their interests with those of shareholders. The tax implications of such plans should be carefully considered in advance to ensure that they are carried out in the most beneficial and efficient manner for the management and the company.

Exit scenarios

It is common for private equity funds to regulate certain exit scenarios in the transaction documentation, especially when the aim is to exit through an IPO or trade sale. It is common to seek a tag along clause to give the investor an option to exit together with the other selling parties (typically in proportion to their shareholdings) or to request a drag along clause to ensure that if a trade sale is conducted the buyer can acquire the entire company.

Furthermore, it is also common to regulate deadlock provisions for joint ventures to ensure that where the shareholders are unable to agree on certain matters they have ways of resolving the dispute. Given the varying strengths of the parties, the specific types of deadlock clause should be carefully considered together with an advisor to ensure that the most effective measure is adopted.

Few companies choose to exit through IPOs in the Baltics due to the small market and size of the transactions. Therefore, seeking an exit by way of an IPO is not feasible in most cases.

5 CAPITAL MARKETS – KEY ISSUES RELATED TO ACQUISITION OF SHARES IN PUBLICLY TRADED ENTITIES

■ Acquisition of shares in listed companies

In the case of merger or acquisition of shares in a company listed on a local stock exchange, certain notification and disclosure requirements under local law and stock exchange rules apply.

As a guiding principle, listed companies should notify the stock exchange about all relevant changes in their activities which may influence their share price or seek an exemption from this requirement from their supervision authority if this information would otherwise be harmful to the company or its shareholders (eg, disclosure of trade secrets). For example, a proposed merger, dissolution or transformation of a listed company, proposed co-operation projects, establishment of joint venture, a decision to acquire a holding in other companies, transactions with fixed assets, which are beyond the scope of day to day business activity or changes in the management are likely to impact the price of the company's shares and therefore should be disclosed.

■ Notification requirements

Each jurisdiction requires disclosure of transactions whereby shareholdings in companies listed on the regulated market are increased above or fall below certain thresholds as follows:

- In Estonia, if a person either directly or indirectly, whether individually or together with persons acting in concert, holds or acquires shares admitted to trading on the regulated market the holding of which reaches, exceeds or decreases below 5%, 10%, 15%, 20%, 25%, or 50% or one-third or two-thirds of the total number of votes in the company's general meeting of shareholders, they must notify the company regarding the number of votes held promptly but in any event not later than within four trading days.
- In Latvia, if a person either directly or indirectly, whether individually or together with persons acting in concert, holds or acquires shares admitted to trading on the regulated market and the holding of which reaches, exceeds or decreases below 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75%, 90%, 95% of the total number of votes in the company's general meeting of shareholders they must notify the Latvian Financial and Capital Market Commission as well as the company regarding the proportion of votes held as soon as possible but in any event not later than within four trading days.
- In Lithuania, if a person either directly or indirectly, whether individually or together with persons acting in concert, holds or acquires shares admitted to trading on the regulated market and the holding of which reaches, exceeds or decreases below 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% and 95% of the total number of votes in the company's general meeting of shareholders, they must notify the Lithuanian Securities Commission as well as the company regarding the proportion of votes held as soon as possible but in any event not later than within four trading days.

Listed companies are generally not obligated to disclose information on the process of negotiations, provided that the issuer guarantees that the other party in negotiations keeps the information received from the issuer confidential. Confidentiality is typically achieved through binding non-disclosure agreements. It should be noted that the issuer should disclose all information related to the negotiations that may have an impact on the share price immediately after the negotiating parties have entered into an agreement on material terms of the transaction.

Insider trading rules

An insider of a publicly listed company is subject to restrictions on certain types of trades and during certain disclosure periods under local stock exchange rules and securities market regulations. If a party acquiring or selling shares is an insider of a public company, then careful attention should be paid towards these rules.

Mandatory takeover bids

Persons who directly or indirectly gain a dominant influence or control over a company listed on a local stock exchange either alone or acting in concert with other persons must make a takeover bid for all shares of the target issuer.

The following chart provides a summary of the key mandatory and voluntary takeover bid provisions in Estonia, Latvia and Lithuania:

	Estonia		Latvia		Lithuania	
	Voluntary	Mandatory	Voluntary	Mandatory	Voluntary	Mandatory
Bid threshold	None	Ownership or control over 50% of votes in general meeting, or control over supervisory or management board	10% of all votes in the general meeting of the shareholders	50% or over of all votes at the general meeting	None	Over 40% of all votes at the general meeting
Supervisory authority notification	None	Takeover bid must be made within 20 calendar days as of reaching the threshold and it is required to make a prior notification	Within 10 business days from reaching or exceeding the threshold		None	Within 7 days of exceeding the threshold
Acceptance period	28-42 calendar days		Not less than 4 weeks (30 days) and not longer than 10 weeks (70 days)		Not less than 2 weeks (14 days) and not longer than 10 weeks (70 days)	

The Takeover Directive (2004/25/EC) has been fully transposed in all three Baltic States providing convergence with requirements in other European countries. The Takeover Directive does not create a harmonised single set of takeover rules throughout the EU, as member states may opt out of the provisions regarding defensive measures available to targets under Article 9 and whether or not to apply the breakthrough rule under Article 11.

For example, under Article 9(2) of the Takeover Directive the board must obtain prior authorisation at the shareholders general meeting before taking any action (other than seeking alternative bids) which might result in frustration of the bid. Article 9(3) concerns the capacity of the shareholders meeting to approve or confirm any decision which is not part of the normal course of the company's business and the implementation of which may result in frustration of the bid. All three Baltic States have not opted out of implementing these measures and therefore these obligations apply to targets during public takeover bids in Estonia, Latvia and Lithuania.

Furthermore, under Article 11 of the Takeover Directive the breakthrough rule provides for suspension of certain voting right restrictions and share transfer provisions arising from articles of association or contractual arrangements entered into after adoption of the Takeover Directive on 21 April 2004. Such provisions are suspended for the duration of the takeover bid acceptance period and only with respect to accepting the offeror's bid. In addition, if following the takeover bid an offeror obtains the relevant number of shares required under national law to amend the target's articles of association then any restrictions on share transfer or voting rights mentioned above and any extraordinary rights regarding board member appointment or removal will cease to exist as of convening the first general shareholders meeting of the target. As the Baltics have not opted out of these provisions, these obligations and rules apply to targets during public takeover bids in Estonia, Latvia and Lithuania.

Public to private

Squeeze outs and sell outs

A buyer that acquires 95% (90% in Estonia) of shares and votes in the target company may generally seek to acquire the remaining shares from the minority shareholders provided that a fair price is offered for the shares during the squeeze-out. The price cannot be lower than the highest price per share paid by the buyer during a mandatory or voluntary takeover bid. Similar to the squeeze-out provision above, if the buyer acquires 90% (95% in Lithuania) of shares and votes in the target company, the remaining minority shareholders may generally seek to sell their remaining shares to the buyer provided that a fair price is sought for the shares during the squeeze-out.

Delisting

In the event of delisting a company, the obligation to make a mandatory takeover bid generally arises. Furthermore, local stock exchange rules apply with respect to fair treatment of the minority shareholders of the target company.

In Estonia there is no express requirement to make a mandatory takeover bid in the event of delisting. However, delisting is regulated by the stock exchange rules and the Tallinn Stock Exchange may deny the delisting application if it decides that delisting will harm the minority shareholders.

6 TAXATION[1]

In Estonia, there is no annual corporate tax on income or profits. However, a tax of 21/79 applies to distribution of dividends and other similar payments.

In Latvia, there is a 15% flat tax on profits. There are no withholdings on dividend payments to EU residents and a 10% withholding tax on dividends applies to most residents outside of the EU.

In Lithuania, there is a 15% flat tax on profits. There are no withholding taxes on dividends to foreign residents owning at least 10% shares for twelve months, however, in most other cases a 15% withholding tax is applied to dividend payments.

Advanced binding tax rulings are available in Estonia for a fee and in Latvia without a fee. However, advanced binding tax rulings are not available in Lithuania, but will be introduced as of 1 January 2012 at no charge.

In Estonia, there are no thin capitalisation rules, ie substantial debt financing with market rate interest is tax neutral.

In Latvia, the following thin capitalisation rules apply: debt-to-equity ratio of 1:4 or 1.2 times short-term interest rate as provided by the Statistics Department – the less favourable of the two criteria applies.

In Lithuania, the following thin capitalisation rules apply: debt-to-equity ratio 1:4. If the ratio is exceeded, then accrued interest normally stops being deductable.

[1] Updated as of 1 January 2011

7 SORAINEN M&A AND PRIVATE EQUITY TEAM

Mergers & Acquisitions Practice overview

Mergers & Acquisitions (M&A) is a key SORAINEN practice. The firm deploys the only truly integrated regional M&A Practice and thus offers optimal capacity to advise on regional M&A deals involving two or more of the Baltic States and Belarus, substantially reducing the time, energy and resources necessary to structure and manage regional M&A projects.

M&A transactions require involvement of the most experienced M&A lawyers to assist in efficiently managing complex and intensive projects: from preparing adequate documentation and holding tactical negotiations to ensuring smooth deal closing. SORAINEN specialists in competition, regulatory, finance, real estate and tax operate with the firm's M&A lawyers to provide full servicing in M&A projects. The SORAINEN M&A Practice has an extensive track record in domestic and cross-border M&A transactions in various industries and in advising private equity funds on M&A deals.

SORAINEN is recommended for its M&A Practice by international directories such as *IFLR1000*, *The Legal 500*, *Chambers Global* and *Chambers Europe*.

Private Equity Practice overview

As part of the only truly integrated regional law firm, the SORAINEN Private Equity Practice of over 20 lawyers has the best capacity to advise on regional transactions in the Baltics and Belarus. This substantially reduces the time, energy and other resources required for structuring and managing regional projects.

The SORAINEN Private Equity Practice advises private equity houses and investors on fund formation, transactions and other activities in the Baltic States and Belarus. With in-depth knowledge of the private equity industry, SORAINEN lawyers provide tailored and efficient advice to the firm's private equity clients.

SORAINEN is recommended for its Private Equity Practice by international directories such as *International Financial Law Review*, *The Legal 500* and *Chambers Europe*.

Mergers & Acquisitions transaction experience

The firm is constantly involved in major M&A transactions in the Baltic States and Belarus. According to statistics from *Mergermarket* and other leading international M&A intelligence services, SORAINEN has the largest experience in major M&A transactions in the Baltics and Belarus. Below are some of the larger transactions.

HSBC Bank and the **Lithuanian Government**	**eBay**	**PKN Orlen**	**Latvian Mortgage and Land Bank** and the **Latvian state**
Formation of LEO LT through merger of interests in three Lithuanian electricity companies	Acquisition of Skype Technologies	Acquisition of 90.12% plus 9.88% stakes in Mažeikių nafta	Parex banka bailout, involving acquisition of a 84.83% stake in the bank
EUR 2.2 billion	**EUR 2.1 billion**	**EUR 1.72 billion** and **EUR 210 million**	**EUR 1 billion**, and a **EUR 775 million** state guarantee
Legal Adviser	Buyer's Legal Adviser	Buyer's Legal Adviser	Legal Adviser
Coopernic Alliance (REWE, E.Leclerc, Colruyt, Conad and COOP)	**Unimilk**	**Nordzucker**	**Iberdrola**
Acquisition of 80% stake in Palink, which operates retail chains IKI, Ikiukas and Cento in Lithuania and Latvia	Merger of Unimilk with Danone's Fresh Dairy Product business in the CIS area, including Belarus	Acquisition of Danisco Sugar (now Nordic Sugar)	Acquisition of 150 MW wind farm project
		EUR 750 million	**EUR 200 million** (estimated project cost)
Buyers' Legal Adviser	Legal Adviser	Buyer's Legal Adviser	Buyer's Legal Adviser
Citycon	**International Finance Corporation**	**LOTOS Petrobaltic**	**Vienna Insurance Group**
Acquisition of Kristiine, Mandarinas, Magistral and Rocca al Mare shopping centres	Acquisition of a 19.99% stake in Belarusky Narodny Bank	Acquisition of Geonafta group, the largest oil extraction operation in Lithuania	Acquisition of Seesam Life Insurance (now Compensa Life Insurance)
Over EUR 190 million (in total)	**EUR 5.9 million**		
Buyer's Legal Adviser	Buyer's Legal Adviser	Buyer's Legal Adviser	Buyer's Legal Adviser

■ Private Equity transaction experience

SORAINEN is constantly involved in all types of private equity transactions in various industries. Over the past several years, the firm has advised a number of regional and international private equity players on many major deals in the region, some of which are highlighted below.

Tiger Global	**Citi Venture Capital International**	**Massi Miliano** / Fits.me	**Lords LB Asset Management**
Acquisition of Forticom (holding popular social networking websites in the Baltics, Poland, Russia and other CIS countries)	Growth capital and subsequent further investment in Sanitas	Several rounds of venture capital from the Estonian Development Fund and a conglomerate of venture capital investors	Forming and raising Lords LB Baltic Fund I, the Lithuania-based private equity fund for investing in the Baltic real estate sector
Buyer's Legal Adviser	Legal Adviser	Legal Adviser	Legal Adviser
EBRD	**MTVP**	**BaltCap**	**SEB Venture Capital**
Acquisition of a 25.5% stake in West Ost Union, operator of Buslik retail chain	Sale of MTV Networks Baltic and Hostex	Acquisition of a minority stake in TREV-2	Equity investment in Viginta and subsequent acquisitions by Viginta of two regional cable TV companies in Lithuania
Buyer's Legal Adviser	Seller's Legal Adviser	Buyer's Legal Adviser	Legal Adviser
AAC Capital Partners	**Arco Capital Management**	**EBRD**	**MarkIT**
Acquisition of Empower	Acquisition of Hanseatic Capital, the largest mezzanine financing company in the Baltics and Poland	Acquisition and subsequent sale of a minority stake in LHV Asset Management	Private placement to Ambient Sound Investments
Buyer's Legal Adviser	Buyer's Legal Adviser	Legal Adviser	Legal Adviser

Awards and recognitions

SORAINEN is the only law firm awarded as the best Baltic M&A legal advisor by *The Financial Times & Mergermarket*. The award was presented to SORAINEN at the European M&A Awards in December 2008 for advising on the largest number of M&A (including private equity) transactions and for the largest total value in the Baltic States.

SORAINEN is an active member of various local associations and initiatives which aim to develop the private equity and venture capital industry in the Baltic States: the Estonian Venture Capital Association, the Latvian Private Equity and Venture Capital Association, the Lithuanian Venture Capital Association.

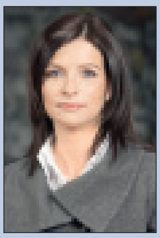
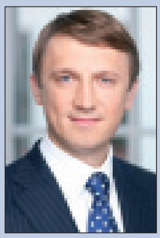
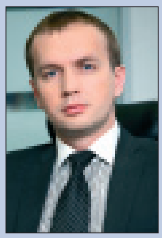
SORAINEN was also named "Baltic Law Firm of the Year" for two years in a row at the *International Financial Law Review* European Awards 2009 and 2010. SORAINEN received these awards for advising on the most complex and innovative international transactions in the areas of M&A, debt, equity and capital markets, project financing and restructuring.

Upon the initiative of SORAINEN, five largest Baltic law firms and alliances made the first Baltic M&A Deal Points Study in 2009, which was the first of the kind in the region. In 2010 similar study based on Baltic experience was organised in Belarus together with five local leading law firms – the first Belarusian M&A Deal Point Study and also the first of its kind in the CIS countries.Deal Point Study and also the first of its kind in the CIS countries.

M&A and Private Equity Team contacts

The regional head of the SORAINEN M&A and Private Equity Team is **Toomas Prangli**, whose contacts appear below.

Local heads of the SORAINEN M&A and Private Equity Team are:

ESTONIA	LATVIA	LITHUANIA	BELARUS
			
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Please note that the SORAINEN Baltic M&A and Private Equity Transaction Guide is compiled for general information only, free of any obligation and free of legal responsibility and liability. It was prepared on the basis of information publicly available on 1 March 2011. The Baltic M&A and Private Equity Transaction Guide does not cover laws or reflect all changes in legislation, nor are the explanations provided exhaustive. Therefore, we recommend that you contact SORAINEN or your legal adviser for further information.

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