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# *LEGAL ASPECTS OF ACQUISITIONS IN ESTONIA*

Similar to most European countries, the limited liability companies in Baltic states are divided into public limited companies and private limited companies. This article deals with legal aspects of company or business acquisitions in Estonia.

The two main types of acquisitions in Estonia are: (1) acquisition by way of business (asset) purchase, and (2) acquisition by way of share purchase.[1] The actual type of acquisition depends, of course, on the intentions of the parties, e.g. whether the investor is interested in the whole or part of the business of the target company, what are the outstanding liabilities of the target company, etc.

## *Transfer of Business*

Transfer of business enterprise, i.e. body of assets and liabilities, must be distinguished from the transfer of shareholding, i.e. transfer of the shares in a company. The Estonian Commercial Code defines business as an economic entity through which the company is operating. One company can have several enterprises, e.g. such structural entities like production plant, retail store, etc.

A transfer of business enterprise is usually undertaken when the buyer is not interested in some parts or liabilities of the company. In practice, the investor is mostly interested in certain assets, rights and goodwill of the target company and negotiates the price accordingly. Possible liabilities of the target company are sometimes disregarded. However, according to the Commercial Code, <u>upon transfer of assets that form a business enterprise, obligations related to the assets sold are also transferred to the buyer</u>. In result, buyer of the assets will be jointly and severally liable for the enterprise-related obligations of the seller which are created before the transfer of the enterprise and the due date of which arrives during 5 years after the transfer of assets. This applies even if the parties state otherwise in their contract. A similar regulation is included in Estonian labour law for the protection of employees in case of a business transfer.

The buyer of an business enterprise can reduce the above risk by obliging the seller to obtain a written consent from the main creditors stating that they agree to non-transfer of

[1] Should the foreign investor already have a subsidiary in Estonia, merger may also come under consideration. Cross-border mergers are not possible in respect to Estonian, Latvian and Lithuanian companies.
[2] The draft Law of Obligations Act (Võlaõigusseadus), however, prescribes a written form for the transfer of business.

their claim towards to the target company to the buyer. It is recommended to obtain the written consent before the closing of the acquisition deal.

There is no statutory requirement as to the form of the asset purchase.[2] However, if particular assets involved require a particular form of contract (e.g. transfer of real estate must be notarised), the entire purchase agreement needs to be in that form. Alternatively, the acquisition may be performed by different transactions in different forms. It should also be noted that public permits and licenses are not transferred upon sale of business enterprise and must be obtained by the acquiring company separately.

The transfer of business enterprise is not subject to any specific taxes, except for the value added tax in respect to the VAT-liable assets transferred.

## Transfer of Shares

If the shares in a company are acquired, the buyer acquires all rights and obligations as a shareholder of the company. The assets and liabilities of the company will not be modified, thus no "pick and choose" like in transfer of business. There are a number of procedural requirements that should be kept in mind:

(1) *Form of the transaction*. In case of private limited company (OÜ), the acquisition of shares requires a notarised share transfer agreement. In case of a public limited company (AS), a written share transfer agreement is sufficient.

(2) *Moment of transfer.* The parties are free to determine when the title to the shares shall be transferred. However, for the purposes of the target company (i.e. with regard to right to vote, right to dividends, etc.), the share shall be deemed to be transferred as of entry of the transfer into the list of shareholders (OÜ) or into the share ledger (AS).[3]

(3) *Pre-emptive rights of other shareholders.* If the buyer is not an existing shareholder of the target company and does not acquire 100% shareholding in the target company, the other shareholders of a private limited company (OÜ) have a pre-emptive right to purchase the shares, unless the articles of association of the target company provide otherwise. In case of a public limited company (AS), the shareholders have the pre-emptive right only if it is prescribed in the articles of association.

No value added tax nor other transfer taxes are applicable in case of share transfer.

## Due Diligence

In order to reduce the risks of possible adverse surprises, it is highly recommended to conduct a due diligence (legal, financial, management, environment or other) of the target company before closing the deal. In addition to acquisition by way of share purchase, legal due diligence is also important in case of acquisition of business enterprise, because certain obligations may be considered as transferred although the parties have not so foreseen in their contract. The extent and procedure of the due diligence as well as the grounds for adjustment of contemplated purchase price may be specified in the letter of intent or other pre-contract.

In addition to the standard due diligence checklist, there are certain specific issues that

[3] If a public limited company has issued bearer shares, title to the shares is transferred by handing over the share certificate. However, the new Securities' Central Register Act (*Väärtpaberite keskregistri seadus*) requires all Estonian public limited companies to exchange their bearer shares into registered shares by December 31, 2001, and register all of their shares with the central register by January 1, 2003.

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a foreign investor should consider when conducting a legal due diligence in Estonia:

(1) Due to the ongoing process of land reform, it should be investigated whether the target company has duly submitted the application to privatise the land and how far the privatisation process is. Companies where more than half of share capital belongs to foreign person cannot use privatisation vouchers and cannot pay by instalments for privatisation of land. Thus, it may be necessary to pursue the finalisation of the privatisation process already before the implementation of the acquisition of majority shareholding in the target company.

(2) Many companies have been privatised earlier based on a privatisation agreement between the state and private investors. A privatisation agreement usually includes strict reporting obligations, a business plan to be observed for a certain period (usually 5-10 years), retention of employment level obligation, etc. Also, a permission by the Estonian Privatisation Agency may be needed in order to transfer the shares or assets in a privatised target company.

(3) Due diligence is considerably new phenomenon in Estonia. Usually, the local seller and the management of the target company have a rather sceptical and repulsive attitude towards disclosure of information and documents regarding the company. Also, the management may find it difficult to compile the documentation according to the request, whereas a great amount of valid licenses, agreements keep appearing until the final stage of the due diligence.

(4) Due to the youth of Estonian commercial legal system, the corporate documentation of the target company is often defective. Sometimes even a share ledger is not kept for a target company.

(5) Estonian companies have not yet paid much attention to the legality of the intellectual property used in their business. However, the police together with software companies are imposing stricter scrutiny over the use of software.

(6) Very few environmental audits were carried out during the soviet era and the target companies do not often have an overview of possible contamination on their land or of the pollution caused by their business activities. Nevertheless, the governmental and municipal bodies impose stricter scrutiny over the company after the company is controlled by a foreign investor.

## Competition Matters

Transfer of majority shareholding, or acquisition of control over the company by some other means, is considered as merger for the purposes of Estonian competition law. Thus, acquisition by way of share purchase is subject to merger control but the acquisition by way of business (asset) purchase is not.

The merger control in Estonia is currently limited only to informing the Competition Board about the merger/acquisition. The Estonian Competition Board does not yet have a power to ban the merger. However, the threshold of providing information to the authorities is quite low:

(1) the aggregate annual turnover of the merging companies (including other companies in the companies' group) exceeds EEK 100 million (approximately EUR 6,4 million); or

(2) the merging parties separately or jointly have control over more than 40 per cent of the relevant market.

The acquisition may not be implemented before the Competition Board has confirmed that it has received all the information prescribed by law. In 1999, the Estonian Competition

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Board received 39 merger notifications and in 2000 there were 29 notifications, most of which involved foreign investment.

In the draft new Competition Act (*Konkurentsiseadus*), the term “concentration control” is used instead of the “merger control” and the acquisition by way of business purchase will also be subject to the concentration control. Under the draft act, the Competition Board can ban the concentration, but the threshold of the concentration control will be increased so that the aggregate annual turnover of the merging companies must exceed EEK 500 million (approximately EUR 32 million) and at least two of the merging parties have annual turnover exceeding EEK 100 million, whereas at least one of the companies does business in Estonia.

In conclusion, the legal aspects of acquisitions in Estonia are not very different from those in the European Union countries and there are no special restrictions on foreign capital. Nevertheless, certain disparities occur mainly due to the transition from the former soviet block. Although the local legal rules do not usually surprise the foreign investor, the enforcement of such rules is considerably weak and diverse due to lack of court and administrative practice in the field.

Sorainen Law Offices have during recent years counselled almost 100 acquisitions in Estonia, Latvia and Lithuania.

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