

MARKO PIKANI, MARIANA HAGSTRÖM, ERIK SALUR &
RASMUS ÕISMA

CORPORATE
ACQUISITIONS
AND MERGERS
IN ESTONIA



Wolters Kluwer

Corporate Acquisitions and Mergers in Estonia

Marko Pikani

Mariana Hagström

Erik Salur

Rasmus Öisma

TEDER Law Firm

This book was originally published as a chapter in Corporate
Acquisitions and Mergers.

General Editor: Peter Begg



Wolters Kluwer

Published by:

Kluwer Law International B.V.
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.wolterskluwerlr.com

Sold and distributed in North, Central and South America by:

Wolters Kluwer Legal & Regulatory U.S.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@wolterskluwer.com

Sold and distributed in all other countries by:

Quadrant
Rockwood House
Haywards Heath
West Sussex
RH16 3DH
United Kingdom
Email: international-customerservice@wolterskluwer.com

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Printed on acid-free paper

ISBN 978-90-411-8988-2

This title is available on www.kluwerlawonline.com

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Printed and Bound by CPI Group (UK) Ltd, Croydon, CR0 4YY.

TEDER Law Firm

TEDER Law Firm is a newly established firm made up of experienced and notable practitioners from former well-established firm Glikman Alvin & Partners. Our team consists of experienced multilingual proactive legal experts ready to meet the demanding challenges of the local and international regulatory and business environment. Law Firm TEDER has several renowned cooperation partners in a network of European and other international law firms, ensuring the best counsel for our clients wherever they do business.

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Working languages are Estonian, English, Finnish and Russian.

For further information on TEDER Law Firm, please contact Mariana Hagström or Marko Pikani on +372 663 1700.

TEDER Law Firm (Advokaadibüroo Teder OÜ)
Liivalaia 45, 13th floor
10145 Tallinn

Estonia
Tel.: +372 663 1700
E-mail: info@tederlaw.ee

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LOCAL ECONOMIC, POLITICAL AND CULTURAL ASPECTS

Population, Language, Currency

[01] The population of the Republic of Estonia is 1.28 million and the population density is approximately thirty inhabitants per square kilometre. Sixty-seven per cent of the Estonian population lives in urban areas.

[02] The capital of Estonia is Tallinn, which is the largest city with a population of approximately 414, 000. Thus, approximately 30% of the population lives in Tallinn. The second largest city is Tartu with a population of approximately 97, 000.

[03] The national language of the Republic of Estonia is the Estonian language and approximately 69% of the population are native Estonian speakers. Russian is also widely spoken, approximately 25% of the population being native Russian speakers.

[04] Estonia adopted the euro ('EUR') as its official currency on 1 January 2011.

Government and Political System

[05] Estonia is a parliamentary representative democratic republic. Estonia declared independence on 24 February 1918. Estonia maintained its independence until 1940, following which Estonia was occupied by the Soviet Union, and thereafter (1941-1944) temporarily also by Germany. The long Soviet period ended and formal independence was declared on 20 August 1991, and the pre-1940 state was reconstituted.

[06] The Parliament of Estonia (Riigikogu) has 101 members in a single chamber. The legislative branch is elected by citizens for a four-year term by proportional representation. The most recent parliamentary elections took place in 2015. The Prime Minister is Mr Taavi Rõivas. The multiparty Government of the Republic of Estonia is formed by the Prime Minister.

[07] The President of the Republic of Estonia is the head of state. The President is elected by the Parliament (or in certain cases provided for by law, by a special electoral body), for a five-year term. The current President of the Republic of Estonia is Mr Toomas Hendrik Ilves who was re-elected in 2011. The new President will be elected in August-September of 2016.

[08] Estonia has been a Member State of the United Nations since 1991 and of NATO and the European Union since 2004. Since the early 1990s, Estonia has been involved in active trilateral Baltic states cooperation with Latvia and Lithuania. Estonia has been a member of the Schengen area since 2007.

Overview of the Legal System

[09] The Estonian legal system is a civil law system and follows the legal traditions of continental Europe. The main source of law is statutory law (case law is often cited in court proceedings by both attorneys and courts, but is not technically considered as a direct source of law). The hierarchy of national legislation is as follows:

- (i) The Constitution (passed on 28 June 1992).
- (ii) Laws, i.e., the legislation passed by Parliament (Riigikogu).
- (iii) Decrees issued by the President of the Republic of Estonia (the President issues decrees only when there is an urgent national need and the Parliament is unable to convene).
- (iv) Regulations and orders issued by the Government of the Republic and regulations issued by the ministers – these acts can be issued only on the basis of and in compliance with the laws.
- (v) Local government legislation.

[10] Legislative power rests with Parliament. Under Article 103 of the Constitution of the Republic of Estonia, the right to initiate legislative proposals rests with Members of Parliament, Parliamentary political groups, Parliamentary committees, the Government of the Republic and the President of the Republic. However, the President of the Republic may only initiate amendments to the Constitution of the Republic of Estonia. Parliament debates draft legislation and decides whether to adopt it into law or to reject it.

[11] The legislative process in the Estonian Parliament comprises the following stages:

- (i) initiation of draft legislation;
- (ii) examination of draft legislation;
- (iii) adoption of draft legislation.

[12] The number of Members of Parliament required to vote in favour of a law to be adopted is laid down in Articles 73 and 104 of the Constitution of the Republic of Estonia. Based on the necessary quorum, the legal acts are categorized as:

- (i) Constitutional laws, i.e., acts requiring an absolute majority of the Members of Parliament (more than half of the total of all 101 Members of Parliament must vote in favour of adopting the law).
- (ii) Ordinary laws.

[13] The President of the Republic proclaims the laws adopted by Parliament or refuses to do so. In the latter case, the President of the Republic returns the law, together with his justification for doing so, to Parliament for a new debate and decision.

[14] The laws and most important legal instruments and international agreements are published in the electronic state gazette (Riigiteataja) available on the web page: www.riigiteataja.ee. Laws and regulations gain legal force only if they have been published in the state gazette.

[15] In accordance with Article 3(1) of the Constitution of the Republic of Estonia, generally recognized principles and rules of international law are also an inseparable part of the Estonian legal system.

[16] Estonia is a Member State of the European Union and therefore Estonia is also bound by the legislation of the European Union. The Constitution of the Republic of Estonia Amendment Act (passed on 14 September 2003) enacts the principle of the primacy of the law of the European Union. According to Articles 1 and 2 of the said law, Estonia may belong to the European Union, provided the fundamental principles of the Constitution of the Republic of Estonia are respected; and the Constitution of the Republic of Estonia is applied without prejudice to the rights and obligations arising from the Accession Treaty.

[17] The rulings of the European Court of Justice are also relevant because they are part of the body of European Union law.

[18] The Estonian court system is divided into three levels: courts of first instance (county courts and administrative courts), courts of appeal (circuit courts) and the Supreme Court located in Tartu which also functions as a constitutional court.

Current Economic Aspects

[19] In 2015, the total GDP in Estonia at current prices was EUR20.15 bn and the GDP per capita was EUR13 589. According to Eurostat, Estonia had the lowest ratio of government consolidated debts to GDP among EU countries at 6.7% at the end of 2010. In the year 2012, the same figure was 10.1%.

[20] In June 2016, CPI inflation was 3.78%. After the 2008-2009 recession, the economic situation stabilized in 2010 and started a growth based on strong exports.

[21] Estonia today is mainly influenced by developments in Finland, Sweden, Latvia, Lithuania, Russia and Germany – the main trade partners of Estonia. Embargo instated by the government of Russian Federation has also influenced Estonian economy, with the most apparent negative effects to dairy product producers.

[22] Estonia has credit ratings from Fitch Ratings, Moody's and Standard & Poor's. Fitch's credit rating for Estonia stands at A+, Moody's rating is A1 and Standard & Poor's credit rating is AA-.

[23] A balanced budget, almost non-existent public debt (lately though some economic experts have argued that fiscal policy of the state is too conservative and is holding back economic growth), a flat-rate of income tax, a free trade regime, a competitive commercial banking sector, innovative e-services, e-residency and even mobile-based services are all hallmarks of the Estonian market economy.

Main Industries

[24] The main fields of Estonian economic activities are manufacturing, wholesale and retail sales and services, real estate activities, transport and storage and construction.

[25] Estonia produces a substantial amount of the electricity it consumes, and the majority of this is generated from locally mined oil shale. Alternative energy sources such as wood, peat and biomass are also used.

[26] Estonia has a strong information technology sector, partly due to the *Tiigrihüpe* project undertaken in mid-1990s, and has been mentioned as the most ‘wired’ and advanced country in Europe in terms of e-government. The start-up industry has grown exponentially over the last decade. Skype, written by Estonia-based developers, has become the symbol of Estonian information technology sector. The high level of internet penetration, technical education and the influence of Skype have led to the growth of start-up companies, such as Taxify, GrabCAD and TransferWise, all founded in Estonia. In March 2016, TransferWise was valued at USD1.1 bn. In 2015, the company received over USD58 mn in funding and the funding by venture capital firms is over USD116 mn in total. Other big investments into start-up companies include AdCash, a worldwide advertising platform, which has received over USD26 mn in funding, Fortumo and Lingvist, which have both received funding around USD10 mn. Other notable Estonian start-ups include Jobbatical, an international job matching site for tech companies and workers, Pipedrive, a cloud-based sales software company and fits.me, a virtual ‘fitting room’ for online clothing retailers. Fits.me was acquired by Japanese online retailer Rakuten in 2015 for undisclosed amount. Highly appraised for their innovative energy storage solutions, developer and producer of ultracapacitors – Skeleton Technologies – will open a second manufacturing plant after an additional EUR13 mn investment in Germany in 2017 and the company is expected to grow into a worldwide industry leader by 2025. To summarize developments on the market in 2015 and first 2 quarters of 2016 it may be said that the M&A market in Estonia became more and more active (pursuant to a study compiled by Tark Grunte Sutkiene in 2015 there were twenty more M&A transactions than the year before). The lead on this growth was in large part facilitated by tech companies and successful start-ups.

[27] Of all Estonian exports approximately 28% is machinery and appliances. Other important export articles are mineral products, agricultural products and food, metals and metal products, wood and articles made of wood. The main imports include machinery and appliances, mineral products, agricultural products and food, transport equipment, chemical products and metals and products thereof. The most significant export and import partners of Estonia are Finland, Sweden, Russia, Latvia and Lithuania.

[28] According to Statistics Estonia, in 2015 the exports of goods from Estonia at current prices totalled EUR11.6 bn and imports EUR13.1 bn. In 2015 exports of goods increased by 4% and imports by 5% compared to 2014. In 2015, 75% of Estonia’s total trade was with EU member countries.

Geographical and Cultural Aspects

[29] Estonia is a state in the Baltic region of Northern Europe. It is bordered to the north across the Gulf of Finland by Finland, to the west across the Baltic Sea by Sweden, to the south by Latvia and to the east by Russian Federation.

[30] Estonia is known for its marshes and bogs, its e-government, e-residency and its song festival called Laulupidu, which is one of the largest amateur choral events in the world.

[31] Estonia is highly ranked for the quality of its education system, well above the OECD average. Around 89% of Estonian adults aged 25-64 have earned the equivalent of a high-school degree, one of the highest rates in the industrialized world. Compulsory school attendance in Estonia begins at the age of 7 and lasts until completion of basic education, which covers the grades 1-9 or up to the age of 17. Basic education is funded by the state budget and by local government.

[32] In the first quarter of 2016 more than 60% of people aged 15-74 in Estonia had a paid job. In the first quarter of 2016, the unemployment rate was 6.2%.

REGULATORY FRAMEWORK

Overview of Estonian Corporate Law

Laws, Regulations, Guidelines

[33] The main source of Estonian corporate law is the Commercial Code (passed on 15 February 1995, as amended) regulating the sole proprietorships and business entities, such as general partnership, limited partnership, private limited company and public limited company. Also, it serves as a general basis for the commercial associations which are regulated in detail in the Commercial Associations Act (passed on 19 December 2001, as amended).

[34] In Addition, the Trading Act (passed on 11 February 2004, as amended) and the Securities Market Act (passed on 17 October 2001, as amended) form an important part of the legislation regarding the Estonian commercial law. In some areas of activities, such as finance, insurance, etc., special laws provide additional requirements for the companies.

[35] Also, there are several procedural laws that have relevance in the economic activities, such as the Register of Economic Activities Act (passed on 11 February 2004, as amended) and the General Part of the Economic Activities Code Act (passed on 23 February 2011, as amended).

[36] The General Part of the Economic Activities Code Act replaced as of 1 January 2014 the previous Register of Economic Activities Act (passed on 11 February 2004, as amended) and it is the main and general act regulating most of the economic activities and will establish the general conditions and procedure for exercising the freedom of economic activity, it will regulate the commencement, pursuit, termination and resumption of economic activities, the maintenance of a register, state supervision and liability.

[37] Additionally, the main principles of civil and contract law such as the principles of good faith, reasonableness, freedom of contract and *pacta sunt servanda*, as

regulated mainly by the General Part of the Civil Code Act (passed on 27 March 2002, as amended) and the Law of Obligations Act (passed on 26 September 2001, as amended), are also applied to the corporate relationships.

[38] The strongest influence on the development of the Estonian civil law system has been the German civil law system; however, also the Dutch, Swiss and Austrian civil codes and the Principles of European Private Law were used as models for Estonian post-soviet civil law (since during the soviet era there was no private property most of the legislation became useless after independence was regained and laws needed to be newly drafted).

Different Forms of Trade or Business

[39] Business in Estonia may be carried out either in a form of a sole proprietorship (natural person who offers goods or services for charge in his or her own name where the sale of goods or provision of services is his or her permanent activity) (in Estonian: *füüsilisest isikust ettevõtja* abbreviated as FIE) or through business entity, i.e., companies, which are created by entry into the Estonian Commercial Register (in Estonian: *äriregister*).

There are five types of business entities in Estonia:

- (i) a private limited company (in Estonian: *osäühing* or *OÜ*);
- (ii) a public limited company (in Estonian: *aktsiaselts* or *AS*);
- (iii) general partnership (in Estonian: *täisühing* or *TÜ*);
- (iv) limited partnership (in Estonian: *usaldusühing* or *UÜ*); and
- (v) commercial association (in Estonian: *tulundusühistu*).

[40] These companies are registered in the Estonian Commercial Register and are seen as separate legal entities or legal persons.

[41] Additionally, non-profit associations (in Estonian: *mittetulundusühing*) and foundations (in Estonian: *sihtasutus*) could be established for the purposes of non-profit activities, but may also be engaged in business activities. Non-profit associations and foundations are also registered in a state register – the Non-profit Associations and Foundations Register and are likewise seen as legal persons governed by private law. Non-profit associations and foundations will not be dealt with further in this overview.

[42] A foreign company may also undertake business activities in Estonia via a branch office, without setting up a separate company under the Estonian law. A branch must also be registered in the Estonian Commercial Register, but the branch does not obtain a status of a legal person. There are no requirements concerning the minimum capital of a branch – the parent company is fully responsible for all debts of its branch.

[43] As said above, business can also be conducted as a sole proprietorship (in Estonian: *füüsilisest isikust ettevõtja*), which, although registered in the Estonian Commercial Register, is not considered a separate legal entity. The same applies to joint ventures, which are not regulated by law. Joint ventures may result from shareholders' agreements, joint projects and various pooling arrangements between enterprises.

[44] In general, the form of a business in Estonia may be freely chosen among those as currently recognized and regulated by law. In certain regulated areas, such as financial services and insurance services, this choice is restricted to certain corporate forms.

[45] The most popular form of business in Estonia is overwhelmingly the private limited company. Out of a total of 200 729 enterprises and traders registered in the Estonian Commercial Register by the end of March 2016, 157,654 were private limited companies and 3,452 public limited companies, compared with 32, 068 sole proprietorships. Further, also 2, 726 limited partnerships, 2, 539 general partnerships, 1, 703 commercial associations and 553 branch offices had been registered with the Estonian Commercial Register.

[46] Hereinafter in this overview we concentrate to the limited liability companies that are the most common forms to conduct business in Estonia.

Limited Liability Companies

General Principles of Limited Liability Companies

[47] Limited liability companies are most common in Estonia, constituting nearly 97% of all registered companies. There are two possible forms for limited liability companies: private limited companies (in Estonian: *osaühing* or *OÜ*) and public limited companies (in Estonian: *aktsiaselts* or *AS*).

[48] The share capital of both private and public limited company is divided into shares and the liability of the shareholders of a limited liability company is limited with their contributions to the company.

[49] Generally, for the small and medium sized enterprise it is easier to conduct business activities through the form of a private limited company, whereas for an enterprise with a considerable list of shareholders who wish to issue listed securities on the exchange market, the formation of a public limited company is necessary.

[50] A limited liability company can be established by one or more founding shareholders who can be either legal entities or private individuals.

[51] As said above, the principle of freedom of contract is also applicable in the corporate relationships, including in the relations between the shareholders of a company. The shareholders may agree on different matters regarding the company, except for the imperative terms and conditions provided in the Estonian Commercial Code, and in case of companies with more than one shareholder, the conclusion of shareholders' agreements is rather common in Estonia. According to the Estonian law, the shareholders' agreements are considered as agreements under the contract law, and not under the corporate law, and therefore are binding only upon the parties. A breach by a party of such an agreement has consequences only to the contractual parties.

[52] Additionally, it should be noted, that there are certain areas of activities which require a licence or activity permit (e.g., certain financial services, medical, transport, postal, etc. services) and other areas of activities which do not require a licence or

activity permit, but still require registration in the Register of Economic Activities (e.g., area of trade, accommodation and tourism services, building services, mining, fire safety, etc.). Therefore, when deciding on establishing a company and conducting business in Estonia, it is important to ascertain whether an activity permit or registration is required to conduct the planned business.

Private Limited Company

Incorporation

Incorporation Documents

[53] For the establishment of a private limited company a memorandum of association (or in case of one founder the foundation resolution) must be signed by founders or their representatives and this must be notarized.

[54] The memorandum of association of a private limited company shall set out:

- (i) the business name, registered office and address of the company being founded;
- (ii) the name and residence or registered office of the founder(s);
- (iii) the amount of share capital and procedure for payment of share capital contributions (time and place of payment);
- (iv) the nominal value and number of shares and their division among the founders;
- (v) if a share is paid for by a non-monetary contribution, the item of the non-monetary contribution and its valuation method;
- (vi) information on the members of the management board and, if a supervisory board is formed, on its members; and
- (vii) information on procurators or auditors (if appointed).

[55] The company's articles of association must be attached to the memorandum of association. The minimum contents of the articles of association shall include:

- (i) the business name and registered address of the company;
- (ii) the amount of share capital which may be specified as a specific amount or as a minimum and maximum capital such that the minimum capital shall be at least one-quarter of the maximum capital;
- (iii) the procedure for payment for shares;
- (iv) the specific rights pertaining to a share, or those of a specific shareholder, in case the specific rights pertaining to a share are prescribed and various classes of shares are issued. The articles of association shall specify the designation of various classes/types of shares and the specific rights pertaining to a class/type of shares;
- (v) if a share is paid for by a non-monetary contribution, the valuation method of the non-monetary contribution;
- (vi) the formation and amount of legal reserve;
- (vii) the number of members of the management board and, if there is a supervisory board, the number of members thereof, which may be expressed as a specific number or a maximum and minimum number; and
- (viii) if necessary, the specifications for the right of representation of the members of the management board.

[56] The articles of association may also prescribe other terms and conditions which are not in conflict with the law. If a provision of the articles of association is in conflict with a provision of law, the provision of law shall apply.

Share Capital and Payment of the Subscription Price

[57] The minimum share capital of a private limited company is EUR2 500, with the minimal nominal value of one share being EUR1.

[58] Each shareholder may have one share of the same class, unless otherwise provided by law. In case of acquisition of an additional share of the same class, the nominal value of the share of this class shall increase accordingly. The merger of the shares shall not take place in case the initial share and the additional share acquired by the shareholder are encumbered by different rights and the parties concerned do not agree in a notarized form on the type of further effect of the rights encumbering the shares.

[59] As a general rule, the founders shall pay for the shares in full before submission of an application for entry of the private limited company in the Commercial Register. However, the memorandum of association may prescribe that the founders are not required to pay for the share upon the foundation of the private limited company, provided that:

- (i) the founders of the private limited company are natural person(s); and
- (ii) the planned share capital of the company is not larger than EUR25 000.

[60] In the aforementioned case, until the shareholder has completely paid the contribution under the memorandum of association, the shareholder shall be liable to the private limited company for the obligations of the private limited company in the amount of the outstanding contribution, unless the obligation of the private limited company can be performed on the account of the assets of the private limited company. Additionally, until the complete payment of the contributions by all the shareholders, the private limited company shall neither increase nor decrease the share capital and, in addition, the private limited company shall not make any disbursements to the shareholders.

[61] A subscription price shall be paid by monetary or non-monetary contribution.

[62] A share shall be paid for in money, unless the articles of association prescribe payment by a non-monetary contribution.

[63] The subscription price in cash is to be paid into an account of the company to be opened in an Estonian credit institution.

[64] A non-monetary contribution may be any thing which is monetarily appraisable and transferable to the company or a proprietary right which may be the object of a claim. However, service or work provided to the company or the activities of the founders in the foundation of the company cannot be accepted as a nonmonetary contribution.

[65] If the subscription price is paid in full or in part by non-monetary contribution, the sufficiency of the value of the object of the contribution for the nominal value of the share of the shareholder obliged to make the non-monetary contribution shall

be valued by the management board of the company. The usual (market) value of a thing or right shall be taken as the basis for the valuation of a nonmonetary contribution. If the share capital of the company is at least EUR25 000 and the value of a non-monetary contribution exceeds one-tenth of the share capital or if all non-monetary contributions of such company collectively form more than one-half of the share capital, the valuation of the non-monetary contribution shall be verified by an auditor.

Registration in the Estonian Commercial Register

[66] A private limited company becomes fully incorporated upon registration in the Commercial Register. To register the company in the Commercial Register a notarized application signed by all members of the management board of the private limited company must be submitted.

[67] The memorandum of association, articles of association, as well as other documents required by the law shall be appended to the application. Documents in foreign language shall be submitted to the Commercial Register together with notarized translation into Estonian and the state fee must be paid in full before submitting an application.

[68] The company will not be entered in the Commercial Register, if the application for entry in the register is submitted later than one year after the date of conclusion of the memorandum of association.

[69] If the required documents are submitted and the Commercial Register has established that the submitted documents meet the requirements, then the registration of a private limited company takes up to five working days.

Incorporation of a Private Limited Company in an Expedited Procedure

[70] Additionally to the incorporation pursuant to the general procedure as described above, a private limited company may, under certain conditions, also be incorporated in an expedited procedure. In the expedited procedure, an application for entry shall be reviewed by the register and the incorporation resolution shall be made not later than during the next working day after the date of receipt of the application. This means that in case of such intention, it is possible in Estonia to establish the private limited company with two days only, in practice often the entry to the register is made even within one day.

Private limited company can be established in the expedited procedure, provided that:

- (i) the standard form of the articles of association provided in the Commercial Code is used (i.e., no specific regulations are used);
- (ii) the shares of the company will not be registered in the Estonian Central Register of Securities (ECRS);
- (iii) only monetary contributions are made into the share capital and such contributions are transferred to the deposit account of the registrar or the account specified in the Money Laundering and Terrorist Financing Prevention Act (passed on 19 December 2007, as amended), except when the procedure for the foundation of a private limited company without making contributions is chosen (as was described above);