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A practical insight to cross-border Mergers & Acquisitions

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Chapter 20

Latvia


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1 Relevant Authorities and Legislation

1.1 What regulates M&A?

The public stock exchange market in Latvia is rather underdeveloped and a considerably small number of companies have decided to become publicly traded (currently around 40). Therefore, the major part of M&A transactions in Latvia take place as private acquisitions, and public takeover transactions are almost non-existent (due to the comparably small public shareholder base of such publicly traded companies). Most public companies are companies which were "forced" to become public by means of and through the privatisation procedure. Thus far, public takeover mechanisms like voluntary share buy-out offers have been used by market players primarily to increase their existing shareholding and to decrease/eliminate the minority shareholder base.

Private acquisitions are primarily regulated by the Commercial Law (*Komerclikums*) and Group of Companies Law (*Koncernu likums*). The public takeover process is primarily regulated by the Financial Instruments Market Law (*Finanšu instrumentu tirgus likums*), Finance and Capital Market Commission Law (*Finansu un kapitala tirgus komisijas likums*) and the Commercial Law. More detailed provisions regarding the public takeover process can be found in the regulations of the Finance and Capital Market Commission (*Finanšu un kapitala tirgus komisija*) ("FCMC"), the regulations of the Riga Stock Exchange (*Rigas Fondu bir a*) and the regulations of the Latvian Central Depository (*Centralais depozitarijs*).

1.2 Are there different rules for different types of public company?

No legal distinction has been drawn and the rules do not differ depending on whether the company is/has been traded in Latvia or outside Latvia.

1.3 Are there special rules for foreign buyers?

There are no special rules or restrictions for foreign buyers.

1.4 Are there any special sector-related rules?

Different rules may apply depending on the business sector in which the company is engaged; e.g. regulated market participants like credit institutions, insurance services providers, etc. will be subject to specific regulatory frameworks under the Credit Institutions Law (*Kreditiesta u likums*) and the Insurance Companies and Their Supervision Law (*Apdrošinašanas sabiedribu un to uzraudzibas likums*), etc.). Specific rules apply in regulated sectors like financial institutions and insurance companies, setting forth special thresholds and criteria for the determination of significant participation (which triggers the necessity to obtain approval from the FCMC), special qualifying criteria for the shareholders of such targets, etc.

1.5 What are the principal sources of liability?

The Financial Instruments Market Law prohibits insider dealing, as well as market manipulations (including distribution of false or misleading information in relation to the target's price). In the case of a breach, the FCMC may, *inter alia*, suspend trading with the target's shares, suspend the operations of the financial instruments market participant for a term of up to 6 months, impose a penalty of up to 10,000 Lats, etc. The person liable for insider dealing or market manipulations can also become subject to civil liability - the investors may claim compensation of damages in civil proceedings under the Financial Instruments Market Law and the Civil Law (*Civillikums*). In relation to the consequences of failure to comply with the notification requirements or requirements to make a mandatory share buy-out offer, see the answer in question 5.1 below.

2 Mechanics of Acquisition

2.1 What alternative means of acquisition are there?

In some cases, the merger can be considered as an alternative to an acquisition. Thus far, however, there have been no cases of mergers with a Latvian publicly traded company involved. The merger procedure is more complex and subject to high thresholds of shareholder consent (at least a ¾ majority vote is required). Minority shareholders voting against the merger shall be entitled to claim buy-out of their shares (to be requested within 2 months after the date of merger).

2.2 What advisers do the parties need?

There are no established rules to follow. Normally, the bidder will act through its investment bankers/brokers. Depending on the scope of the transaction, external legal and financial advisers may also be involved.

2.3 How long does it take?

The first stage is the preparation of the document package and application for approval of the voluntary buy-out offer with the FCMC. Formally, the FCMC has to provide its approval or rejection within 10 days after all the necessary documents are submitted by the potential offeror. In practice, the timing may vary depending on a variety of factors (like the scope of the planned takeover transaction, the target, the identity of the potential offeror, etc.).

Within 5 business days after the receipt of FCMC approval, the offeror has to publish the offer in the Official Gazette "Latvijas Vestnesis". The term of the offer can be determined as between 30 and 70 days, at the discretion of the offeror. Share purchase transactions must be closed within 5 days from the expiry of the offer term.

Important factors that may affect timing are clearance from the competition authorities (e.g., clearance from the Latvian Competition Council may take up to 4 months), and receipt of approvals from the other (sector-specific) regulatory authorities, if any.

2.4 What are the main hurdles?

The main hurdles are general approval by the FCMC and, where necessary, clearance by the competition authorities.

2.5 How much flexibility is there over deal terms and price?

The law or regulations do not set forth any requirements regarding the minimum or maximum offer prices; therefore, this is fully at the discretion of the bidder.

The principal requirements to be observed are as follows:

- the validity term of the offer may not be less than 30 days and may not exceed 70 days;
- the offeror must set forth either the maximum or minimum number of target shares which are subject to buy-out offer; and
- the minimum (qualifying) target of the voluntary share buy-out offer must reach a 10% participation share in the target.

Where the offeror sets forth the maximum number of target shares, and the number of shares offered for sale is higher than the maximum, the offeror shall buy the shares in proportion from all persons offering their shares for sale.

Where the offeror indicates the minimum number of target shares which should be subject to a buy-out offer, it must be clarified whether the offer remains valid if the minimum threshold is not achieved. The offeror may only refuse to purchase the shares offered for sale if it has clearly indicated that the buy-out offer will become invalid if the minimum threshold is not reached.

2.6 What differences are there between offering cash and other consideration?

There are no major differences. If other financial instruments are offered as consideration additionally to the cash, the emission prospectus should contain the description of such financial instruments (e.g. bonds) and the respective transfer / exchange procedures.

2.7 Do the same terms have to be offered to all shareholders?

The offeror has to offer equal terms for all target shareholders holding shares of the same category (i.e. terms can only be different in relation to different categories of shares).

2.8 Are there any limits on agreeing terms with employees?

There are no specific statutory employee consultation and approval requirements applicable in the context of public takeover transactions. The offeror is required, *inter alia*, to describe in the offer prospectus its plans in relation to the employment matters of the target company (i.e. whether or not it plans to reduce the staff, what (if any) will be the potential consequences of the successful transaction on the employment in the target, etc.).

2.9 What documentation is needed?

The person intending to make a voluntary share buy-out offer has to apply to the FCMC, submitting a respective application accompanied by the following documents:

- offer prospectus;
- copy of the offeror's registration certificate (in the case of a legal entity - non-resident); and
- document(s) certifying sufficiency of funding for the offer (for example, a commitment letter issued by a credit institution or insurance company certifying the availability of funding necessary to comply with the offeror's commitments against the target's shareholders).

The primary document is the offer prospectus containing the terms and conditions of the offer (term, price, procedure for acceptance of the offer, applicable law, etc.).

2.10 Are there any special accounting procedures?

There are no particular financial disclosure and reporting procedures that should be complied with by the bidder to make a voluntary share buy-out offer.

2.11 What are the key costs?

Generally, the key costs would be the consultants'/advisers' fees. There are no material State duties or similar payments to the authorities to be made for the purposes of the share buy-out offer.

2.12 What consents are needed?

The share buy-out offer can only be issued after the receipt of approval of the FCMC. If the transaction is subject to clearance by the competition authorities, the respective approval should be obtained from the Latvian Competition Council prior to implementation and/or, where applicable, from competition authorities of other countries/EU authorities.

2.13 What levels of approval or acceptance are needed?

Generally, no statutory target shareholders' approval or acceptance is required for an acquisition. A merger is subject to the approval of at least a ¾ majority of the target's shares with voting rights represented at the meeting (unless the charter of the target company provides for a higher threshold, in which case such higher threshold shall apply).

2.14 When is the consideration settled?

As a general rule, the payment of consideration in relation to public emission shares takes place simultaneously with the transfer of shares. The same rule is respectively applied to the transfer of closed emission shares, to the effect that title to the shares passes from the seller to the purchaser by payment of consideration. The management board of the target makes the respective entry in the shareholders' register on the basis of the documents certifying payment. Details of payment procedures shall be provided in the offer prospectus.

3 Friendly or Hostile

3.1 Is there a choice?

Latvian law does not distinguish between friendly and hostile transactions. In both cases, the bidders will be subject to and will have to abide by the same regulatory framework.

3.2 How relevant is the target board?

Formally, the target board's opinion is not essential for making a successful buy-out offer; however, in practice its opinion and activities may to some extent influence the process and outcome of the planned transaction. Thus, the board is required to prepare and publish: its opinion on the offer (within 5 business days after the respective offer is announced); the estimate/evaluation of the offer (and its potential results) on the interests of the company (in particular - employment issues); as well as an opinion on the offeror's strategic plans in relation to the target company and the effects of those plans on the company and employment issues. The board may summon an extraordinary shareholders' meeting to decide on potential counter-measures; it may also (without summoning the general meeting) take actions to seek alternative offers. Apart from that, however, the board of the target is prohibited from any actions or omissions that may hinder the buy-out offer process.

3.3 Does the choice affect process?

In practical terms, a hostile approach would result in potential counter-measures launched by the board/shareholders of the target (e.g., an alternative/competing offer) being more likely.

4 Information

4.1 What information is available to a buyer?

In the case of a public takeover, where no information is provided by the target, the scope of information would primarily be limited to "public information", i.e. information required to be disclosed by the applicable laws (e.g. annual accounts of the company); information contained in public registries (Commercial Register of the Republic of Latvia containing all material corporate information on the company, the Land Register containing information on the real estate owned, etc.); and the information disclosed by the company to the market organiser in accordance with its respective regulations, and published by the market organiser (e.g. interim financial/business reports, information on any material events/circumstances affecting the target/its business, etc.).

4.2 Is negotiation confidential?

The laws do not contain any specific guidelines as to the rights and responsibilities of the management board to engage in and conduct negotiations with the potential offeror/purchaser of the company's shares. Whereas the board is subject to the general duty of care and the potential takeover may qualify as a material event affecting the interests of the target company and its shareholders, it can be expected that the board would elect to take a careful approach, i.e. it would not engage in any confidential negotiations regarding the potential takeover transaction.

Generally, there are no restrictions regarding the negotiations with the shareholders of the target (provided that insider dealing rules are complied with), and, as a general rule, shareholders are not subject to mandatory disclosure requirements (unless the respective shareholder is a public company itself).

4.3 What will become public?

There are no specific requirements regarding disclosure of information about prior negotiations or transfer of information between the bidder and the target.

4.4 What if the information is wrong or changes?

Latvian law does not provide for an option to cancel or otherwise invalidate the share buy-out offer on the basis of incomplete or false information on the target. The offeror may, however, apply to the FCMC with the request to cancel a buy-out offer on the basis of breaches of legal requirements/law or on the basis of circumstances out of the control of the offeror qualifying as force majeure (i.e. the share buy-out offer can be cancelled but only by the decision of the FCMC).

In any case, such circumstances may serve as the basis for a civil liability claim for the compensation of damages.

5 Stakebuilding

5.1 Can shares be bought outside the offer process?

Shares can be bought outside the offer process. Generally, there are no limitations. However, upon reaching certain thresholds, the acquirer of shares becomes subject to certain statutory obligations:

1) When the total amount of target shares, whether directly or indirectly acquired, **reaches thresholds of 5%, 10%, 25%, 50%, 75% or 95%** of the total amount of shares with voting rights, the acquirer should within 5 business days **notify** the market organiser and the target's management board. This requirement applies irrespective of whether the shares acquired are fully or partially public emission shares or closed emission shares. The market organiser immediately publishes such information on its Internet homepage. The Management Board of the target company, not later than within 7 business days after the receipt of notice, makes it publicly available in Latvia and in any other country where the target company's shares are traded in such form that allows all shareholders of the company to obtain this information.

In some limited cases (e.g. if the disclosure of information would harm the interests of the general public, or if the disclosure would cause damage to the respective target company, or to third parties), the FCMC, on the basis of a motivated application by the target company, may release the company from the obligation to publish information on the changes in shareholding. Such exemption may be applied for only in cases where it would not result in misleading the actual or potential shareholders of the company on facts or circumstances which are material to the purposes of evaluation of shares of the target company.

2) When the total amount of target shares, whether directly or indirectly acquired, **exceeds 50%** of the total amount of shares with voting rights, the acquirer (or acquirers collectively, if two or more persons are acting in concert) **must issue** to other shareholders of the target company a **mandatory share buy-out offer**. This requirement applies irrespective of whether the shares acquired are fully or partially public emission shares or closed emission shares. This requirement does not apply if the shares are acquired as a result of voluntary share buy-out offer.

The mandatory share buy-out offer is subject to a regulated price. Namely, the price per share may not be lower than either of:

- the price at which the offeror has acquired the shares of the company (where the offeror has acquired shares at different prices, the highest price applied during the last 12 months prior to the date when the circumstances triggering offer have occurred, will be used);
- the average stock price during the last 12 months prior to the date when the circumstances triggering the offer have occurred, where it is determined based on the stock price in active market; or
- the value of the shares, determined by dividing the 'clean net asset value' of the company by the total number of shares issued. The 'clean net asset value' shall be determined through the deduction of the total net asset value of the company from the value of the shares and commitments. (For the purposes of this method, the data indicated in the last annual accounts of the company as approved by sworn auditor(s) and the shareholders' meeting of the company shall be used. The last quarterly accounts shall be used instead of annual accounts if this would result in at least a 10% higher price.)

All the above methods must be used and the highest price shall apply. If the offeror, during the period between 'the date when circumstances triggering offer' and the last date of the offer term, enters into an agreement on the purchase of the company's shares at a price higher than the offer price, the price used in such transaction becomes the price of the offer.

After the closing of the mandatory offer procedure, during a period of 6 months the offeror may purchase the target company's shares at a price higher than the price used in the mandatory offer only if the offeror compensates to all sellers within the mandatory buy-out process the difference between the new purchase price and the purchase price used in the mandatory offer.

3) When the total amount of target shares, whether directly or indirectly acquired, **reaches or exceeds 90%** of the total amount of shares, each of the minority shareholders of the company may request that the majority shareholder purchase its shares at a price that is not lower than the price determined according to the methods used for the purposes of the mandatory share buy-out offer. Such request is binding for the majority shareholder.

A person who fails to comply with the respective notification requirements and/or to issue a mandatory buy-out offer potentially faces the following negative consequences:

- such person is not entitled to exercise the voting rights attached to the shares which it owns, as well as indirectly acquired voting rights. The decisions of the shareholders' meeting taken in violation of the abovementioned principle, shall be considered invalid; and
- the FCMC is entitled to issue a warning or impose a penalty of up to 10,000 Lats.

The latter applies also in the case of failure of the majority shareholder, who holds at least 90% of the total amount of the shares, to comply with the request of the minority shareholder to purchase its shares.

5.2 What are the disclosure triggers?

The person extending a voluntary offer is subject to a general requirement to notify and publish results of the offer process. Thus, within 5 business days after the expiry of the offer term, it is required to:

- submit a detailed notice to the market organiser and to the management board of the target company; and
- publish a detailed announcement in the Official Gazette "Latvijas Vestnesis".

Any person acquiring at least 5%, 10%, 25%, 50%, 75% or 95% of the shares with voting rights is required to notify the market organiser and the management board of the target company (for details, see the answer in question 5.1 above).

5.3 What are the limitations?

There are no limitations on the ability to accumulate shareholdings, outside the general (voluntary) bid process (provided the acquirer complies with the respective notification obligations and, where applicable, the requirement to issue a mandatory share buy-out offer).

6 Deal Protection

6.1 Are break fees available?

There are no rules specifically addressing availability of "break fees" or similar payments. Where any agreement is entered into (e.g. in the case of a merger process or in the case of any separate share purchase transaction), the principle of contractual freedom can be used to include such provisions.

6.2 Can the target agree not to shop the company or its assets?

Under the Latvian law, it is not possible to require the target company/its board not to seek alternative/competing offers. The management board is entitled to do so without approval of the shareholders' meeting.

6.3 Can the target agree to issue shares or sell assets?

Decisions on the issue of shares under Latvian law are within the competence of the general meeting rather the management board of the company (or target itself). As a general rule, the management and supervisory board members of the company are prohibited from any activities or omissions that may hinder the offer process; however, there is no such prohibition in relation to the decisions of the general meeting of shareholders of the target, except for the below.

After the public announcement of the buy-out offer, the company may not issue new shares or convertible bonds which may result in a change in distribution of voting rights in the shareholders' meeting. The company also may not decide on the distribution of dividends, change the nominal value of shares or decide to merge or split share emissions of the target. These restrictions apply until the expiry of the offer term.

6.4 What commitments are available to tie up a deal?

There are no specific rules established or specific legal instruments available.

7 Bidder Protection

7.1 What deal conditions are permitted?

Latvian law does not provide for conditional buy-out offers, i.e. it is not expressly permitted to include in the offer any provisions other than those listed in the law (e.g. price, terms of the offer, payment/exchange procedures, procedure for acceptance of the offer, etc.).

7.2 What control does the bidder have over the target during the process?

Unless the offeror has already some control over the target (as a shareholder or otherwise), there are no specific legal mechanisms to allow the offeror to exercise any control over the target before or during the offer process. The offeror has limited rights to change the offer (subject to the approval of the FCMC); for example, to extend the term of the offer, to increase the price, etc. to the extent that it does not harm the shareholders of the target who have already accepted the offer. The offeror may also request the FCMC to cancel the offer, provided it can demonstrate sufficient grounds (see the answer in question 4.4 above).

7.3 When does control pass to the bidder?

The bidder can only exercise direct control over the target through the shares and respective voting rights in the shareholders' meeting, i.e. the bidder can take effective control of the target at the earliest when the first shareholders' meeting takes place, after the bidder has acquired a sufficient percentage of shares to exercise respective control.

7.4 How can the bidder get 100% control?

When the bidder has acquired at least 95% of shares with voting rights, it is entitled to make a "final share buy-out offer", i.e. to request the minority shareholders to sell their shares to the majority shareholder. In such case, other shareholders are obliged to sell their shares.

The price is determined using the same methodology, as in the case of a mandatory share buy-out offer (see the answer in question 5.1 above). If the bidder has reached the 95% threshold as a result of a voluntary share buy-out offer, it is entitled to make the final buy-out offer at the same price as determined in such voluntary buy-out offer.

A final buy-out offer can be made within 3 months after the date upon which the bidder acquired at least 95% of the total number of shares with voting rights. As a precondition for such offer, the target must pass a decision to leave the regulated market.

8 Target Defences

8.1 Does the board of the target have to tell its shareholders if it gets an offer?

The law is not explicit in this respect. It is determined that the person intending to make a voluntary share buy-out offer has to notify the management board of the target as soon as the decision to extend an offer is passed. Details of the offer and offer prospectus should only be provided to the target after the bidder has received the approval of the FCMC. It is not specified whether the board should or should not disclose to its shareholders the offer and/or the public information received from the potential bidder, thus leaving this to the discretion of the target's board. The management board is committed to prepare and publish its opinion on the offer after the offer is approved by the FCMC.

8.2 What can the target do to resist change of control?

There are no explicit rules regulating available defences. As soon as the board receives information on the planned offer, the board is entitled to seek alternative offers upon its own initiative. Any other activities that may potentially upset the planned offer process or outcome are subject to the approval of the shareholders' meeting.

8.3 Is it a fair fight?

No specific legal framework has been established to address and regulate situations with a preferred bidder and a hostile bidder.

9 Other Useful Facts

9.1 What are the major influences on the success of an acquisition?

Currently there are no Latvian-based public companies which have a large public shareholder base. Normally, there are one or several major shareholders which exercise control over the target. Thus, any takeover attempt aimed at obtaining control over the target will primarily depend on soliciting the majority shareholder(s) to sell their shares. Such sale-purchase transaction generally would be treated on an individual basis and not within the scope of a regulated buy-out offer.

9.2 What happens if it fails?

Latvian law does not provide any specific adverse legal consequences for the bidder that fails at an attempted takeover.

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