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# THE MERGERS & ACQUISITIONS REVIEW

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THIRD EDITION

EDITOR  
SIMON ROBINSON

LAW BUSINESS RESEARCH

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For further information please email  
[Adam.Sargent@lbresearch.com](mailto:Adam.Sargent@lbresearch.com)

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THIRD EDITION

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SIMON ROBINSON

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The past year has seen the financial crisis continue to escalate. Financial markets have witnessed a number of events that have had global effects, from the collapse of Lehman Brothers in September 2008, to Iceland's banking crisis and the nationalisation of various financial institutions by several governments. The consensus is that the decision not to rescue Lehman was a mistake, although, to date, this appears to be an isolated – if serious – error by the authorities in response to the banking sector crisis. Other responses to these turbulent market conditions include the decision to reduce interest rates to historically unprecedented levels and massive fiscal stimulus in many countries. More controversially, several monetary authorities have implemented a 'quantitative easing' policy. Taken together, these efforts seem, at the moment anyway, to have averted a full-scale depression, but this has clearly been achieved at the price of huge public-sector deficits and substantial debt burdens for future generations.

The current debate centres around whether the next stage will be a continuing crisis, a return to 'normality' or, as seems more likely, a slow and anaemic recovery. In any case, many observers predict significantly higher levels of inflation than seen in recent years. Although some tentatively predict that a recovery from the financial crisis is on the horizon, the topic remains one of ferocious debate.

Some questioned whether the banking crisis would seriously affect the wider economy. The last year has proved beyond doubt that those who predicted a wider financial crisis were correct. The crisis in the real economy has much further to run and a significant increase in unemployment, particularly in Europe, regrettably seems inevitable.

M&A activity has reflected this crisis. Lending remains very constrained and the most significant activity has been in the financial sector, although property companies are also severely stressed. The less welcome development over the past year or so has been the steady stream of distressed corporate rescues, some by takeover. More optimistically, many are now commenting that, for those with cash, there are bargains to be had.

From the lawyers' perspective, the next stages are likely to be of great interest as the authorities take steps to rebuild confidence in financial institutions. The regulatory architecture will change significantly, although the final form is not yet obvious.

I again wish to thank all the contributors for their continued support and cooperation – and all the unnamed others who have helped to produce this book, which, given the current economic climate, should hopefully provide interesting reading.

**Simon Robinson**  
Slaughter and May  
London  
August 2009

## Chapter 36

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# LITHUANIA

*Paulius Gruodis\**

### I OVERVIEW OF 2008/2009 M&A ACTIVITY

In 2008, Lithuania continued to see quite intense activity in the M&A market which, however, as elsewhere in Europe, in the end of the year was dramatically affected and stagnated by the global economic downturn. The credit crunch and consequent difficulties in obtaining financing for M&A deals clearly have had an adverse impact on deal-making, which directly affected the private equity players and constrained their significant role and ability to invest on the M&A market.

The marked downturn in both the volume and value of deals in the Lithuanian M&A market in the end of 2008 and beginning of 2009 can be illustrated by information made available by the Competition Council of the Republic of Lithuania with reference to the following statistics: permissions for concentration issued by said agency in the year 2008 totalled 54 (compared to 74 in the year 2007), while in the first half of 2009 there were only 19 permissions issued.

During 2008 Lithuania was not only attracting foreign investors, its companies continued to be equally active in foreign countries such as Russia, Poland, Serbia, the United Kingdom and other Baltic States.

In 2008, Lithuania saw both noticeable concentration of local businesses, such as milk production, metal constructions and other sectors, and entrance of foreign investors into the Lithuanian or Baltic markets (e.g., acquisition by IKEA of particleboard company UAB Girių Bizonas; acquisition by Coopernic of UAB Palink; acquisition by Terminal investment limited of second stevedoring company LKAB Klaipėdos Smeltė; acquisition by Societe Generale of UAB General Financing ('Kreditas 123'); acquisition by American company Moon of UAB Viltechmeda, etc.).

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\* Paulius Gruodis is an associate partner at Bernotas & Dominas Glimstedt.

## II GENERAL INTRODUCTION TO THE LEGISLATIVE M&A FRAMEWORK

The main legislative acts regulating M&A in Lithuania are the Civil Code of the Republic of Lithuania ('the Civil Code'), the Company Law, the Competition Law, the Securities Law and the Law on Markets in Financial Instruments. The Labour Code of the Republic of Lithuania and the respective subordinate legislation are also applicable to M&A transactions.

The Civil Code of 18 July 2000 establishes general provisions governing pre-contractual and contractual relations between the parties and regulates such processes as reorganisation or restructuring of legal entities. It also introduces such option as the sale of a company (as complex of assets, contracts, company name, trade marks, etc.), which in practice is not encountered due to ambiguity of the provisions and specific requirements relating to security of creditors. Pursuant to the Civil Code, the agreement of sale of a business (company) must be notarised and evaluation of the company and of its assets made by an independent auditor must be attached to the agreement. There are also other requirements making transactions of this type unattractive to the market players.

The Company Law of 13 July 2000 regulates share transfers in public and private companies in detail, imposing notification requirements and terms, defines the competence, rights and duties of company shareholders and governing bodies and deals with reorganisation, spin-off, merger or restructuring of companies. It also regulates matters pertaining to the statutory capital, shares and funds of the company.

The Competition Law of 23 March 1999 regulates the competition clearance processes. Pursuant to the Competition Law, notice of the intended concentration must be given to the Competition Council if the combined aggregate income of the participating companies exceeds €869 million in the previous financial year and the aggregate income of each of at least two companies taking part in the transaction exceeds €1.45 million in the previous financial year.

The Securities Law of 18 January 2007 deals with issues relating to publicly listed companies. The Law establishes rules for mandatory takeover bids, squeeze-out and sell-out processes as well as requirements for announcement, registration and implementation of tender offers, disclosures and the like. The Regulations of the Securities Commission of the Republic of Lithuania and the Trading Rules of the Stock Exchange may equally be applicable to transactions carried out by such publicly listed companies.

The Labour Code of 2 June 2002 and the subordinate legal acts regulate participation by the employees in M&As and provide for certain protective measures that can be exercised by the employees in such transactions.

Taxation aspects of M&A transactions are regulated by the Law on Corporate Income Tax of 20 December 2002, the Law on Individual Income Tax of 2 July 2002 and by other tax legislation.

Depending on the nature of the transaction and the type of the parties involved, other legal acts may be applied. In general, the applicable legislation is in conformity with the EU legislation.

### **III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT**

In May/June of 2008, several amendments were made to the Lithuanian Company Law. The amendments were aimed at implementing Directive 2006/68/EC amending Directive 77/91/EC as regards the formation of public limited liability companies and the maintenance and alteration of their capital ('the Directive') and at addressing some of the questions that had arisen in practice under the previous law.

One of the most significant novelties relates to the relaxation of the rules on contributions which was introduced by the Second Company Law Directive (i.e., Directive 77/91/EC). Previous wording of the Company Law expressly required all non-cash contributions for newly-issued shares of a company to be evaluated by an independent expert. The amendments abolished the requirement for such expert valuation in case the non-cash contributions are made by means of: transferable securities or money market instruments with a certain track record of trading on a regulated market; or assets which have been valued by an expert not less than six months before the date of contribution in accordance with the laws on valuation. These provisions are applicable only in case of capital increase and cannot be used while establishing the company and forming its statutory capital.

Amendments to the Company Law also introduced certain modifications to the procedures of redemption by the public company of its own shares. Previously such redemption had to be done through the voluntary tender offer but this requirement has since been abolished. Nevertheless, the company must ensure equal treatment and equal possibilities for all the shareholders to transfer their shares to the company.

The amendments introduced prohibition on reduction of company's authorised capital aimed at cashing out the funds to the shareholders if the company in question has long term liabilities, unless written consents from all of its long term creditors are obtained.

While implementing Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, the Parliament has adopted the Law on Cross-border Mergers of Limited Liability Companies which came into force on 29 December 2007. The directive and the law authorise mergers where at least one of the companies involved in a merger is registered in another Member State of the European Economic Area. Prior to the implementation of the directive, such cross-border mergers could be effected only through formation of a European Company (SE). The directive and the law simplified and harmonised the procedures of such mergers and it is expected to facilitate cross-border mergers.

The Law on Markets in Financial Instruments adopted in 2007 eliminated the rule requiring securities orders to be executed only in regulated markets. The Law on Markets in Financial Instruments introduced multilateral trading facilities making it possible to organise trading with fewer requirements for access to the trading on a stock exchange and without the monitoring by the authorities. As a result, the stock exchanges of the three Baltic States have established an alternative market – First North. This market and the stock exchange of the Baltic States both belong to the OMX Group which was merged with NASDAQ in the beginning of 2008. This alternative stock exchange is orientated to the needs of smaller, yet developing and growing companies,

which have an intention to trade on the stock exchange and attract new capital. First North was launched in the end of 2007. However, presumably due to the ongoing economic slowdown, so far none of the companies have expressed interest to enter the First North alternative market in Lithuania.

It is worth noting that in June 2009 the Lithuanian government initiated amendments to the existing Lithuanian mortgage legislation. Should the Parliament accept the proposed amendments, the creation, perfection and enforcement of mortgage and pledge over assets should become more liberal, flexible and easier. The proposed amendments *inter alia* suggest the abolishment of the current mandatory standard form mortgage or pledge bonds, which would provide more flexibility for the parties in negotiating and agreeing the terms and conditions of the security documentation.

#### **IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS**

Pursuant to the data of the Lithuanian Statistics Department, the foreign direct investment (FDI) in Lithuania grew by 20 per cent in 2008. Based on provisional data of 1 April 2009 FDI has decreased by 11.3 per cent in comparison with 1 April 2008 and amounted to 31.48 billion litas. The biggest FDI growth in 2008 was seen from investors from Poland, Denmark, Sweden, Russia and Germany.

In 2008, the bulk of investment fell in manufacturing, direct investment in real estate, renting and business activities, financial intermediation, wholesale and retail trade, and electricity, gas and water supply. A decrease was observed in the direct investment in manufacturing, electricity, gas and water supply enterprises.

In 2008 Lithuanian enterprises' direct investment abroad constituted 4.87 billion litas, or 31.7 per cent more than in 2007 (3.70 billion litas). The main investment destinations included Estonia, Germany, Latvia and Russia.

As far as investment abroad is concerned, Lithuanian enterprises mostly invested in real estate, renting and other business enterprises, financial intermediation, manufacturing, wholesale and retail trade, transport, storage and communication.

#### **V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES**

The most significant transactions in Lithuania during the year 2008/2009 to be mentioned include the disposal by the Lithuanian government of its remaining 9.98 per cent stake in AB Mazeikiu nafta, the acquisition by Deka Immobilien GmbH of Kaunas' Akropolis shopping and entertainment centre and the sale of 80 per cent of the shares of UAB Palink, the second largest food and grocery retail chain in Lithuania.

##### *Sale of 9.98 per cent of shares in AB Mazeikiu Nafta by the Lithuanian government*

Back in 2007, PKN ORLEN SA, Central Europe's largest oil refinery, listed on the Warsaw Stock Exchange, acquired 84.36 per cent of shares in the Lithuanian AB Mazeikiu Nafta, the only oil refinery in the Baltic States, including 30.66 per cent stake held by the government of the Republic of Lithuania. The terms of the said transaction

included the put option right of the Lithuanian government to sell to PKN ORLEN SA its remaining 10 per cent stake in AB Mazeikiu Nafta within a five-year period.

In March-April 2009, the government of the Republic of Lithuania exercised its put option right and sold to PKN ORLEN SA all of its remaining shares in AB Mazeikiu Nafta. It was reported that the value of the transaction amounted to €210 million.

#### *One of the largest property deals in the Baltics*

In 2008, German investor Deka Immobilien GmbH acquired a 100 per cent equity interest in UAB Kauno Audiniu Projektas, a company holding and operating Kaunas' Akropolis, the shopping and entertainment centre of approximately 60,000 m<sup>2</sup> gross leasable area.

Said acquisition represented the second investment by Deka Immobilien in Lithuania. A few years ago the same investor acquired BIG shopping centre based in Vilnius.

The transaction in question was closed in September 2008. The value of the transaction has not been disclosed but it was ranked as one of the largest property deals in the Baltic region.

#### *Takeover of 80 per cent shares of UAB Palink, operator of IKI, Ikiukas and Cento stores*

In the spring of 2008 the European Alliance of Independent Retailers 'Coopernic' acquired over 80 per cent of shares in UAB Palink, a company operating IKI (the second largest food and grocery retail chain in Lithuania), Ikiukas and Cento stores in Lithuania and Latvia. IKI Group is the second largest retail company in Lithuania with an estimated 18 per cent market share, and number three in the Baltics.

The alliance 'Coopernic' is the alliance of the firms Colruyt (Belgium), Conad (Italy), Coop (Switzerland) and E.Leclerc (France) alongside REWE Group (Germany) which is active in 18 European countries.

Although the financial information of the transaction was not disclosed, following some mass media information, the value of the transaction may reach €300 million. In order to complete said transaction, one of the members of Coopernic, REWE Group (Germany) had to obtain the antimonopoly clearance from the European Commission under the EU Merger Regulation.

Following the IKI Group information, that was the first time in Europe that an alliance of independent retailers had made an acquisition of such a type.

#### *Recent trends*

The markets of all three Baltic States – Lithuania, Latvia and Estonia – are usually referred to as the single market. Given the fact that many companies operate in all three Baltic States, this was always an attractive factor to the investors as they get access to three or at least two EU Member States' markets at the same time through the completion of only one transaction.

During recession, as there are more restrictions on getting deal financing the Baltic market may still remain attractive to investors as smaller scale investments usually require less financing. Due to the global economic crisis, slowdown of economies and

uncertainty of business prospects, the owners of local businesses are becoming eager to exit their businesses and demonstrate flexibility in negotiating the exit price.

## **VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS**

Lithuania, as did the rest of Europe, faced the same M&A financing trends – increased use of debt capital for the financing of acquisitions as well as popularity of equity financing.

As in former years, in 2008 most of the recent major deals were structured through a special purpose vehicle, which gets financing from its mother company and later on is merged with the target. In certain cases such merger results in goodwill, which, pursuant to the tax legislation, may be amortised over a period of 15 years, and thus provide tax benefit.

Despite the popularity of the leveraged buyouts, in 2008 cash remained a well-liked form for consideration, especially in domestic deals.

In general, the means of financing mostly depend on the structure and value of the deal. The majority of domestic deals in 2008 were financed by loan capital or in certain cases out of the funds of the bidder. Despite the start of the global economy slowdown in the beginning of 2008, the banks still remained the willing risk takers with regard to provision of deal financing. However, in the course of 2008 they have started gradually applying a more and more conservative approach in terms of crediting and the terms of the deal financing became much more strict and less encouraging to the M&A market players. From the start of 2009 the external financing of the potentially new M&A deals actually stopped.

## **VII EMPLOYMENT LAW**

During the years 2008 and 2009 there were no major changes in the employment law with regard to M&A. Provisions regarding grounds for termination of employment contracts, as well as an obligation to inform the employees about possible changes in the activities of the company remained the same. Pursuant to the Labour Code of the Republic of Lithuania, changes of the owner of an undertaking, the subordination, founder or name thereof, any consolidation of the undertakings, division, parcelling out, division or joining to another undertaking, transfer of business or a part thereof may not be a legitimate reason to terminate employment relations. Such provision of the Labour Code implements the main principle of the employees' protection during M&A proceedings – the continuity of employment relations. The decision of the Supreme Court of the Republic of Lithuania confirmed this rule. In its ruling the court stated that only factual and real structural changes within the company may be the lawful ground for the termination of employment relations – if the structural changes result only in the change of the position name or subordination and the functions of the employee remains the same, the employer does not have the right to terminate the employment agreement.

It is worth mentioning that as regards the obligation of the employer to inform the employees, the Lithuanian Labour Code was supplemented with a few new provisions

that oblige the employer not only to inform the representatives of employees, but also to consult them prior to adopting a decision to reorganise the company and other decisions which may have an essential impact to the legal situation of the employees. The requirement of the Law on Securities that the companies involved in the tender offer must immediately inform their employees about the intentions to launch the tender offer remains unaffected. The law establishes some other duties for the bidder and the target related to the provision of the information to the employees and their representatives.

Under current economy recession circumstances the Lithuanian government has initiated certain amendments to the labour legislation aimed at liberalisation of the employment relations by way of facilitating termination of the employment contracts, changing the order of remuneration for overtime and night work and introducing many other amendments and supplements to the Labour Code. However, many of the initiatives are facing objections from the trade unions and other representative bodies of employees. The approval of said amendments by the Parliament is pending.

## **VIII TAX LAW**

In December 2008 several material amendments were made to the Lithuanian tax legislation aimed at balancing the state revenue in the conditions of the economic slowdown and came into effect as of 1 January 2009. Notably, as most of those amendments were introduced hurriedly under threat of the forthcoming global economic downturn, it has already turned out that some of them resulted in adverse or even opposite economic and social effects and therefore it is expected that they might be abolished or alternatively relieved in the course of 2009.

Effective 1 January 2009, the VAT rate has been increased from 18 per cent to 19 per cent. Lithuanian corporate income tax has been increased from 15 per cent to 20 per cent. The special social tax of 3 per cent that was due on business profits in 2006/2007 has been abolished.

Current special favourable rules contained in the Lithuanian Corporate Income Tax legislation on taxation of capital gains remained unamended during the overviewed period. Namely, capital gain that is realised from the transfer of shares from a company registered or otherwise organised in a European Economic Area state is exempt from the Lithuanian corporate income tax provided the Lithuanian seller has continuously held more than 25 per cent of the shares in the company for the last two years.

As of 2009, under the Lithuanian Individual Income Tax Law different taxation rates on different types of income for permanent Lithuanian residents are no longer applicable (except for special rate for dividends). Incomes of individuals are subject to a general 15 per cent Lithuanian individual income tax (dividends are taxed at 20 per cent individual income tax). It is also noteworthy that as of 2009 incomes of individuals are additionally taxed with the social (health) insurance contribution the rates whereof depend on the type of income. Capital gain realised by permanent Lithuanian residents is subject to an additional 6 per cent social (health) insurance contribution.

In case of Lithuanian permanent residents, generally, capital gain realised from the transfer of shares is subject to the Lithuanian individual income tax at the rate of 15

per cent and social (health) insurance contribution at the rate of 6 per cent. The current capital gain tax exemption rule remained unamended, i.e., capital gain is tax-exempt if the individual has held the securities for more than 366 days and for a period of three years has held less than 10 per cent of the company's shares. This exemption is not applicable in the event that the securities are transferred to the company that has issued them.

## IX COMPETITION LAW

As mentioned above, competition matters are regulated by the Competition Law of the Republic of Lithuania and the respective subordinate legislation. The monitoring authority is the Competition Council of the Republic of Lithuania. In general, the Lithuanian Competition Law is in conformity with the EU competition legislation.

During the recent year there were no material changes or developments in the competition legislation producing any major effect on M&A activities in Lithuania.

In 2008 the volume of concentration control has decreased. The Competition Council has noted that for the past several years the pattern of the development of concentration notifications was hardly changing. However, in 2008 the number of concentration notifications decreased, mostly in view of the increasing recession in the market of construction of residential and commercial developments.

## X OUTLOOK

Despite the difficulties in global economy, the activities in the M&A market in Lithuania remained intensive until the end of 2008. However, these activities have significantly changed thereafter and since then the M&A market has seen a marked downturn in both the volume and value of deals.

The high M&A volume seen in 2007 and the first half of 2008 is unlikely to be repeated for a few upcoming years due to the credit crunch that undoubtedly has had its far-reaching impact on the Lithuanian M&A market. Therefore, it is very likely that the difficulties in obtaining financing for M&A deals will continue as long as the financial turmoil and global economy remains unstable.

Looking forward, the M&A market anticipates a larger role played by banks as financing issues continue to impact many sectors of economy, and a certain level of defensive M&A as companies react to the credit markets and ongoing economic woes. Therefore, the search for new alternative ways of holding the particular market could also progress in a positive way under present economic circumstances.

It is also expected that in the second half of 2009 the M&A market should revive as the investors will start looking for possibilities of acquiring the distressed businesses and assets in Lithuania, which have been adversely affected and devalued as a result of the ongoing economic fall.