

The International Comparative Legal Guide to:
Corporate Governance 2009

A practical insight to cross-border corporate governance



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1 Setting the Scene - Sources and Overview

1.1 What are the main corporate entities to be discussed?

The most commonly used legal forms for corporate entities in Estonia are private limited company (*osajühing*, “OÜ”) and public limited company (*aktsiaselts*, “AS”). Private limited companies make up the vast majority of registered companies, while public limited companies account for a modest proportion of companies on the Commercial Register.

A private limited company is a company characterised by smaller capital requirements (EEK 40,000, approx. EUR 2,560) and a simple, 1-tier management structure. Private limited companies tend to be closely-held businesses formed and managed by a relatively small group of shareholders.

A public limited company is characterised by greater capital requirements (EEK 400,000, approx. EUR 25,600) and the possibility to have different classes of shares; it is required to register its shares with the Estonian Central Register of Securities (ECRS) and to submit to independent audits. The management structure of a public limited company must include a supervisory council in addition to the shareholders’ meeting and the management board. Most large companies are public limited companies.

The single type of corporate entity in Estonia, the shares of which are publicly tradable, is the public limited company.

1.2 What are the main legislative, regulatory and other corporate governance sources?

The legal environment of the corporate governance is set by the Commercial Code, which includes most of the regulation related to day-to-day management of companies.

Other main sources of corporate governance regulation include the Law of Obligations, the General Principles of the Civil Code Act, the Competition Act and the Securities Market Act. In addition, certain commercial entities, such as banks, investment funds, and insurance companies, are subject to various industry-specific regulations.

In addition to the abovementioned legal acts, corporate governance of listed companies is further regulated by the Tallinn Stock Exchange Rules, issued by the Tallinn Stock Exchange, and the Corporate Governance Recommendations (hereinafter the “CGR”), issued by the Financial Supervisory Authority in co-operation with the Tallinn Stock Exchange. The former is mandatory for listed companies whereas the latter is mandatory on a comply-or-explain basis. The CGR are recommended but not mandatory also for non-listed companies.

1.3 What are the current topical issues, developments and trends in corporate governance?

The most recent developments, introduced on 27 February 2009, include amendments to the Commercial Code which facilitate additional issue of shares of public limited companies intending to bring their shares to be traded in a regulated market or the shares of which are already traded in a regulated market. The aim of the amendments was to facilitate the transfer of newly issued shares to investors simultaneously with payment for the respective shares and to ensure that such shares could be traded immediately in the regulated market after their transfer to the investors.

In addition to the above, another draft amendment act of the Commercial Code is currently being processed, enabling shareholders of public limited companies to cast their votes by mail or in electronic format and requiring companies to disclose more information on their web-sites concerning the proposals made in connection with the agenda of upcoming shareholders’ meetings and earlier meeting minutes.

2 Shareholders

2.1 What rights and powers do shareholders have in the operation and management of the corporate entity/entities?

The shareholders of both private and public limited companies have all basic shareholder rights, including the right to obtain information on the company on a timely and regular basis, the right to participate and vote in the shareholders’ meetings, the right to elect supervisory council members (management board members in case of a private limited company without a supervisory council), and the right for a share in the profits of the company.

The shareholders’ rights in a company are exercised through the general meeting. A general meeting is exclusively competent to amend the articles of association, increase and reduce share capital, issue convertible bonds (in case of public limited companies), elect and remove members of the supervisory council (management board members in case of a private limited company without a supervisory council), elect an auditor, designate a special audit, approve the annual accounts and distribute profit, decide on dissolution, merger, division or transformation of the company, decide on conclusion and terms and conditions of transactions with the members of the supervisory council, decide on the conduct of legal disputes with the members of the supervisory council, and appointment of the representative of the company in such transactions and disputes; and decide on other matters placed in the competence of the general meeting by law.

In case of private limited companies, additional issues may be placed within the competence of the general meeting. The same does not apply to public limited companies, the general meeting of which may adopt resolutions on matters not listed in the Commercial Code only at the demand of the management board or supervisory council of the company. In either case, shareholders are held jointly and severally liable in the same manner as members of the management board or supervisory council for damage caused by resolutions adopted in issues falling into the competence of the respective managing bodies.

2.2 Can shareholders be liable for acts or omissions of the corporate entity/entities?

Shareholders are not held personally liable for the obligations of the company. However, if a shareholder has wrongfully caused damage to a third party, to another shareholder or to the company itself, the shareholder will be held liable for such damage. A shareholder will not be liable for any damage caused if the shareholder did not participate in the adoption of the resolution which resulted in damage or if the shareholder voted against the resolution.

2.3 Can shareholders be disenfranchised?

Provided that certain conditions are present, a shareholder can be excluded from a private limited company upon the request of other shareholders. The same does not apply in public limited companies, except in case of exercising the general takeover of shares for monetary compensation by a shareholder holding the shares representing at least nine-tenths of the share capital provided that at least 95% of the votes represented by the shares vote in favour of the takeover.

2.4 Can shareholders seek enforcement action against members of the management body?

The shareholders and the company have the right to seek enforcement action against members of the management board and the supervisory council in the event of a breach of respective individual's obligations. Please see also question 3.6 below.

2.5 Are there any limitations on, and disclosures required, in relation to interests in securities by shareholders?

As to the speed of acquiring securities or the maximum amount of shares held by a shareholder, no regulatory limitations exist which would fit in the scope of the present questionnaire. However, the provisions of mandatory takeover need to be taken into account in case of a listed company. One should also consider the restrictions imposed by the insider trading related provisions.

As to disclosure, together with the annual accounts the company must present the list of shareholders who own more than 10% of the votes represented by the shares whereas such level for listed companies is 5% of the votes represented by the shares.

If all the shares in a company belong to one single shareholder or if, in addition to the single shareholder, the shares of the company are owned only by the company itself, the management board shall immediately submit a corresponding written notice to the Commercial Register.

Further, a person acquiring, directly or indirectly, the number of votes in a listed company up to or more than 5, 10, 15, 20, 25 or 50% or up to or more than 1/3 or 2/3 of all the votes represented by such issuer's shares shall notify the issuer of such acquisition within

4 trading days. The issuer will disclose respective information according to applicable rules. The same obligation of disclosure applies in case the number of votes of a shareholder in an issuer falls below the said thresholds.

Certain disclosure obligations are also imposed on a listed company acquiring or transferring its own shares.

2.6 What shareholder meetings are commonly held and what rights do shareholders have as regards them?

In private limited companies, the shareholders can adopt resolutions either in general meetings or by a written procedure without calling a meeting (written resolution).

In public limited companies, a general meeting must be held annually, within 6 months of the end of the financial year. This meeting must approve the annual accounts and decide distribution of profit or measures to be applied for covering the loss. Passing of other resolutions at the ordinary general meeting is also common.

In case of both private and public limited companies, one or more shareholders together representing at least 10% of the company's share capital can require the management board to call a special general meeting. If the management board does not call this meeting within 1 month after receipt of the shareholders' request, the shareholders can call the meeting themselves and decide its agenda.

Shareholders can require an issue that is not on the agenda of a general meeting to be included, if at least 90% of the shareholders representing at least two-thirds of the company's share capital consent to this.

3 Management Body and Management

3.1 Who manages the corporate entity/entities and how?

The management structure of private and public limited companies is very similar. Both are governed by a meeting of shareholders (general meeting) and a management board. In addition, public limited companies must have a supervisory council. Private limited companies must only have a supervisory council if either: (i) there are fewer than 3 management board members and the share capital exceeds EEK 400,000; or (ii) the company's articles of association require it.

The management board is an executive body charged with day-to-day management duties, as well as representing the company in its relations with third persons. The management board may consist of one or several members elected for 3 years, unless the articles of association provide a different term of authorities. The CGR suggests having more than 1 member in the management board. Every member of the management board may represent the company in all legal acts, unless the articles of association prescribe a joint right of representation for some or all of the members of the board. Joint representation shall apply with regard to third parties only if it is entered on the Commercial Register.

The supervisory council engages in surveillance and longer-range management activities, such as supervising the management board and devising business plans. There must be at least 3 members in the supervisory council. The management board is accountable to the supervisory council and must follow the lawful instructions the supervisory council issues. The management board needs to obtain the consent of the supervisory council for conclusion of transactions which are beyond the scope of everyday economic activities, including conclusion of transactions which bring about the acquisition or termination of holdings in other companies, the

foundation or dissolution of subsidiaries, the transfer or encumbrance of immovables or registered movables, the making of investments or the assumption of loans exceeding a prescribed sum of expenditure for the current financial year, etc. The articles of association of the company may also exempt the management board from applying for the consent of the supervisory council for conclusion of certain transactions or include additional transactions for which the consent of the supervisory council is required.

The general meeting of shareholders is the supreme decision-making forum of a company. Resolutions may be adopted at either regular or extraordinary general meetings. Shareholders of private limited companies may adopt resolutions also in a written procedure without convening a meeting. The same option (adopting a resolution without convening a meeting) is available for shareholders of public limited companies only if they all consent to the resolution and sign it.

3.2 How are members of the management body appointed and removed?

Members of the supervisory council are elected and removed by the shareholders' general meeting. Articles of association may stipulate that up to 50% of the members of the supervisory council may be appointed and removed in a different way (e.g. appointed by a certain shareholder, etc.). Under the CGR at least half of the members of the supervisory council must be independent within the meaning of the CGR. The respective resolution is submitted to the Commercial Register by the management board, along with the list of supervisory council members and the written consent of the newly elected supervisory council member. From among its members, the supervisory council elects a chairman who takes care of the administrative issues in the workings of the supervisory council.

Supervisory council members are elected for 5 years unless the articles of association stipulate a shorter term of office.

Management board members are elected by the supervisory council or, in a private limited company without a supervisory council, by a shareholders' meeting. The resolution of the supervisory council/shareholders' meeting on election or removal of management board members is submitted to the Commercial Register, along with a notarised application signed by the elected board member and either (i) another board member already entered to the company's registry card (in case of private limited companies without a supervisory council) or (ii) the chairman of the supervisory council. Instead of filing notarised documents, residents with Estonian identification cards can file digitally signed documents to the Commercial Register.

The members of the management board are elected for 3 years unless the articles of association stipulate another term of office (which cannot, however, be longer than 5 years).

3.3 What are the main legislative, regulatory and other sources impacting on contracts and remuneration of members of the management body?

The main sources impacting contracts and remuneration of members of the management boards and supervisory council are the Commercial Code, which provides general framework for payment of remuneration, and the Law of Obligations, which regulates mandate agreements (the service contracts of management board and supervisory council members qualify as mandate agreements under Estonian law). Further detailed regulation of management board and supervisory council members' service agreements and payment of fees (including issuing options) has been provided in the Tallinn

Stock Exchange Rules and in the CGR for listed companies.

Management board and supervisory council members can receive remuneration corresponding to their tasks and the financial situation of the company. The amount and procedure for paying the remuneration to management board members is determined by a supervisory council. The remuneration of supervisory council members and management board members of private limited companies without a supervisory council is decided by the general meeting resolution.

If the economic situation of a company significantly deteriorates and further payment to a member of the management board or supervisory council of the fees established for or agreed upon with the member, or further allowing of other benefits to the member would be extremely unfair to the company, the company may require a decrease of the fees or benefits. If a decrease of fees or other benefits is demanded, the member of the management board or supervisory council may cancel the contract concluded with him or her by notifying the company 1 month in advance.

3.4 What are the limitations on, and what disclosure is required in relation to, interests in securities held by members of the management body?

For unlisted companies, the Commercial Code does not restrict the purchase or sale of shares by members of management bodies. Insider trading is prohibited in listed companies. Members of management board and supervisory council are insiders under the Securities Market Act and cannot, directly or indirectly, acquire or transfer, either for themselves or for others, securities to which the inside information relates. More detailed rules for avoiding insider trading derive from the Tallinn Stock Exchange Rules, which prohibit members of the management bodies and persons related to them to trade in the issuer's securities with the purposes of gaining profit on short-term fluctuation of share prices and during the prohibited periods set forth by the Rules.

The members of the management bodies of listed companies are obliged to disclose to the company information on their interests and transactions in securities of the company. In addition, certain specific disclosure requirements apply to the members of managing bodies of credit institutions and investment fund managers under field-specific regulation.

3.5 What is the process for meetings of members of the management body?

The Commercial Code does not provide any formal requirements for the adoption of resolutions by the management board, and it is not common to specify any requirements in the articles. Typically, if the management board meetings are held in the company, a management board meeting is quorate if more than 50% of management board members are present. A simple majority of votes is usually sufficient to adopt management board resolutions.

The supervisory council adopts its resolutions in its meetings, which are held when necessary and at least once every 3 months, or, alternatively, in a written procedure. A meeting shall be called by the chairman of the supervisory council or by a member of the supervisory council substituting for the chairman. Advance notice of at least 1 day shall be given of the holding of a meeting and of its agenda unless the articles of association prescribe a longer term.

The quorum for a supervisory council meeting is more than 50% of the supervisory council members and a resolution is passed if more than 50% of the participating supervisory council members vote in favour of it. The articles may provide a larger quorum requirement

and for a larger majority to be required to pass resolutions.

A meeting of the supervisory council shall be called if this is demanded by a member of the supervisory council, the management board, an auditor or shareholders whose shares represent at least one-tenth of the share capital. If the meeting is not called within 2 weeks after the date of receipt of the relevant request, a member of the supervisory council, the management board, auditors or shareholders have the right to call the meeting themselves. An issue which is not included in the agenda in the notice may be added to the agenda by the supervisory council only if all members of the supervisory council participate in the meeting and at least three-quarters of the members of the supervisory council support including the issue on the agenda.

The course of supervisory council meetings is documented in meeting minutes. The minutes are signed by all members of the supervisory council who participate in the meeting and by the secretary of the meeting. The dissenting opinion of a member of the supervisory council is entered in the minutes and confirmed by his or her signature.

If the requirements of law or of the articles of association are violated in the calling of a meeting of the supervisory council, the supervisory council is not authorised to adopt resolutions, unless all the members of the supervisory council participate in the meeting. Decisions made at such meeting of the supervisory council are void unless the members of the supervisory council with respect to whom the procedure for calling the meeting was violated approve of the decisions.

3.6 What are the principal general legal duties and liabilities of members of the management body?

Members of a company's management board and supervisory council must fulfil various general duties for the company, including upholding a fiduciary duty of loyalty, acting with due diligence, performing their duties with sufficient skill and in a manner commensurate with their knowledge and abilities, and acting to maximise the benefits to the company and to prevent any losses. A strict confidentiality requirement also applies where members of the management board or supervisory council learn of facts that the company has a legitimate interest in keeping confidential.

Members of the management board and supervisory council who cause damage to the company by violation of their obligations will be held jointly and severally liable for compensation for the damage caused. The liability of the management board and supervisory council members does not depend upon their individual culpability. The limitation period for filing claims against management board and supervisory council members is 5 years under the Commercial Code.

The members of the management board and supervisory council shall not bear liability if they act pursuant to a lawful resolution of the shareholders' general meeting or any other competent body of the legal person.

The liability of members of managing bodies of a company may be limited or restricted only in the internal relationship between the company and the members of the management board or supervisory council. The company may waive its right to file claims against the management board or supervisory council member either in the mandate agreement concluded with such member or by entering into a compromise agreement with the member when the claim has already arisen. A third party creditor may, nevertheless, file a claim against the management board or supervisory council member liable for the damage in case the assets of the company alone are not sufficient to satisfy the claims of the creditor.

3.7 What are the main specific corporate governance responsibilities/functions of members of the management body?

The management board is responsible for everyday management of the company, *i.e.* for organising the accounting, preparing the general meetings of shareholders, concluding agreements with clients, employees and other third persons, preparing annual accounts, *etc.* The management board is responsible for ensuring the company's compliance with anti-trust, environment, health and safety regulations as well as any other general or field-specific regulations that apply to the company.

The management board also guarantees the application of necessary measures and above all, the performance of internal audit in order to detect, as early as possible, any circumstances which are likely to pose a danger to the operation of the company.

The supervisory council supervises the activities of the management board, grants approvals for concluding transactions beyond everyday business activities, presents to the general meeting a written opinion on the annual accounts prepared by the management board, *etc.*

3.8 What public disclosures concerning management body practices are required?

Unlisted companies are not subject to any specific requirements to disclose information concerning management body practices.

Listed companies should, according to the CGR, publish the division of management tasks of the company between the management board and the supervisory council to the extent not already provided in the articles of association. In case of changing the division of tasks the company must publish the content of the change, the effect to the company and the period of implementation of the change.

The CGR set forth that the notice on calling of a general meeting has to be published on the company's website simultaneously with sending the notices out to the shareholders as well as relevant information pertaining to the agenda of the general meeting. In addition, the supervisory council shall disclose its opinion on the item on the agenda of the general meeting (please see question 5.4 below).

3.9 Are indemnities, or insurance, permitted in relation to members of the management body and others?

Estonian law does not prohibit members of managing bodies of a company from obtaining civil liability insurance or the company from paying such insurance payments. So far it has not, however, become a common practice in Estonian companies, except for in certain larger corporations.

4 Corporate Social Responsibility

4.1 What, if any, is the law, regulation and practice concerning corporate social responsibility?

There are no legal requirements or regulations with regard to corporate social responsibility in Estonia. Nevertheless, quite a few companies contribute to the social sphere via direct funding or via participation in charity events and the like.

4.2 What, if any, is the role of employees in corporate governance?

In Estonia the employees do not have direct role in corporate governance.

However, under the employment laws the company must consult the employees on various matters, for example prior to collective termination of the employment contracts, change of the employer due to the merger or enterprise transfer.

5 Transparency

5.1 Who is responsible for disclosure and transparency?

The disclosure requirements stipulated by law, the Tallinn Stock Exchange Rules or the CGR are usually directed at the “company”, the “issuer” or the “management board”. As the management board is liable for the management of the company and represents the company, then it may be stated that the board as a whole, not any one individual member, has the liability for disclosing the information requested to be published by the applicable laws and regulations. There are very few exceptions when the disclosure must be made by any other body (e.g. under the CGR the supervisory council of the issuer is requested before the general meeting of the shareholders to publish its proposed agenda items on the issuer’s website).

5.2 What corporate governance related disclosures are required?

Both the private limited companies and the public limited companies are required to prepare the annual accounts, which must be approved by the shareholders. The approved accounts must be submitted together with the profit distribution proposal and the auditor’s report (if auditing is required) to the Commercial Register as a result of which the accounts will become publicly available.

The listed companies are required under the Tallinn Stock Exchange Rules to publish through the information system of the exchange also their interim financial reports, the same requirement arises also from the CGR and certain industry-specific laws.

5.3 What is the role of audit and auditors in such disclosures?

All public limited companies (incl. the listed companies) must have their annual accounts audited. Private limited companies are not required to audit their accounts unless they meet certain economic or corporate criteria requiring the auditing of the accounts.

The main role of auditing the accounts is the examination of the accounts and the provision of an opinion pertaining thereto according to the auditing rules. The auditor’s report must be presented together with the annual accounts to the general meeting of the shareholders for their approval. The auditor who prepared the auditor’s report must participate in the making of the decision to approve the annual report, and provide explanations concerning the auditor’s report if such request has been made by shareholders whose shares represent at least one tenth of the share capital.

The CGR stipulates additional tasks to the auditors. Among other obligations the auditor is obliged to disclose to the supervisory council and at the general meeting the facts, which become evident to the auditor during the course of exercising of a regular audit, indicating non-compliance with the CGR by the management board or the supervisory council, and to provide to the supervisory board certain opinions and overviews upon introducing the report.

5.4 What corporate governance information should be published on websites?

At present it is not required under the mandatory laws of Estonia that all the companies limited by shares must publish certain corporate governance information on their websites (please see question 1.3 above). Several industry-specific laws (such as the Investment Funds Act, the Credit Institutions Act) request the disclosure of certain information (e.g. notices calling the general meeting of shareholders, annual accounts and interim reports).

However, certain disclosure requirements are stipulated in the CGR. Under these rules, upon notification of shareholders and investors the issuer shall use proper information channels, including his own web site, whereas the published information must be available also in English. Among other information companies applying the CGR need to publish on their website (i) notification calling the general meeting of the shareholders, (ii) the names of the members of the management board, the supervisory council and the auditor, (iii) basic wages, payable benefits and bonus schemes of a management board member as well as their essential features, (iv) existence, duties, membership and position of the committees (e.g. audit committees) established in the issuer, (v) agreements between shareholders concerning concerted exercise of shareholders rights (if those are known to the issuer) and (vi) annual accounts and the interim accounts.

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Karina graduated the Faculty of Law in the University of Tartu in 1998. Before joining Luiga Mody Hääl Borenius, Karina worked as in-house counsel of PricewaterhouseCoopers.



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