Lithuania

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

This guide provides an overview of the law and practice dealing with private M&A transactions in Lithuania. This guide does not constitute legal advice. Anyone involved in private M&A transactions should seek specialist advice.

1.1 History of M&A in the country, important recent developments in relevant statutory law, trends and the impact of Covid-19

Historically speaking, Lithuania's M&A market is still in a rather nascent stage, from both economic and legal perspectives; there is a lot of room to grow.

In terms of both deal volume and value, Covid-19 did not have a material negative effect on the Lithuanian M&A market in 2020. Despite the ongoing pandemic, 2021 was a highly successful year for the Lithuanian M&A market. Publicly available information indicates that, the volume of transactions has already surpassed 2018 by the third quarter of 2021. The main driver for deal activity in 2021 was investments by private equity funds which had accumulated large cash reserves and were eagerly looking to employ them somewhere.

Business owners in industries heavily affected by Covid-19 are looking to divest, which may also create a spike in deal volume in these market sectors. Moreover, a further increase of venture capital investments in high-technology start-ups is expected in 2022, which has been a continuing trend for the past few years.

In the last several years, a very clear trend towards a more standardised private M&A process has emerged. Sellers are increasingly opting to conduct the sale of their businesses by way of controlled auctions, to create a competitive environment between the bidders and extract a higher price due to bidders fighting to acquire the target, as well as to force the buyers to accept more seller-friendly terms of the share purchase agreement. Based on the 2020 Baltic Private M&A Deal Points Study the percentage of deals conducted via controlled auctions almost doubled from 10 per cent in 2018 to 19 per cent of all recorded M&A deals in 2020.

There have not been any recent noteworthy developments in relevant statutory law with respect to privately negotiated M&A.

1.2 Brief introduction to the legal landscape applicable to M&A transactions (including foreign investment policy, relevant statutes, relevant statutory bodies or regulators)

Lithuania does not have a single designated law for mergers and acquisitions. Instead, there are several legal acts that regulate acquisitions such as the Law on Companies, the Civil Code, the Law on Securities, and others.

The legal landscape is friendly with respect to M&A transactions. Foreign investors are also rather active in the Lithuanian market, as financial advisers running structured auctions are actively seeking to involve foreign investors in these auctions to improve the likelihood of achieving a satisfactory outcome for the seller.

There are no specific restrictions on foreign investments besides national security review. The most affected industry sectors are energy; transport; information technology, telecommunications and other high technologies; finance and credit; and military equipment.

1.3 Rather buyer or seller-friendly M&A market in the relevant country?

The prevailing economic situation and an influx of cheap cash would suggest that Lithuania's M&A market is showing seller-friendly tendencies at the current time. Sellers are able to negotiate rather lenient liability clauses, whereby the buyer may be exposed to more risks that may not be covered by representations and warranties given by the sellers, as liability caps, baskets and thresholds have shrunk significantly in private M&A transactions.

Furthermore, buyers are increasingly opting to acquire warranty and indemnity (W&I) insurance policies to protect themselves against unknown risks associated with the acquired target. It is practically a must for the buyers in controlled auction situations if they want to remain competitive and have a sufficient level of protection against any seller breaches of the share purchase agreement. It is not unheard of that, in controlled auction situations, sellers even demand the bidders to arrange the W&I insurance if they want to stay in the process at all.

Buyers are already looking forward to employing their cash in the coming years; therefore, we expect even more fierce competition for sold assets in the near future, which sounds like good news to business owners looking for exit or growth opportunities.

2. TYPE OF TRANSACTION STRUCTURES ADOPTED IN PRIVATE M&A TRANSACTIONS

2.1 Advantages and disadvantages of each structure

As in the majority of jurisdictions around the world, there are three main techniques with respect to M&A used in Lithuania: share deal, asset deal or corporate reorganisations.

91 per cent of all M&A transactions in 2020 were share deals, while asset deals and other forms of transactions comprised the remaining 9 per cent (2020 Baltic Private M&A Deal Points Study). Asset deals are less common but also used in certain circumstances.

Corporate reorganisations are used more often in internal corporate restructurings rather than M&A deals; the procedure is quite formal and the likelihood of corporate reorganisation being executed as a way to facilitate an M&A transaction is rather low.

Venture capital transactions, on the other hand, often include the issue of new shares by the target company and investors injecting capital straight into the target without a consideration payable to the shareholders, although in certain situations shareholders are entitled to also transfer some shares to the investor.

The legal framework applicable to a transaction will also differ depending on the type of company involved and whether the transaction is structured as a purchase of shares, transfer of assets or corporate restructuring. The choice of the transfer method will depend on various factors, including timing, tax structure, scope and complexity of the target business, and liability for both the buyer and the seller.

A distinction should be made between a transfer of certain assets and the transfer of assets of an undertaking as a going concern, as defined in Lithuanian and European Union legislation. The sale of assets alone may not be a transfer of the undertaking as, in theory, separate assets could not be considered autonomous enough. However, if the asset purchase is of an economic entity or business that is sufficiently structured and autonomous, and where such undertaking is transferred as a functioning entity (as a going concern), there may be material implications and potential liability for the purchaser.

According to the law, the procedure of sale of the enterprise is quite complicated (eg, it includes the auditor's report on the assets and their price, special requirements for the protection of the creditors' rights, certification of the transaction by a notary etc.). Due to the complexity of the aforementioned procedure, it is rarely followed in practice.

The main advantages of share deals are for the sellers, as they effectively separate themselves from the sold business and only agreement-based liability shall be borne for a period set out in the agreement. The buyer also purchases the rights and obligations of the shareholder and is generally free of any liability as they are shielded by a corporate veil.

One of the main advantages of an asset acquisition is that the buyer may pick and choose specific assets or liabilities to be purchased or assumed, leaving behind those assets and liabilities that it does not require (unless the business is bought as a going concern).

2.2 Typical documentation used in each structure

Both share and transfer asset deals are agreement-based transactions. Parties are generally free to agree on any conditions unless they are expressly prohibited by the law.

When not all shares are sold, parties generally enter into a shareholder agreement that governs relations between them as it relates to the future governance of the company, exit strategies, distribution of dividends, expansion, and other provisions.

Corporate reorganisations require documents explicitly set out in the law, such as shareholder decisions, merger terms, auditor opinions and additional documents required to properly effect reorganisation (such as notices to creditors, new articles of association, etc.).

2.3 Tax considerations for each structure

2.3.1 Corporate income tax implications

Based on the Lithuanian tax legislation, there are no transfer or other kind of taxes related to the transfer of shares between two legal entities. Nevertheless, the seller could become liable for corporate income tax (CIT) duties because of capital gains generated from the respective transaction. Transfer of shares is exempt from CIT when a legal person has held more than 10 per cent of the voting shares and they have held those shares for at least two years.

If the seller is a natural person, then personal income tax (PIT) must be paid on capital gains generated from the respective transaction. Tax implications in the event of the asset deals vary based on whether it is:

a) *Sale of business:* sale of assets as well as rights and obligations related to it. Capital gains derived from the sale of business should be included in the taxable income of the seller for CIT purposes and taxed at a rate of 15 per cent CIT.
b) *Sale of assets only:* capital gains from such a transfer would also be subject to 15 per cent CIT. The capital gain in this case would be the difference between the sale value of assets and net book value of the transferred assets.

Corporate reorganisations are generally tax neutral but must be evaluated on a case-by-case basis.

2.3.2 VAT implications

The transfer of shares generally is not subject to VAT. Thus, a share transaction should not create any VAT consequences neither for the seller nor for the buyer. VAT implications for arising from a transfer of assets will depend on the chosen type of the sale:

a) *Sale of business:* assets, rights and liabilities constituting a functioning business as an ongoing concern is deemed as not subject to VAT if both parties are VAT payers in Lithuania and the acquiring entity continues carrying on the transferred business activities. The transferring entity is not required to adjust its VAT deduction upon the transfer of the business (due to loss of assets); this obligation would fall on the acquiring entity if in the future the purpose of the transferred assets changes (Article 9 of the Lithuanian Law on VAT).
b) *Sale of assets:* sale of assets such as sale of a new building, a building under construction or land plots for development are subject to standard 21 per cent VAT rate and general taxation rules in Lithuania.

2.4 Specific compliance considerations relevant to each structure

Labour law regulations come into play only in cases where business transfers through asset deals or reorganisations take place, which happens very rarely (as mentioned, the vast majority of M&A transactions are implemented through share deals). In these cases, acquirers should consider that certain consultation obligations with employee representatives apply: employees of the target company have a right to demand to be transferred together with the business to the acquirer on the same employment terms as they had in the target, or to terminate the employment contract with the target company. It is generally prohibited for the target company or the acquirer to terminate an employment contract solely on the basis of the business transfer.

Furthermore, the rights of creditors of the company selling business in an asset deal must be protected. Creditors must be informed by individual notices at least 20 days prior to signing the business transfer agreement. Creditors whose rights might become difficult or impossible to fulfil due to the business transfer, or if their current securities are not sufficient to secure their rights, have a right to require additional security. A similar procedure must be carried out in the event of corporate reorganizations, whereby the creditors have to be notified of the forthcoming reorganisation. There are two possible options:

a) make three public announcements, using a standardised text informing about commenced procedures and providing information where interested persons can get acquainted with the merger documentation, to be published in a source specified under the articles of association (the journal published by the Register of Legal Entities) with at least 30-day intervals between announcements; or
b) make one public announcement and inform all creditors by individual notices.

3. PRE-AGREEMENT DOCUMENTATION

3.1 Advantages and disadvantages of each type

There are two main pre-agreement documents used in private M&A transactions:

a) Letter of intent (LOI);
b) Confidentiality or non-disclosure agreement (NDA).

An LOI (sometimes referred to as a term sheet) is a useful pre-agreement tool to bring the seller and the buyer closer together on items that may not be so easy to agree on later in the process.

Parties are generally free to agree on any items in the LOI, including provisions regarding the principles of purchase price determination mechanism, the scope of due diligence and other conditions. It may also include exclusivity and confidentiality provisions. LOIs are more predominantly used in non-structured sale processes, where the parties agree on the main commercial points of the transaction and set them out in writing prior to negotiating the main transaction.

Non-disclosure agreements are mostly used in transactions whereby the target company discloses some information about the sale process, or right before access to the sensitive information about the company is granted to the potential acquirer and its advisers.

There are no *prima facie* advantages or disadvantages to either of the mentioned documents; usually the seller decides which approach shall be used.

3.2 Binding nature of clauses in the pre-agreement documentation.

In general, LOI clauses do not bind parties to conclude the contemplated transaction. However, certain clauses, such as confidentiality, dispute resolution and similar remain binding after the term of the LOI has lapsed. Parties are nevertheless bound to negotiate in good faith under Lithuanian law. In the event of a breach of such a duty, the breaching party is obliged to compensate the non-breaching party the damages that the party incurred by assuming that the agreement will be concluded.

NDAs usually are valid for a number of years after the transaction in order to ensure that confidential information is not used in the event the transaction has not materialised and the receiving party does not profit from non-public information.

Any party may claim contractual damages in the event the other counterparty has breached its obligations under any pre-agreement documentation; therefore parties must fulfil their obligations properly despite non-binding nature of such documents.

4. DILIGENCE STAGE

4.1 Points to be cognisant of

Points of emphasis of any due diligence proceedings differ based on the target and sector where it operates. Recent developments in Lithuania have put a spotlight on cybersecurity and data protection issues, as well as general compliance issues.

Buyers have become extremely razor-sharp in evaluating the areas of the target's activity which may have been affected by Covid-19, such as whether the target has solid financial fundamentals, whether there is any need for financial or operational restructuring, and whether its relations with material suppliers and customers are sustainable.

In the event the transaction is negotiated between competitors, some of the most sensitive information may only be disclosed to the so-called 'clean team' of advisers, who cannot then share their findings unless they are generalised and no sensitive information is actually shared between the competitors.

Due diligence is usually performed prior to the execution of the acquisition agreement. Vendor's due diligence is performed in structured sale processes. In rare cases, the acquirers may agree on a confirmatory due diligence after signing of the transaction, either full or limited to specific fields.

4.2 A brief overview of issues that are typically seen and how they are typically addressed

Typically, companies in Lithuania have deficiencies in data protection measures. In the past, compliance with data protection laws was not emphasised to the extent it now is by local authorities in Lithuania. Prior to entering into force of the EU General Data Protection Regulation (GDPR), the local data protection authority did not have appropriate resources to carry out individual inspections in all industries. As a result, only around 30 companies have fined in the years since the GDPR came into force. Thus, attention to the GDPR has greatly decreased in the past few years, especially by SMEs.

Some practitioners in M&A negotiations have even argued that the buyer should accept the risk of a target's data protection non-compliance because it is a general market risk. If any specific indemnities in connection with data protection breaches were given at all, they were usually capped at the amount of the largest fine imposed by the local data protection authority, which is still rather small compared to the potential risk exposure – especially as fines may be calculated on global turnover of the acquirer's group.

Significant issues are typically solved by either resolving them prior to closing or by inserting indemnities into the transaction documents. Sellers are usually somewhat reluctant to undertake indemnities, as such undertakings may limit the possibility of a clean break from the target company and expose them to potentially significant liabilities.

Moreover, either of the parties to the transaction may obtain W&I insurance policy and therefore protect themselves from risks that were not or may not have been identified during due diligence of the target company.

5. MAIN TRANSACTION AGREEMENT

5.1 Formal requirements

The Law on Companies states that shareholders of a private limited liability have a pre-emptive right to acquire shares being sold by other shareholders. The right of pre-emption to acquire all the shares offered for sale in a private limited liability company is vested in the shareholders who own shares on the day of receipt of the selling shareholder's notice of intention to sell the shares.

Furthermore, share sale and purchase agreements for private limited liability companies must be certified by a notary public if:

a) 25 per cent or more of total shares in the target company are sold, or
b) shares are sold at a price higher than €14,500.

The certification of the share sale and purchase agreement by notary means additional costs for the company and a more complex share transfer procedure. However, the notarisation requirement is not applicable when shareholders' personal securities accounts are managed by licensed account managers (commercial banks or securities brokerage firms). There are several banks and securities brokerage firms providing such services in Lithuania. The company must transfer the accounting of its shares to a licensed account manager prior to entering into the main transactional documentation. Furthermore, some typical conditions precedent may not be certified by a notary, therefore parties generally avoid the notarisation procedures in favour of licensed account managers.

The procedure of transferring the accounting of shares from the company involves anti-money laundering checks on the target company and, in some instances, transaction counterparties prior to the transaction. Parties typically perform this task prior to the conclusion of negotiations.

Furthermore, as most transactions involve covenants on the sellers (typically not to compete with the target company's business and not to solicit its employees), the parties' requirements pertaining to competition law have to be taken into consideration while negotiating transactions. This is also applicable when the signing and closing of the transaction do not occur at the same time, and the sellers undertake standstill obligations with respect to daily operations of the target company.

In addition to the above, parties are generally free to negotiate and conclude transaction documents of their choosing.

5.2 Overview of the typical key clauses in the agreements

Generally speaking, the structures of transactional agreements and their key clauses are similar to those seen in other European jurisdictions.

The obvious key clauses in any transfer agreement are the subject matter of the agreement and the consideration. Parties also include covenants that are applicable after the agreement is concluded, such as non-compete and non-solicitation clauses.

With respect to determination of the price, parties are generally moving on from the locked-box principle; some sort of price adjustment is typically performed post-closing. The seller is usually tasked with preparing the closing accounts and therefore calculating the price that is determined on the factual closing date. In the event the parties disagree, a procedure is usually set out in the transaction documents whereby an expert from one of the 'Big Four' audit companies is appointed to provide an independent opinion, which is then binding on the parties. In practice, however, the parties usually settle differences in calculations amicably and therefore experts are used rather rarely.

Earn-out payments are also included in cases whereby the seller continues to be involved in the target company. This tactic also usually helps to bridge the gap between parties' valuation of the target company as the sellers are then given a right to earn additional consideration, which also works in the favour of the buyer.

Depending on what kind of sale process is taking place (a structured auction or a straight transaction between one interested buyer and a seller), the catalogue of requested warranties and warranties given may differ significantly. Buyers also give a limited set of warranties to the seller. These are usually quite formal, such as corporate standing, financial capabilities to consummate transactions and similar.

Sellers are usually asked to give indemnities for known risks based on material findings; however, no visible trends may be identified apart from data protection indemnities. It should be noted that, if any specific indemnities in connection with data protection breaches are given at all, they are usually capped at the amount of the largest fine that could be imposed by the local data protection authority, which is still very small compared to the potential risk exposure (small fines in the past do not guarantee small fines in the future).

Fully-fledged tax indemnities irrespective of due diligence findings (or lack thereof) are also becoming more common in Lithuania. This has mainly been influenced by investors from the Western European countries, but it should not be considered as market standard yet.

6. TYPICAL CONDITIONS FOR CLOSING/RELEVANT REGULATORY REGIME

6.1 Typical conditions for closing

Typical conditions can be divided in three categories:

a) traditional conditions found in most M&A transactions around the world;
b) regulatory conditions precedent that are different and unique to each jurisdiction; and
c) conditions based on due diligence findings.

Examples of typical conditions could be as follows:

a) accuracy of representations and warranties at closing;
b) no material adverse effect; or
c) no infringement of interim obligations between signing and closing.

More tailored conditions precedent may be inserted based on due diligence findings, such as:

a) a requirement to obtain certain consents from target's counterparties, such as main suppliers, customers or financiers;
b) correction of deficiencies identified during due diligence (such as preparing correct data protection documentation or introducing technical meaning to the same extent); or
c) entering into new agreements or extending existing agreements.

Regulatory conditions depending on the transaction and certain thresholds may involve merger clearance or foreign direct investment (FDI) clearance.

In the event it is evaluated that parties do not require any regulatory consents to close the transaction, signing and closing usually take place simultaneously. Parties obtain certain other consents and similar non-time-consuming deliverables prior to the signing of the transaction.

There is not much publicly available information about the volume of transactions that fail to close because of conditions not being fulfilled. Some transactions include deal-break provisions, whereby the party responsible for conditions not being fulfilled has to compensate damages or pay a fine in line with the provisions of the respective transfer documents.

6.2 Relevant regulatory requirements and issues

The primary regulators of M&A activity in Lithuania are:

- the Competition Council of the Republic of Lithuania (the Competition Council), which is responsible for merger control;
- the Bank of Lithuania (BoL), the authority responsible for supervising the Lithuanian financial market, including takeovers and acquisitions of qualifying holdings in financial market participants; and
- the Commission for Coordination of Security of Objects Important to Ensuring National Security of the Republic of Lithuania (Strategic Commission), which is

responsible for conducting national security review of investments in certain entities and economic sectors.

Additional regulators may also come into play if the target company is operating in a specific regulated sector (eg, telecommunications, energy or similar).

6.2.1 The Competition Council

The Competition Council must be notified of the proposed concentration. Authorisation must be obtained if the total gross income of the entities participating in the concentration in the last financial year before the concentration exceeds €20m, and if the total gross income of at least two entities participating in the concentration in the last financial year is more than €2m each.

The transaction cannot be closed until the Competition Council issues permission to the buyer to take over the control of the target company. In the event parties do close the transaction prior to the merger clearance, the transaction may be wound up and the parties involved may be fined accordingly.

The Competition Council review is by no means a formality. Therefore, parties need to be ready to provide all required information in a timely manner. Failure to do so may lead to fines imposed by the Competition Council.

The Competition Council has also introduced a new 'stop the clock' procedure used extensively in complex mergers, which has resulted in those mergers being examined for extended periods of time (six to nine months). While this provides more flexibility and time for the Competition Council to assess complex deals, businesses notifying such transactions are left with much more uncertainty when planning their deal timelines and post-merger activities.

6.2.2 Bank of Lithuania

The BoL must be notified of the proposed acquisition if the subject matter is acquisition and disposal of a qualifying holding of the capital and/or voting rights of financial market participants that are under the supervision of the BoL. Market participants are understood as enterprises holding a banking licence, management companies, financial brokerage and financial advisers' firms, and insurance and reinsurance undertakings.

6.2.3 The Strategic Commission

The investor has a duty to notify the Strategic Commission about an investment into a company operating in one of the aforementioned industry sectors if both of the following conditions are satisfied:

a) the investor acting alone or jointly with other investors seeks to enter into any transaction that reaches the threshold of 25 per cent of voting rights; and
b) the investment may have an impact on critical infrastructure objects, critical technology or security of resource supply, ability to gain access to non-public information or ability to control it. The second condition is left for self-assessment by the investor.

At present, the applicable laws do not set out any specific criteria which the investor could use to ascertain the impact of the investment to be made. Thus, in practice, investors usually choose to notify the Strategic Commission every time an investment exceeds 25 per cent of voting rights if the activities of the target are related to the sector indicated above.

If the investor has failed to notify the Strategic Commission about the investment and it is later deemed that the investor does not conform to national security interests, the transaction can be declared null and void.

Parties usually have a good understanding of whether any regulatory consents are required prior to the conclusion of negotiations. Parties usually outline the timing schedule in the share purchase agreement, whereby the party responsible for submitting any regulatory notifications has an obligation to prepare the notification within a certain timeframe. Parties also usually undertake cooperation obligations to be able to obtain all approvals as soon as possible.

7. CLOSING ACTIONS

7.1 Typical steps to be undertaken for consummation of the proposed transaction

Closing of the transaction usually occurs at the date indicated in the share purchase agreement, once all conditions precedent are in place or have been waived by the respective party.

At closing, parties usually go over a list of actions agreed in the transactional documents, which ranges from providing documents that evidence the title to shares on the closing date (an extract from the personal securities account of the seller is required in Lithuania) to confirmations that no material adverse effects occurred in the target company and paying the purchase price.

After the purchase price is paid and credited to the account of the seller (or paid into the escrow account), parties usually instruct the person maintaining the securities accounts of the target company to make entries evidencing that the buyer has acquired and the seller has sold the shares of the target company. Such am entry formalises the transfer of title to the buyer, as set out by the law.

Afterwards, the seller usually provides the resignations of the previous management and the buyer appoints new management in their place.

Where only some shares are sold, a shareholders' agreement is signed and/or enters into force when only some of the company's shares are transferred to the new shareholder.

There may also be other actions (such as concluding a new employment agreement with the CEO, entering into a lease agreement, etc.) that may be a part of the closing steps. This, however, differs on a case-by-case basis and these types of actions are rarely identified during the due diligence.

Finally, the transaction is considered closed when a closing certificate is executed, evidencing that all of the actions above have been completed.

7.2 Any additional inputs in cross-border M&A

The technicalities of cross-border M&A transaction have to be considered, such as the provision of extracts evidencing the corporate standing of the company, persons having legal authority to sign on behalf of any of the parties and similar. As the legality of some of these corporate documents needs to be recognised in Lithuania (documents have to be legalised or affixed with apostille), parties need to consider the time implications – these minor and technical details may significantly hinder planned closing timelines.

The pandemic has somewhat restricted travelling and face-to-face closings; therefore, alternative ways to close transactions were explored. Parties started using electronic signing with qualified electronic signatures as a way to conclude transactional documents. This approach, however, presents some obstacles to foreign nationals.

One of the more important points to take notice of is the requirement to identify the persons signing when the actual transfer of shares happens. Parties may appear in person or sign documents by electronic qualified signature in line with eIDAS Regulation (Regulation (EU) No. 910/2014).

Furthermore, not all electronic qualified signatures are accepted in Lithuania. Therefore, foreign parties usually issue powers of attorney to their counsel so that they may sign the closing documents on their behalf.

8. POST-CLOSING

8.1 General actions for post-closing

Post-closing actions usually involve filing of the new owner's data in public registers as well as other corporate changes if the management of the company is being replaced.

General issues of integrating the target into the buyer's corporate structure also must be considered. Parties sometimes agree on a transitional period when a company is carved out of another group of companies which provided IT, accounting and other services. Such carve-outs are generally difficult from the operational perspective; therefore, parties usually agree on steps to be followed during the negotiation phase.

Furthermore, in most cases, the actual operations of the acquired business, such as access to bank accounts and similar, have to be taken over as well. Recent changes to anti-money laundering operations have significantly hindered the smooth transition of operating bank accounts when the ultimate beneficial owners (UBOs) of the buyer are not based in the EU.

8.2 Regulatory filings

Most regulatory filings are done prior to closing of the transaction, as there are certain restrictions that prevent parties from closing until regulatory approvals are in place.

8.3 Regulatory requirements including ongoing statutory compliances

The acquirers may need to ensure that permits acquired prior to the transaction remain valid afterwards, such as clearances received from the BoL and the Strategic Commission (UBOs, for example, must remain in conformity with the requirements of the national security interests of the Lithuania).