Estonia

Financial Assistance
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INTRODUCTION

This guide provides a concise overview of the rules applicable to financial assistance under Estonian laws in connection with closely held limited liability companies (*osaühing* or *OÜ*) and widely held limited liability companies (*aktsiaselts* or *AS*).

FINANCIAL ASSISTANCE UNDER ESTONIAN LAW

There is no specific definition of 'financial assistance' under Estonian law. However, there are specific provisions in the Estonian Commercial Code (**CC**) setting out a prohibition on companies granting loans to specific categories of persons or for specific purposes or to secure such loans (collectively financial assistance rules). Financial assistance rules apply in a similar manner to both OÜ and AS companies. These rules are set out in CC Sections 159 (OÜ companies) and 281 (AS companies).

More specifically, a company is not allowed to grant a loan:

- to a shareholder whose share represents more than 5 per cent of an OÜ company's share capital, or more than 1 per cent of an AS company's share capital;
- to a shareholder or member of its parent company, whose share represents more than 5 per cent of the parent company's share capital in the case of an OÜ company, and 1 per cent of the parent company's share capital in the case of an AS company;
- to a person for the purpose of acquiring the company's shares; or
- to its management or supervisory board member or to its procurator (*prokurist*).

Companies are also prohibited from securing loans granted to the above persons.

The financial assistance rules are not limited to transactions which formally qualify as loans. They also apply to other economically equivalent transactions. For example, all kinds of credit arrangements and sale transactions where the payment due by a shareholder to the company is deferred are likely to fall under the financial assistance rules.

EXCEPTION REGARDING INTRA-GROUP LENDING

There is an exception to the financial assistance rules regarding intra-group lending. A subsidiary may grant a loan to, or secure a loan of, its parent company or a shareholder or member of its parent company, which belongs to the same group with the subsidiary, provided that it does not negatively affect the economic situation of the company or the interests of its creditors. Therefore, to determine whether the group exception is applicable, the following tests should be applied.

Do the company and the borrower belong to the same group of companies?
According to the CC, a group consists of a parent company together with its subsidiaries. A shareholder is a parent company if it owns a majority vote in the respective company; in this case, the latter company is considered a subsidiary. A company is also considered a subsidiary, if

- another subsidiary or subsidiaries have a majority vote in such company, either with or without the parent company; or

- if the other company (parent) has control over the respective company based on a contract or other arrangement.

Does the loan negatively affect the economic situation of the company or the rights of its creditors?
An intra-group loan must not negatively affect the economic situation of the grantor or harm the rights of its creditors. A loan should normally not be considered as harming the economic situation of the subsidiary if it is granted on market terms – ie, at-arm's-length conditions.

The interest rate, the term of the loan and other material conditions should not be less beneficial for the grantor compared to a loan granted to a third (unrelated) party, nor should the interests of the minority shareholders be overlooked. With regard to creditors, the company must make sure that it remains fully solvent and able to fulfil its obligations after the loan is granted.

Is the borrower solvent?
Intra-group lending is only allowed if the borrower is solvent and the repayment of the loan is possible. The subsidiary is obligated to evaluate the solvency of the borrower.

Is the loan granted for the purpose of acquiring the share(s) in the company?
Lending is prohibited if the purpose of the loan is to acquire the share(s) of the lender.

As mentioned above, the exception is also applicable to securing a loan taken by the parent company, or a shareholder or member of the parent company which belongs to the same group with the subsidiary that is securing the loan. As with the loan, it is prohibited from securing the loan if the purpose of the loan is to acquire the share(s) of the lender. Using the company's assets as collateral in management buy-out or leveraged buy-out transactions where the target is the stake in the company itself, is prohibited.

OBJECTIVES OF THE FINANCIAL ASSISTANCE RULES

Granting or securing a loan to a shareholder
Financial assistance rules are aimed to prevent the return of the equity contributions made by the shareholders to the company. For example, without the financial assistance rules it would be possible for the company to repay its equity contributions by lending them back to the shareholders, which is normally contrary to the interests of the company itself and its creditors. Even though the company would still have a receivable against the shareholder instead of the cash, the company will not actually have the amount lent to the shareholder at its disposal. The objective of the loan security prohibition is the same.

As mentioned above, in some cases it is allowed to grant a loan to a minority shareholder, or to secure it, if the shareholder's stake does not exceed a certain percentage of the share capital.

Granting or securing a loan to a member or a shareholder of the parent company
Similar to lending to shareholders, the objective of prohibition to grant or secure a loan to a member or a shareholder of the parent company is to avoid outflow of the company's funds, thus harming the financial situation of the company and the interests of its creditors.

As mentioned above, a company is allowed in some cases to grant or secure a loan to a minority shareholder or a minority member of its parent company.

Granting or securing a loan to a management board or supervisory board member, or a procurator

The primary objective of the financial assistance rules with respect to management board members, supervisory board members and procurators is not so much protection of the creditors, but rather to avoid transactions made in conflict of interest between the company and its governing body member, and also to avoid provision of unfair benefits by companies to the members of their corporate governance bodies.

Granting or securing a loan for the purpose of acquiring the shares of a company

The purpose of the financial assistance rules is also to prohibit a company from granting or securing loans to existing shareholder(s) and person(s) wishing to become a shareholder. Granting or securing a loan to already existing shareholder or person that wishes to become a shareholder is likely to damage the rights of the other existing shareholders. In a situation where a company grants a loan to, say, its majority shareholder to acquire additional shares in the company, that majority shareholder would receive an unfair advantage compared to other shareholders.

Another objective is to avoid situations where the management of the company effectively decides, by way of making a loan available, who will become the shareholders of the company.

CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE

Consequences regarding validity of the transaction

Transactions in breach of the loan prohibition rules are void and unenforceable. However, transactions in breach of the loan security prohibition are considered valid, but the person whose obligation was secured must compensate the damage caused to the company by such transaction.

Civil claims arising from the breach of financial assistance rules

The primary consequence of a transaction in breach of the loan prohibition rule is that such transactions are void. This means the lender has an unjustified enrichment claim against the borrower. In addition, the lender may have a claim for damages against the borrower, the purpose of which is to protect the company beyond the amount actually lent to the borrower.

In case of a breach of the loan security prohibition, the company will have a claim for damages against the person whose loan was secured by the company.

Civil and criminal liability of the management

Subject to certain conditions, members of a company's governing bodies responsible for a breach of financial assistance rules may be held liable for the damages caused by such transaction to the company.

Breaching the financial assistance rules is not directly criminalised. However, if a member of the management board knowingly materially reduces the solvency or causes insolvency of the company by breaching the financial assistance rules, then criminal charges may, on certain conditions, be brought against such management board member for causing insolvency.