Latvia
Negotiated M&A Guide
Corporate and M&A Law Committee

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1. **Introduction**

**A. Principal Legislation Relevant to Acquisitions**

Under Latvian law, no single act of legislation governs the acquisition of companies or other types of business entities or assets. Rather, such acquisitions are governed by general laws governing contracts, in particular the Civil Law, and by laws governing the establishment and operation of commercial entities ("merchants"), in particular the Commercial Law. Other relevant legislation includes the Competition Law, the Labour Law and the myriad laws and regulations governing corporate, individual and other types of taxation.

**B. Types of Entities that are Targets of Acquisitions**

1) **Limited Liability Company**

The most popular type of business entity in Latvia is a limited liability company ("sabiedrība ar ierobežotu atbildību" or "SIA" – hereinafter “LLC”). An LLC is a private capital company whose shares may not be publicly traded, and it is easily established with a minimum share capital of EUR 2,800. The Articles of Association of the LLC may be very complex, or they may be very brief (firm name, number of shares, par value, share capital, number of management board members and their representation rights). Any governance issues not covered by the Articles of Association are provided for by the Commercial Law. A management board (composed of one or more members) elected by the shareholders jointly manages the LLC, however, board members may represent the company individually if so permitted by the Articles. Appointment of a supervisory board is optional in the case of an LLC.

With respect to acquisitions, the shareholders of an LLC have the right to freely sell their shares at a negotiated price (unless limited by the Articles or by a shareholders’ agreement), however, under the Commercial Law the other shareholders of the LLC have a right of first refusal to acquire the selling shareholder’s shares, unless provided for otherwise by the Articles.

2) **Joint Stock Company**

Another popular business entity in Latvia is a joint stock company (“akciju sabiedrība” or “AS” – hereinafter “JSC”). A JSC is a capital company which may be private or whose shares may be publicly traded. As opposed to an LLC, the minimum share capital of a JSC is EUR 35,000 (although banks, insurance companies and some other exceptions require higher minimums). The other principal difference between a JSC and an LLC is that the JSC is required to have a supervisory board elected by the shareholders, consisting of at least three members (five, if the JSC is publicly traded). The supervisory board in turn elects the management board, which must have at least one member (three, if the JSC is publicly traded).

With respect to acquisitions, the shareholders of a JSC have the right to freely sell their shares at a negotiated price, however, the Articles of the JSC may: (i) provide restrictions such as requiring the consent of the other shareholders; or (ii) grant rights of first refusal to the other shareholders.

3) **General partnerships and limited partnerships**

The Commercial Law provides for general partnerships ("pilnsabiedrība") and limited partnerships ("komandītsabiedrība"). However, such business organizations are very rare in Latvia and will not be further discussed in this chapter.
2. **Structure of the Transaction**

Acquisitions are performed in Latvia by way of: a) a purchase of shares; b) a purchase of assets (which may include a transfer of undertaking); c) acquisition by reorganization (usually a merger); and d) acquisition via a joint venture (the latter not described further below).

**A. Share Purchase**

A share purchase is a preferred structure for performing acquisitions in Latvia. A share transfer from one person to another is a relatively simple procedure in Latvia. Title to the shares of an LLC will pass at the moment when both the purchaser and the seller, as well as the chairman of the management board of the company, duly sign the company’s shareholders’ register before a notary. As such, an acquisition by share purchase can be much less time consuming and costly than an asset purchase. Share acquisitions are generally more expedient than acquisitions by merger due to various statutory procedures that must be followed in mergers.

That said, in a share purchase the purchaser assumes all of the target company’s obligations and liabilities, whereas in an asset purchase the purchaser may be able to limit the acquired obligations and liabilities to a certain extent. Since in a share purchase scenario the purchaser cannot limit the assumption of the target company’s obligations and liabilities, significant effort must be made by the purchaser, during due diligence, to understand such liabilities and then to extract from the seller extensive representations, warranties and indemnity provisions for any undisclosed liabilities.

Another relevant factor for the purchaser in a share purchase is the impact that change of control provisions may have on governmental licences or permits issued to the target company and on agreements between the target company and third parties (if such agreements contain change of control provisions).

**B. Asset Purchase**

In the case of an asset purchase, generally the purchaser may choose which assets to acquire as well as the liabilities to assume (to a certain extent). In contrast, in a share purchase the purchaser receives all of assets and liabilities of the target company. However, an asset purchase may be more complex than a share purchase in terms of the time and effort that may be required to transfer each asset, and also from a taxation perspective.

An additional complexity occurs when the transfer of assets is a *transfer of undertaking*, as defined in Latvian and EU legislation. The sale of assets alone may not be a transfer of the undertaking. 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. Under the relevant EU and Latvian legislation, in the case of a transfer of the undertaking the employees of such undertaking are automatically transferred with the undertaking and the employees will have the right to continue their legal employment relationships, on the same terms and conditions that were established prior to the transfer. In the case where an asset purchase is deemed to be a transfer of undertaking, the Labour Law of Latvia prescribes the rights of the transferred employees and the liabilities of the purchaser towards such acquired employees.

In addition, under the Commercial Law, the acquirer of the undertaking will be responsible for all of the liabilities of such undertaking (although the seller will be jointly liable for liabilities of the undertaking that arose prior to the transfer and are to be fulfilled in the five year period after the transfer). Thus, the purchaser in an asset deal must carefully make a determination whether the asset purchase may be deemed to be a transfer of the undertaking and conduct due diligence to determine the extent of the liabilities that it may acquire in such asset purchase.
Also relevant in an asset purchase is timely planning. One must allow sufficient time to examine the assets subject to the transfer as well as the formalities needed to transfer each asset. For example, real estate and movable assets such as vehicles, equipment and facilities, supplies and inventory may each require a different mechanism for transfer; the same will apply to intellectual property (software, data bases, domain names, trademarks). Moreover, under the Civil Law, contracts, rather than being assigned to the purchaser, must be transferred by a novation agreement involving the purchaser, the seller and the third party contract partner. The purchaser must pay special attention to the transfer of licenses and permits, and be aware that some types of assets, such as bank accounts and some insurance policies, cannot be transferred at all. Provisions for the above complexities must be adequately provided for in the asset purchase agreement.

C. Acquisition by Reorganization (statutory merger)

An acquisition by reorganization is, under the Commercial Law, a transaction where one company is legally absorbed into another, and the survivor succeeds to all of the assets and liabilities of the absorbed company. Such an acquisition, however, is a time consuming process as the parties need to comply with the reorganization procedures of the Commercial Law, including lengthy procedures established for the protection of the creditors of the absorbed company.

3. Pre-Agreement

A. Confidentiality Agreement

The most typical “pre-agreement” agreement employed in acquisition transactions in Latvia is a confidentiality or non-disclosure agreement (NDA). In most private acquisitions, the seller will wish to keep the fact that its company is for sale confidential, in order to protect its ongoing business and avoid any impact to its contractual, employment and other stakeholders’ relationships. Second, since the seller will be expected to disclose sensitive information about the company to the potential purchaser, whether in due diligence or otherwise, the seller will seek to restrict the potential purchaser’s use of such information and disclosure to third parties.

Such a confidentiality agreement must be specific enough to properly define the information that is intended to remain confidential and to whom, and under which circumstances, it may be disclosed. The agreement must also (i) address how the potential purchaser will handle and destroy the confidential information in the event the acquisition is not consummated; and (ii) specify the extent of the continuing obligations of the potential purchaser not to disclose the information.

B. Letter of Intent

A letter of intent is a document that is often negotiated and executed prior to the negotiation of the acquisition agreement. It may or may not include the terms of a confidentiality agreement. Such a pre-agreement agreement may also be called a term sheet or a memorandum of understanding. There is no common terminology that is used in transactions in Latvia. Such agreements are all very similar. That said, the legal meaning and legal consequences of each is determined by its contents and the intention of the parties. The purpose of such documents is to memorialize or document the commercial intentions of the parties and provide a useful benchmark to identify the main terms of a transaction, especially in a protracted or complex negotiation.

The more detailed the terms of the pre-agreement, the less likely that it will be concluded. The parties may get drawn into negotiations better left for the acquisition agreement. Conversely, it is much easier for the parties to agree on the terms of a less detailed pre-agreement (for example, general structure of deal, deadline for signing the agreement, terms of due diligence, purchase price mechanism, a rough outline of the assets (and liabilities) included in the purchase price, exclusivity period), but this may lead to disputes during the negotiation of the acquisition agreement if the parties have different interpretations.
of what was agreed during the pre-agreement phase. There must be a balance between the effectiveness of the pre-agreement and the time it takes to complete.

Generally, the letter of intent will contain a clause stating that the agreement is not binding on the parties. However, even if the agreement contains such non-binding language, the parties must be careful that the letter of intent does not contain the main components of a contract under the Civil Law of Latvia. A court may later find it to be binding. Under the Civil Law, even under an agreement stated to be non-binding, the parties have the legal obligation to negotiate in good faith.

Even in an agreement stated to be non-binding, the parties will include clauses making particular provisions binding, such as clauses on confidentiality, exclusivity, responsibility for costs/expenses incurred during the negotiation, breach of undertakings and related damages or penalties if such are agreed.

**C. Due Diligence**

Having entered into a confidentiality agreement and/or a letter of intent, the parties to an acquisition agreement will enter the due diligence phase of the transaction and the purchaser will be provided the opportunity to examine the company or the assets to be acquired. The purchaser will be looking to confirm that the proposed purchase price is in line with the state of the company or the assets (and liabilities) to be acquired and to identify potential risks. In addition, due diligence will enable the purchaser to determine the optimal transaction structure and identify the key matters to be negotiated in the acquisition agreement.

Legal and financial due diligence are typical in almost every transaction; some transactions will require separate advisers to perform tax due diligence, environmental, IT or other technical due diligence, real estate, employment, etc.

Due diligence performed by the purchaser itself is most typical in Latvia. Sellers’ due diligence, where the seller provides the due diligence report to potential purchasers, is much less common in Latvia.

In most cases the due diligence will be performed prior to the signing of the acquisition agreement. Sometimes it will continue after signing the acquisition agreement, up to completion of the transaction. For example, where the purchaser is an actual or potential competitor, prior to signing the acquisition agreement the seller will significantly limit the amount of information to be disclosed. In this case the purchaser will seek to conduct additional due diligence after the signing of the acquisition agreement.

In any transaction, the scope of disclosure during the due diligence process may require extensive negotiation between the parties. A seller having little experience with acquisition transactions may balk at disclosing too much information about its company out of concern for confidentiality, even with a strong confidentiality agreement in place, and a seller concerned about the real intentions of its suitor may limit what it deems to be sensitive competitive information. The amount of information disclosed will also be influenced by the time available. Another factor is the capacity of the seller to physically prepare the due diligence documents for inspection by the purchaser, especially where only a limited number of the seller’s representatives have knowledge of the proposed transaction due to confidentiality concerns. Physical data rooms, where paper documents are assembled in a conference room in binders or otherwise, are sometimes still used in Latvia, however, virtual data rooms have become the norm.

Typical areas of inquiry for legal due diligence include: 1) basic corporate information; 2) reorganisations and affiliations; 3) subsidiaries, representative offices and branches; 4) licences, permits and consents; 5) litigation and disputes; 6) fixed assets; 7) real estate; 8) commercial agreements and other matters; 9) insurance; 10) loans and liabilities; 11) workforce and employment contracts; 12) labour relations and labour safety; 13) product liability, consumer protection and personal data protection; 14) intellectual property; 15) information technology; 16) taxation and other obligatory payments; 18) environmental matters; and other areas specific to the target company or industry.
Due diligence in an asset acquisition is just as important as in a share acquisition, in order that the purchaser understands both the extent of the assets to be acquired and whether each asset (or contract) is capable of being transferred. In addition, the purchaser must be aware of any transfer of undertaking that may occur with the asset purchase, and the resulting liabilities acquired as a result of that transaction.

The results of the legal due diligence must be tailored to the needs of the purchaser so that the purchaser can best negotiate the acquisition agreement, including adequate representations, warranties and indemnity provisions. Of course, the seller will wish to limit its liability as much as possible and in the negotiations seek an admission from the purchaser that the due diligence was adequate and satisfactory and that the purchaser will have no claim against the seller in relation to any information that was disclosed during the due diligence. This debate between the parties is most typical during the final phase of the negotiations of the acquisition agreement, which is why at the outset of the due diligence it is important that the parties adequately define the scope of the due diligence and what information will and will not be disclosed and relied upon in signing the acquisition agreement.

4. **Acquisition Agreement**

A. **General Structure of Acquisition Agreement**

The general structure of an acquisition agreement is fairly similar to that encountered in most Anglo-Saxon and Northern European jurisdictions. In the case of a share acquisition, the general structure may include: a clear identification of the parties and the object of sale; a clear statement of the sale and purchase of the shares to be transferred; the purchase price, including the methodology for the calculation of the purchase price and specific arrangements for its payment and related security or escrow arrangements as well as provisions for any necessary purchase price adjustment; the conditions precedent to closing the transaction; the closing procedure including a detailed procedure on the transfer of title to the shares; the covenants of the seller; the parties’ representations and warranties; other obligations of the parties, including certain restrictions on the seller such as non-competition or non-solicitation arrangements; additional undertakings of the parties that are specific to the circumstances of the relevant transaction; remedies for breach of the representations and warranties and other obligations under the agreement and the terms of indemnification and related claims procedures; choice of law and dispute resolution; termination provisions; and others. In order to ensure the clarity of the acquisition agreement, it may contain a list of defined terms and have attached numerous schedules or exhibits.

B. **Parties, Object of Sale**

All acquisition agreements in Latvia begin with an identification of the parties to the transaction, including details as to each individual’s declared residence and personal identification number and each legal entity’s registered address and registration number, as registered in the Commercial Register of the Register of Enterprises of Latvia. The object of the acquisition, either the shares of a company or particular assets, must also be identified in some detail. In the case of an asset sale, the assets are listed in detail in attached schedules. The acquisition agreement must contain a clear statement that the seller has agreed to sell to the purchaser, and the purchaser has agreed to purchase from the seller, the object of the sale, upon the terms set out in the agreement.

Although a purchaser of a Latvian company will most often seek to purchase one hundred percent ownership of the target, the initial acquisition may be for fifty-one percent or some greater or lesser percentage. Foreign investors, in particular, may wish to retain minority shareholders who have knowledge and experience of the business, subject to a detailed shareholders’ agreement regarding the management of the company and subject to the exercise of call or put options, in the future, whereby the purchaser may obtain one hundred percent ownership at a later time.
C. Purchase Price and Payment

1) Purchase Price Calculation

The acquisition agreement must state the consideration to be paid by the purchaser for the acquisition of the assets or shares (the purchase price) as well as the mechanism to calculate the purchase price, the payment terms and procedure for payment. In the simplest case: (i) the purchase price may be stated as an absolute total figure to be paid for the shares/assets, or (ii) the purchase price for shares may be stated on a per share basis (in the event of several sellers), or (iii) the purchase price for assets may be stated on an asset class-by-asset class basis. Also, in the simplest case, the parties will agree that the purchase price will be paid in full at closing (subject to the agreed closing procedure, that is, whether title to shares/assets will pass prior to payment or in the reverse – see Section 4(E) below).

Most often the parties will agree on a fixed purchase price, utilizing a locked-box pricing approach. However, in many cases the final purchase price is not known at the time the acquisition agreement is signed. The acquisition agreement, in this case, must clearly outline the procedure for the calculation of the purchase price, including the benchmarks, dates and principles on which the calculation will be based. In most cases, the parties will agree to adjust the purchase price after closing and after the target company’s closing (or completion) day accounts have been audited. Since such audited financial results may be available only several months after closing, the parties must agree on a specific procedure for the purchase price adjustment and how to quickly and efficiently resolve any disputes that may arise in the process.

In Latvia, acquisition agreements involving private companies where the purchase price may be based on the future economic performance of the target company (an earn-out) are much less common, simply due to the fact that the Latvian M&A market is less than twenty-five years of age and many participants may not be trustful of such arrangements and will prefer that the total purchase price be known, to a good approximation, at the signing of the acquisition agreement. That said, as long as the approximate aggregate purchase price is known, it is not unusual for a split payment arrangement where the seller receives several instalments of the purchase price over a defined time period.

2) Security Arrangements

A seller will often demand that the purchaser pay a deposit or earnest money at the time of signing the acquisition agreement. This is particularly the case after the seller has revealed its confidential information during due diligence and is not sure that the purchaser will complete the transaction. Such a deposit may range from five to twenty-five percent of the purchase price, and often the seller will demand that if the transaction is not completed, due to the fault of the purchaser, then the seller will retain the deposit as a contractual penalty.

From the purchaser’s perspective, in many share acquisition transactions it is typical for the purchaser to negotiate to hold back some component of the purchase price as security against the seller’s breach of its representations and warranties and other obligations under the agreement. Such a holdback amount may generally range from five to twenty percent of the purchase price, but it may in certain cases be greater. The length of the holdback period will vary due to the peculiarities of the transaction and the results of the due diligence, but it may generally range from six to twenty-four months. In addition, the amount of the holdback may be reduced over time if the purchaser believes that some risks will subside.

A common security arrangement in Latvian acquisition transactions is the use of escrow accounts. In most cases, the purchaser will expect to receive title to the acquired shares before payment of the purchase price. In turn, the seller will demand that the purchaser transfer the amount of the purchase price into an escrow account, prior to the transfer of title to the acquired shares to the purchaser. Thus, in concert with the negotiation of the acquisition agreement, the parties will involve one of the respected banks in Latvia and negotiate an escrow account agreement(s). Latvian banks each have their own form of escrow agreement which may be used as the starting point for negotiation. The parties must agree on
the specific documents to be presented to the bank in order to release the funds from the escrow account. For example, the purchase price may be released to the seller upon the bank’s receipt of: (i) a copy of the shareholders’ register showing the purchaser as the owner of the shares, or (ii) a report from the Commercial Register showing that the change of ownership has been filed with the Commercial Register. Escrow accounts are also used as a depositary for holdback amounts. The effect is the same as above regarding holdback amounts (where the purchaser holds back some amount of the purchase price from the seller), except that the amount held back is held by the escrow bank. The latter arrangement, however, adds to the complexity of the transaction as the parties must clearly specify the procedure for release of the holdback amount, as well as how to address disputes about the same.

D. Conditions Precedent

The conditions to be fulfilled prior to the completion of the acquisition transaction will vary depending on: (i) the unique circumstances of the transaction and the parties, (ii) the relevant industry sector of the target company, and (iii) issues arising from due diligence. Some of the typical conditions precedent include the following:

1) approval of the transaction provided by the management board or supervisory board (or shareholders) of the purchaser or some entity related to the purchaser (such as a parent company);

2) waiver of pre-emptive rights by the target company’s shareholders, in the event the target company has multiple shareholders;

3) bank/financing institution approvals, for example, where the target company’s financing agreements contain change of control provisions;

4) financing necessary for the acquisition obtained by the purchaser;

5) repayment or refinancing of debt obligations of the target company, including obligations between the target company and the seller;

6) agreed financial results achieved by the target company for a specified time period;

7) contract partners’ approvals obtained where the target company’s contracts contain change of control clauses;

8) government/regulatory institution approvals, if applicable, such as from the competition authorities or the banking/financial services regulator;

9) specified licences or permissions issued by governmental institutions to the target company are obtained or extended;

10) removal of pledges or other encumbrances on the shares to be purchased;

11) conclusion or termination of specified agreements by the target company, or conclusion of particular side agreements between the parties to the transaction;

12) no breach of the seller’s representations and warranties between signing the acquisition agreement and closing;

13) no material adverse effect having occurred with respect to the target company between signing and closing;

14) an individual or some entity other than seller providing a surety or guarantee with respect to the obligations of the seller, in particular for breach of the seller’s representations and warranties;
15) execution of an escrow agreement and the deposit of the agreed amount into such escrow account.

E. Completion and Closing Procedure

1) Share Acquisition

The acquisition agreement must clearly state the procedure by which title to the shares or the assets will be transferred to the purchaser. Under the Commercial Law, in the case of a share acquisition of an LLC, title to the shares will be transferred to the purchaser upon the execution (before a notary) of the company's share register by the purchaser, the seller, and the chairman of the management board of the company. The company's shareholders' register is maintained by the management board of the company, thus, if the parties agree, the transfer of title to the shares of an LLC can be arranged very quickly. No filing of the shareholders’ register is necessary to effect the share transfer; however, the Commercial Law requires that the amended shareholders’ register of an LLC be filed with the Commercial Register, within three business days of the share transfer, in order to provide notice of the names of the shareholders to third parties.

In negotiating a share acquisition agreement, once the conditions precedent have been fulfilled and the parties are ready to close the transaction, an important issue to consider is the timing of the execution of the shareholders' register and the payment for the shares by the purchaser. In most cases, the purchaser will require that the shareholders’ register be executed prior to payment of the purchase price. Often the purchaser will also require that the change of shareholders’ be filed with the Commercial Register prior to payment of the purchase price, which can delay the payment by up to three business days. The filing with the Commercial Register provides notice of the acquisition to third parties providing additional comfort to the purchaser. However, very often the seller will not be willing to wait and will demand payment at closing, at the same time that the title to the shares is transferred. The compromise may be to ensure that the purchaser pays the purchase price into an escrow account, which is then released either on presentation to the bank of the changed shareholders’ register or a report from the Commercial Register that the changed shareholders’ register has been filed.

The signing of the shareholders’ register and payment of the purchase price are often the last steps in the closing process. Prior to these final steps, the parties typically exchange and/or sign other documents as agreed in the acquisition agreement, including resignation letters by the management board members of the target company and other documents required to be delivered under the terms of the acquisition agreement. The parties may agree that the seller will hold a shareholders’ meeting just prior to the closing, at which meeting the new management board (or supervisory board) members may be elected at the instruction of the purchaser, or changes may be made to the company’s Articles of Association. Alternatively, the purchaser may call a shareholders’ meeting immediately after closing and perform the same actions. Any such election to the management bodies of the target company or adoption of new Articles is effective immediately. Afterward these actions are required to be registered with the Commercial Register in order to provide notice to third parties.

The closing typically is held at the offices of the lawyers for one of the parties; however, if an escrow account is part of the transaction, it is more convenient if the closing is held at the bank’s premises.

2) Asset Acquisition

As stated in section 2(B) above, the transfer of assets can be a complex procedure as each type of asset may require a different transfer mechanism. The parties to the asset purchase agreement need to take account these factors when devising the closing procedure.

F. Covenants

The covenants that bind the seller after the signing of the acquisition agreement, but prior to the completion of the acquisition, may vary depending on: (i) the unique circumstances of the transaction and
the parties; (ii) the relevant industry sector of the target company; and (iii) issues arising from due
diligence. Some of the typical covenants that a purchaser may require from a seller in an asset purchase
transaction include the following:

1) the business of the target company must be conducted in the ordinary course and consistent with past
practices;

2) no action must be taken by the seller or the target company which is inconsistent with the acquisition
agreement or the consummation of the transactions contemplated therein;

3) no changes may be made to the Articles of Association of the target company, and the authorised
capital of the company will not be increased or decreased; no issue of new shares or any other securities
convertible into shares may be effected;

4) no sale or any other transfer, pledge or collateralisation of the shares of the target company will take
place;

5) no dividends or other form of distribution may be paid out to the seller or others;

6) limits on capital expenditure or investments are put on the target company, except in the ordinary
course or with the consent of the purchaser;

7) disposal or acquisition of material assets is limited, except in the ordinary course or with the consent of
the purchaser;

8) the company is prohibited from entering into agreements under which the company will grant
exclusivity to third parties;

9) the company is prohibited from incurring, assuming or guaranteeing any indebtedness;

10) the company is prohibited from increasing salaries and benefits, and is prohibited from hiring or firing
key employees; no change to employment in policies is permitted;

11) the company is prohibited from changing the accounting principles used to date;

12) the company is prohibited from cancelling or waiving claims or other rights;

13) the company must conduct its activities diligently and use its best efforts to preserve its relationships
with employees, customers, contract partners, licensors, licensees, creditors and other persons having a
business relationship with the company.

Such covenants usually lose much of their relevance in transactions where the signing and closing occur
simultaneously or within a relatively short period of time.

G. Representations & Warranties

1) General

The extent of the representations and warranties (the “warranties”) that the parties will agree to in the
acquisition agreement will vary in each transaction, depending on: (i) the negotiation strength of the
parties; (ii) the extent of the due diligence conducted by the purchaser; (iii) the perceived risks of the
particular transaction, including the type of assets or company to be acquired; (iv) the industry sector in
which the target company is engaged; and (v) how clearly the potential liabilities of the target company
may be identified. The purchaser will seek a wide array of warranties to insure its investment, particularly
so if due diligence of the target company or assets was limited. In turn, the seller will seek to limit the
warranties in their number, type and scope as much as possible. Often the negotiation of the warranties will be the most difficult task of negotiating the acquisition agreement. The warranties must be stated to be true and correct both at the signing of the acquisition agreement and the closing of the transaction.

2) Typical Seller’s Representations and Warranties

The following are a sample of the typical warranties provided by sellers in an acquisition agreement in Latvia (these are generalizations, in that the actual warranties are usually much more comprehensive):

a) the target company is duly organized and in good standing and solvent;

b) the seller has the corporate authority to enter the transaction, as well as (in the case of an individual) any necessary spousal consent for the sale of its shares;

c) the seller has valid title to the shares or assets (if an asset transaction) to be sold, and they are not pledged or otherwise encumbered with third party rights;

d) the company’s shares are legally and validly issued and are fully paid and constitute one hundred percent of the issued share capital of the company;

e) all corporate records required to be kept by the company exist;

f) the activities of the company are carried out in the ordinary course of business;

g) the accounts of the company have been prepared in conformity with certain principles, are complete and accurate and all debts and liabilities have been disclosed;

h) all assets and undertakings of the company of an insurable nature are insured against risks normally insured against in the same kind of business as carried on by the company;

i) employment and labour regulations are observed by the company; employment agreements with employees are within the normal scope and do not provide exceptional benefits; there are no deferred compensation agreements, pensions, stock options or termination payments in force; the company has paid all required contributions under pensions and contracts; there are no disputes with employees;

j) the company has filed all tax returns, and all taxes required to have been paid or withheld or collected by the company were paid, withheld or collected by their respective due date; no tax audits or disputes are pending;

k) all governmental and other licences, permits and authorizations necessary for the business of the company are in full force and there are no pending actions or proceedings which seek to revoke such authorizations;

l) all real estate and other leases have been disclosed, and all use of such properties is in conformity with the relevant laws, permits and contracts;

m) the company has valid title to (or right to use) all disclosed movable and immovable assets and none is subject to any undisclosed encumbrances;

n) all material agreements have been disclosed and they are valid and enforceable, and no party to them is in breach; all contracts have been concluded on an arm’s length basis;

o) the company is not subject to any actual or threatened undisclosed litigation, claims or disputes;
p) the intellectual property of the company is validly owned or licensed; and the company does not infringe the intellectual property of others;

q) all information technology used by the company is validly owned or duly licensed;

r) the company has conducted its business in compliance with applicable environmental, health and safety laws and is not engaged in any dispute about the same; the company has no environmental liability arising from any property formerly owned or used by the company;

s) the company is in compliance with all laws, regulations, permits or judgments of courts binding on the company;

t) the company is in compliance with all competition laws and neither the company nor the seller is party to any non-competition arrangements;

u) all information provided by the seller and the company to the purchaser is true and correct both at signing and closing; the seller has not left undisclosed any material facts concerning the company;

v) there are no undisclosed powers of attorney issued by the company; and

w) the seller is not in breach of the covenants.

3) Typical Purchaser’s Representations and Warranties

The typical warranties provided by the purchaser to the seller are far fewer in number than those provided by the seller. The typical warranties provided by the purchaser relate to its organization and existence, its power and authority to enter and complete the transaction, and that it has sufficient funds available to purchase the shares or assets.

4) Limitations on Representations and Warranties

As stated above, the parties to an acquisition agreement may invest a lot of effort to negotiate the warranties. In particular, this applies to negotiating the limitations on the warranties. While the purchaser will seek to extract unconditional warranties from the seller, the seller will seek to limit, qualify and dilute the scope of the seller’s warranties, as much as possible, and make them subject to various thresholds.

First, the seller will seek to introduce materiality thresholds; this will require the parties to define the word “material” or provide some financial threshold to give meaning to the term. Second, seller will seek to qualify certain warranties so that it will be in breach only if it had actual knowledge (knew) or constructive knowledge (should have known) of some fact. Seller will also seek to soften the requirements of warranties with the introduction of a reasonableness factor. In addition, seller will seek to exclude liability for breach of warranties arising from information that was disclosed to the purchaser during the due diligence. The problem that the parties may encounter with the latter situation is that in many due diligence processes, especially those that are performed under time pressure, there may not be a clear record of what information was or was not disclosed during due diligence, and thus the purchaser may object to such an exclusion. For this reason, at the outset of the due diligence process the parties should understand and agree what information will be disclosed during due diligence, and how this should be reflected in the acquisition agreement.

The seller will also seek temporal limits on its liability for breach of the warranties. Thus, the parties may negotiate the time period, after the closing, during which the purchaser will be able to bring a claim against the seller for breach of a warranty. The time limit will depend on the circumstances of the transaction, but generally will range from one year to five years or more. The parties may also negotiate different time limits for particular classes of warranty, for example, those relating to areas where, in the
normal course, breaches may not be noticed for some time (tax audits, environmental liabilities, employment liabilities). Moreover, some warranties, such as the title and authority of the seller to enter the transaction and the capitalization of the target company, are so fundamental that no time limit should be applicable to claims for breach thereof.

H. Other Obligations and Agreements

In many cases the rationale for the purchase of a private company cannot be made if, following the acquisition, the seller immediately establishes a competitor to the target company. Thus, a purchaser will require the seller to agree to a non-competition obligation, which prohibits the seller from competing with the target company. Such prohibitions must be drafted in view of competition laws, and be limited in time, scope and geography. A related prohibition that is negotiated is a non-solicitation obligation, under which the seller is prohibited from soliciting the target company’s employees and/or customers. Both of these restrictions are usually integral parts of the acquisition agreement, and are accompanied with financial penalties in the event of breach.

Outside the confines of the acquisition agreement, the parties (and other third parties) may choose to govern their relationship following the acquisition with, for example, real estate and leasing arrangements, employment or consultancy agreements with management, sureties or guarantees provided to the purchaser to support the obligations of the seller, escrow agreements and other agreements required to fulfill the intent of the parties in entering the transaction. These additional agreements will be referenced in the acquisition agreement, and often their execution is a condition precedent to the closing of the acquisition, or stated to be a post-closing obligation of the parties.

I. Remedies and Indemnification

Generally, the purchaser will seek to include in the acquisition agreement the seller’s obligation to indemnify the purchaser for losses, including legal fees, suffered by the purchaser as a result of breach of any of the seller’s warranties or other obligations under the agreement. The seller will seek to limit the scope of the definition of losses and will seek to exclude indirect or consequential losses.

The seller will want to limit its maximum liability for breach of the agreement. Depending on the specifics of the transaction, the maximum liability can generally range from twenty to one hundred percent of the purchase price. In addition, the seller will want to (i) limit the time period during which the purchaser may be permitted to make a claim, after it becomes aware of its own or a third party claim against the seller; (ii) require the purchaser to mitigate its damages; (iii) allow the seller to step into the shoes of the purchaser to dispute any claims that may result in liability for the seller; and (iv) establish a threshold for a minimum amount of damages that must be incurred by the company, or purchaser, before a claim may be brought. The purchaser will seek the right to aggregate various small claims into a basket so that all such claims may be totalled and if they exceed such threshold, a claim may be brought against the seller.

J. Choice of Law, Language and Dispute Resolution

Most private acquisition agreements involving companies established and operating in Latvia, or involving assets located and registered in Latvia, are generally governed by Latvian law; however, it would not be unusual if an acquisition agreement involving non-Latvian parties may be governed by some other State’s law.

In many cases the negotiation of the forum for dispute resolution is one of the last items agreed by the parties. Often, a seller (in particular where the seller is a Latvian resident or local entity rather than a foreign investor) will prefer that disputes under the acquisition agreement be resolved in Latvian State courts and not in arbitration. Litigation in the local court system may be more familiar to local interests than arbitration. In addition, it is well known that a dispute in a court through final non-appealable judgment may take several years. In turn, a purchaser (in particular a foreign investor) will often prefer
that disputes be resolved in arbitration, as it is seen as a quicker, less expensive and, in some respects, more transparent process.

If the parties do agree on arbitration as the dispute resolution forum, then the next step is to agree on the particular arbitration tribunal. Sophisticated transactions involving very large sums of money often are referred for arbitration at an international arbitration institution (e.g., in Stockholm, Paris or London). However, these foreign tribunals may be seen to be prohibitively expensive and the parties may choose an arbitration tribunal in Latvia. Generally, the most reliable, professional and objective arbitration tribunal in Latvia is the Court of Arbitration of the Latvian Chamber of Commerce and Industry.

As in any agreement, the arbitration clause of the acquisition agreement should contain, at a minimum, the name of the tribunal, the number of arbitrators, the language of the arbitration and the applicable arbitration rules. In this context, the language of the acquisition agreement is relevant. In most acquisition agreements involving a foreign investor, the agreement will be drafted in the English language with or without a Latvian translation attached (depending on the comfort of the parties). Any such agreement should be subject to arbitration in the English language. One of the risks with State court litigation is that any foreign-language document submitted to the State court must be translated into Latvian and such translation must be certified by a notary. There thus exists a risk that during the translation to Latvian some subtleties of the original document in English may be lost.

K. Termination

An acquisition agreement should govern the relationship of the parties in the event that the transaction is terminated. In the most likely scenario, some event may occur after signing but before closing where the parties are unable or unwilling to complete the transaction. The parties may agree on the conditions under which one or both parties have the right to terminate the agreement, and the consequences arising from such an event. In addition, the parties may set penalties or other consequences where termination occurs due to the fault of one party. If confidential information has been disclosed by the seller to the purchaser prior to the termination, then the seller should seek to limit how the purchaser may use the confidential information, especially in the sensitive case where the two are competitors.

A less likely termination scenario may occur after the closing. For example, a decision of the competition authority in Latvia under which the transaction is determined to be an illegal merger and must be reversed. If the specific circumstances of the acquisition are such that this might be a possible scenario, then the parties should provide for this in the acquisition agreement.