



Borenius Group grows in the Baltics



Finnish-sponsored Real Estate Funds Moving to the Baltic States and Russia

A year or two ago, indirect property investments were not a common topic of discussion in Finland, and one could not in all honesty have argued that the Finnish indirect property market was a developed market in any sense. Although Finland has had a special Act on Property Funds since 1997, no funds have been formed under the Act, primarily due to tax considerations. Basically, the only form of indirect investment that was made was investment in a few listed property investment companies.

Things have now begun to evolve, and in one way or another property funds seem to occupy some lawyers' time almost on a daily basis. The most obvious developments may be characterized as follows:

- Although the legal framework has not been changed, a working group within the Ministry of Finance is considering alternatives, with a view to implementing changes to the relevant legislation.
- Finnish institutional investors have clearly taken a new approach to property investments and have during a relatively short period diversified their portfolios by selling Finnish assets and making a number of investments in European property funds. This also includes funds of property funds.
- Foreign property investors have started following the Finnish market and have at an increasing rate made acquisitions in Finland.
- Finnish sponsors have, during a short period, formed a number of property funds targeting investments in Finland, the Baltic States, and Russia.

The Finnish property funds formed so far include a small fund by Auratum, a leveraged structure formed by CapMan, Evli's EPI Baltic I, and Conventum's Vicus fund. Of these four, the latter two are structured as limited companies and intend to invest in the property markets in the Baltic countries; the geographical focus of the Vicus fund also extending to Russia. The other two, like a fund announced by Aberdeen recently, are structured as Finnish limited partnerships. The largest of the funds is currently CapMan's CapMan Real Estate I, totalling €500 million of capital in limited partner commit-

ments, bank finance and subordinated leverage channelled through a special purpose vehicle which issued €100 million worth of bonds listed on the Helsinki Stock Exchange.

From an adviser's perspective it seems that we have only seen the beginning of indirect investments in Finland and the Baltic states. A number of players seem to be considering a move to managing property investments, and there may still be some Finnish investors that might be willing to transfer a part of their portfolio to a property fund.

B&K has been a pioneer in Finnish legal advice on closed-end funds for a number of years and has been able to successfully use that experience in advising clients on raising, structuring, and making investments in property funds. B&K's Baltic offices are ideally placed to advise clients in relation to the legal, tax, and other considerations affecting funds operating in the Baltic countries. B&K has advised, among others, CapMan, Evli and Conventum on the formation of their first-time property funds.

Baltic Tax Planning Opportunities for Finnish Businesses

Expansion of business into the Baltic States – benefits from low corporate income tax rates

The growing business opportunities in the Baltic area are strongly supported by the beneficial corporate income tax regimes in place in the Baltic countries. In Latvia and Lithuania the general corporate income tax rate is 15%, while in Estonia the income tax rate is zero. By way of comparison, the average corporate income tax rate in the 15 old EU Member States is approximately 31%. This means that profits derived from direct investments into the Baltic countries are subject to very low taxation (or even none) at the Baltic subsidiary level. Low corporate income taxation directly affects the return on investments after tax.

The use of Baltic group companies in international tax planning offers several ways to reduce the overall effective tax rate of a multinational group. Considerable tax savings can be achieved by transferring risks and functions (e.g. intellectual property rights) to Baltic group companies, and thereby allocating profits with high margins to those companies. Transfer of risks and functions to a Baltic group company must always be effected at fair market value, which may result in one-off tax implications for the transferring company. However, the ongoing tax savings stemming from a tax-feasible business model and transfer pricing system may in a very short time period cover such implementation costs.

Tax efficient solutions can also be achieved through centralizing the finance functions of a multinational group into a Baltic group company. In such a financing structure, interest income is subject to low taxation in respect of the Baltic group company, while interest payments are deducted in regard of the group companies subject to considerably higher tax rates. It should be noted that, especially where pure financial tax planning schemes are con-

cerned, the Finnish tax avoidance regulations should be taken into consideration.

Repatriation of profits from Baltic subsidiaries

For Finland-based multinationals, it is often important to repatriate profits from foreign subsidiaries, for example, in order to distribute the profits to shareholders of the Finnish parent company. Therefore, profit repatriation planning is an essential aspect of tax planning with respect to Baltic group companies.

As a general rule, repatriation of profits from Latvian and Lithuanian subsidiaries to a Finnish parent company can be effected without tax implications. No withholding tax is due on dividend distributions at source, and dividend income is normally exempt from taxation for the Finnish parent company.

As noted above, corporate income is not subject to taxation for an Estonian company. In the Estonian tax system, corporate profits are taxed in connection with the distribution of profits from a company to its shareholders or other related parties. The distribution tax rate is 24/76 of the net amount of the distribution (the effective tax rate being 24%). Accordingly, repatriation of profits from Estonia through dividend distributions falls under the Estonian distribution tax regime.

It may also be possible for the Finnish parent company to repatriate profits from Baltic subsidiaries without tax implications through sale of the shares in those subsidiaries. A prerequisite is that the requirements prescribed in Finnish tax law for tax-exempt share sales are met. These requirements include, for example, that shares in a subsidiary are regarded as fixed assets for Finnish tax purposes, and that shares subject to sale have been held for a period of at least one year.

New Public Procurement Legislation

Public procurement rules within the EU are complex and often full of surprises for procurement units and participating businesses alike. The applicable procurement legislation is also subject to frequent renewal and amendment.

New Public Procurement Legislation

Two new EU Public Procurement directives were adopted as of 31 March 2004:

- Directive 2004/17/EC coordinating the procurement procedures of entities operating in the water, energy, transport, and postal services sectors; and
- Directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts, and public service contracts.

Legislation procedures are currently under way in Finland in order to implement the new EU directives.

The objective was to implement the new Public Procurement Act in Finland as of 31 January 2006. However, the bill has not yet been passed but it is expected that this will occur early in 2006. It is therefore likely that implementation will be delayed.

Objectives

The new legislation has three main objectives. The first is to simplify and clarify the existing legislation. The second is to adapt new legislation to modern administrative needs, for example by facilitating electronic procurement and, for complex contracts, by introducing more scope for dialogue between contracting authorities and tenderers in order to determine contract conditions. Thirdly, with the objective of enhancing transparency in the award process, the legislative package also includes me-

asures designed to achieve greater clarity in the criteria determining selection of tenderers and award of the contract.

Principal amendments

Procedures of procurement

The new legislation does not affect the use of the present open and restricted procedures of procurement. The use of direct procurement will be restricted in the same manner as it is restricted in the procurement legislation currently in force.

The new provisions aim at broadening the applicability and use of the negotiated procurement procedure, although the prerequisites for its use essentially remain unaltered. The negotiated procurement procedure can be applied, for example, when acceptable tenders have not been received in the initial procurement procedure; when the risks involved or the nature of the project prevents the pre-termination of the overall cost of the project; when the requirements for a service project cannot be assessed in sufficient detail; or when a construction project is made only for research, experiment, or development purposes.

The new legislation also makes available a new form of procedure: competitive dialogue. The procedure may be used in complex cases where procurement units find that open or restricted procedures do not give satisfactory results. This may occur in cases where prior determination of the legal, financial, or technical details of the project cannot be made. The competitive dialogue procedure could be used, for example, in large infrastructure projects.

In the competitive dialogue procedure, the procurement unit shall publish a contract notice in which the needs and requirements of the project are defined. Alternatively, these may be included in a descriptive document. Thereafter, the procurement unit shall open a dialogue with the candidates that meet the stated requirements and ascertain through discussions the appropriate means for satisfying the needs of the procurement unit. When the proper means of fulfilment have been assessed, the procurement unit shall ask the participants to submit their final tenders. The procurement unit shall choose the tender that is most economically advantageous.

Thresholds

The provisions of the new legislation also aim to introduce thresholds that set the scope of the use of statutory public procurement procedures. These thresholds have been subject to political debate and the following values are merely proposed thresholds.

Regarding public supply and service agreements, the proposed threshold is €20,000. Public work agreements would be subject to a €100,000 threshold. In projects not exceeding the

threshold, the procurement unit is free to apply its own procurement procedures. The value of a project is the total amount payable as estimated by the procurement unit. Any applicable form of option or renewal of the agreement shall be taken into account.

Conclusions

The principal and prevailing procurement procedures; open and restricted procedures of procurement remain untouched. The use of direct procurement is also very restricted under the new procurement legislation. Underlying procurement principles, such as the obligation to use existing possibilities of competition, and the obligation to treat the candidates and tenderers on an equal and impartial basis at all stages of the award procedure, are unchanged. Thus, it seems that in practice the new procurement legislation does not provide much that is new as far as the procurement units and participating businesses are concerned.

However, the thresholds introduced, the increased possibilities to use negotiated procurement procedure and the new competitive dialogue procedure do provide additional flexibility and new possibilities for procurement units.



Amendments to the Commercial Code

The Parliament of Estonia has recently adopted a law amending the Commercial Code, which shall take effect as of 1 January 2006. According to the author of the law, the Ministry of Justice, the intention is to increase the stability of the economic situation in Estonia.

The new amendments stipulate that if a member of the management board of a company concludes any agreements that are illegal or clearly in contravention of the articles of association, that member is liable for damages caused to the company by such transactions with all his/her personal assets. The concept of manager's personal liability previously existed in the Commercial Code, but this new amendment will clearly indicate what kinds of actions by the manager involve personal liability and what kinds of actions do not. The regulation of managers' personal liability was not so clear before, and it was left to the courts to interpret the law and form relevant practice.

As of 1 January 2006, it is not necessary to convene a shareholders' meeting in order to

approve the annual accounts of the company, and the approval can be given in writing or by email. The goal of this provision is to decrease the amount of unnecessary administration for the company, and it clearly works to the benefit of foreign shareholders.

The new amendments also introduce the possibility to demand reduction of the salary payable to the manager if the economic situation of the company has worsened significantly and fulfilment of the company's obligations in this regard would therefore unjustly burden the company. In such a case, the manager has the right to terminate the management agreement on giving one month's prior notice.

There is also an amendment to Commercial Code allowing the payment of dividend more often than once a year. Up to now, the law provided that dividends were to be paid once a year on the basis of the approved annual balance sheet. As of 1 January 2006, the clause stipulating 'once a year' has been deleted from the law.



Regulatory Changes to the Banking Market since 1 May 2004

Undeniably, there is a close correlation between banking market developments and market regulation. Therefore, the question of interest for everybody, no doubt, is whether there have been any changes, from the regulatory perspective, since 1 May 2004 when Latvia joined the European Union (EU).

To start with, the framework law governing banking activities in Latvia is the Law on Credit Institutions, which came into force as long ago as October 1995. During the process of accession to the EU, this law was aligned with the instruments of EU legislation relevant to the banking sector. Therefore, much of the work was done prior to accession to the EU. However, some steps remained to be completed and some additional points required attention. If we look at the changes that have been made to the Law on Credit Institutions since 1 May 2004, those can be divided into two categories. In the first, the legislators have attempted to implement the remaining directives and EU regulatory requirements. In the second, attempts have been made to solve the problems of money laundering and financial crime by giving more supervisory powers to different investigatory and quasi-investigatory institutions. This article focuses on the former, leaving aside the amendments aimed at combating money laundering and financial crime.

During 2004, the Law on Credit Institutions was supplemented by provisions aimed at full implementation of directive 2001/24/EC relating to the insolvency and reorganisation of credit institutions. Following the amendments, the Latvian legislation recognizes the fact that, in accordance with the principle of single supervision, the home country supervisory authority should be the only one competent to make decisions upon the reorganisation and insolvency of the credit institutions registered there. Logically, Latvian law also admits the fact that the decisions of the supervisory authorities of the other Member States should be recognised in the Republic of Latvia, and the rights of the relevant third parties respected. At the same time, the amendments provide for cooperation procedures between the FCMC and the other supervisory authorities of the EU Member States in cases in which reorganisation and insolvency occurs. Thus, it could be said that with the implementation of the banking insolvency directive Latvia, as an EU Member State, has undertaken to abolish the doctrine of territorialism in the insolvency regime for credit institutions, and the FCMC should be ready to work with other EU supervisory authorities to find viable solutions in cases where cross-border banking crises also affect the territory of Latvia. While preparing for the worst-case scenario of banking crisis, the amendments also provide additional regulation of the activities of the banks.

To be more specific, in 2004 the concept of e-money was introduced in the Law on Credit Institutions, and the so-called e-money directive was implemented. Accordingly, there is a regulatory and licensing framework for institutions wishing to transmit e-money and provide associated service operations. In accordance with the exceptions contained in the directive, an institution which has a €5 million ceiling on the amount of e-money it transmits shall not be required to obtain a licence from the FCMC. Nevertheless, while 2004 saw the admission of a new institution onto the market of credit institutions, it also saw the introduction of stricter regulation of activities outsourced by the credit institutions. In accordance with the amendments to the Law on Credit Institutions, there will now be many cases in which the banks will have to submit their agreements with outsourced service providers to the scrutiny of the FCMC. All in all, it may be said that the powers of the FCMC have been to some extent widened in this respect.

To this point about the extension of the powers of the FCMC could also be added the fact that the Law on Credit Institutions now allows the FCMC to request information from the banks

concerning their constituent shareholders. In addition, with respect to the FCMC it should be noted that the EU regime for the supervision of financial conglomerates was also very recently introduced in Latvia. Unsurprisingly, the Law on Credit Institutions underwent additional amendments providing for control of capital adequacy and related party activities within the conglomerates.

In summary, the new amendments to the Law on Credit Institutions seem to focus upon the creation of an additional regulatory framework both for crisis situations requiring reorganisation and restructuring as well as for the day-to-day monitoring of banking activities in Latvia. The supervision regime imposed by the EU leaves little room for the supervisory authority to fight for additional powers at the domestic level, since it has received the majority of such powers with the implementation of the EU directives. However, from this perspective the introduction of the powers of control over outsourced activities and the delegation of such control to the FCMC should be considered a step ahead, since the EU regulatory regime does not yet require that.



Recent case-law developments in the field of misleading and comparative advertising

The Supreme Administrative Court of Lithuania (hereinafter the 'Court') gave final judgment in two appeal cases on 17 November 2005. The mobile telecommunications operator UAB 'Tele 2' had appealed the judgment of the Competition Council of the Republic of Lithuania (hereinafter the 'Competition Council') and the Administrative Court of first instance.

These cases represented one of the first occasions in Lithuanian jurisprudence where the issues of misleading advertising, prohibited comparative advertising, and liability have been examined in detail by the Court. In its decisions, the Court explained the practical application of the criteria relating to advertising set out in the Law on Advertising of the Republic of Lithuania (hereinafter the 'Law on Advertising') which were: the accuracy of the claims made in the advertising, the comprehensiveness of the advertising, and the manner or form of presenting the advertising. The Court established that, while assessing whether or not advertising is misleading, at least one of these criteria must be identified. Moreover, an advertisement must also be assessed from the point of view of the average consumer. Finally, in both cases, the Court emphasised the impact of misleading advertising on fair business practices, as misleading advertising is one of the prohibited acts constituting unfair competition under the Law on Competition of the Republic of Lithuania.

Misleading advertising: lack of comprehensiveness of the advertising

The Court established that the economic behaviour of the average consumer is usually determined by the overall effect of a product (packaging, trademark, general information

about characteristics of the product, price of the product), without analyzing the details of this. When comprehensive information is not presented therein, references to a producer's website, or such notes as 'more information at the Tele 2 sale locations' do not constitute the necessary information, because the average consumer might, therefore, reasonably gain the impression that all the terms of the services are accurately described and there is no reason to seek further information.

In the decisions, the Court stressed that the advertised service is purchased without signing contracts, and usually in shopping malls or at newsagents' – locations not specialized in mobile phone sales and where employees, as a rule, cannot provide any information on supplementary terms or the validity of advertising campaigns. For this reason, the average consumer, only provided with part of the information from advertising, usually cannot adopt a critical approach to the information or presume the existence of any supplementary terms, which were not provided in advertising. Therefore, the average consumer can make a decision to purchase an advertised service while being misled, or even not realizing that he or she might be being misled.

Following the above-mentioned criteria, in the first case, the Court ruled that such statements as, 'The users of Tele 2 enjoy the lowest prices. They can call to all networks in Lithuania using the lowest leisure rate – only 0.25 Lt/min.' constitutes misleading advertising because it does not comply with the comprehensiveness criterion. The advertising did not include the information on the proviso that only those already using particular 'Tele 2' mobile service plans (only 11 percent of 'Tele 2' clients) were able to enjoy the advertised services.

In the second case, the Court established that the prices advertised by 'Tele 2' were only valid during the advertising campaign. The Court noted that the average consumer who does not have this information could reasonably have assumed that the advertised rates were permanent. The Court took the view that the statement, 'Text messages for free! 0 ct in "Maylis" network. Voice calls in "Mažylis" network only 7 ct/min.' does not contain time references, while the statement, 'Text messages for Tele 2 mobile "Mažylis" network users are now free and voice calls only 7 ct/min,' contains the word 'now', which creates a precondition to presume that the validity of the advertised rates may be limited to the advertising campaign period. The Court ruled in its decision that the statement containing the word 'now' was not misleading advertising, while the statement not containing 'now' was declared to be misleading.

Inadmissible comparative advertising

Aspects of comparative advertising were analyzed by the Court in the second judgment. In Lithuania, liability for inadmissible comparative advertising equates to liability for misleading advertising as stipulated by the Law on Advertising.

While considering this question, the Court came to the conclusion that, in order to define whether advertising is comparative or not, a competitor need not necessarily be directly named in advertising. Advertising may also be comparative when the average consumer can identify the advertiser's competitor from the details provided in the advertising. Moreover, there are strict requirements applicable to such advertising: the characteristics of the goods or services examined must be objectively compared therein (e.g. comparison of qualities or prices).

The Court concluded that such statements as, 'You will get Mažylis SIM card cheaper by bringing Ežys SIM card to any Tele 2 office', where 'Tele 2' used the name of the product 'Ežys', did not conform with the regulation on comparative advertising. This advertising was deemed to be comparative, as the average consumer was able to recognize the competitor since 'Ežys' is a concrete product supplied by 'Omnitel'. However, the comparison being made was not impartial, as it did not include objective data or reasoning. Efforts were being made to influence the economic behaviour of consumers by suggesting that the consumer dispense with the competitor's product in exchange for a discount on a 'Tele 2' product. The Court found that such advertising not only could disparage the service provided by a competitor, but also failed to meet acceptable standards of honest competition.

In accordance with the Law on Advertising, the supplier of advertising is liable for the usage of misleading advertising. An exception can only be made if an advertiser can prove that failure to comply was not due to fault on its part but on the part of others, such as the producer or publisher of advertising, who knew, or ought to know, that the advertising was misleading or that consumers were actually misled due to their actions in producing or publishing, or the producer or publisher could not provide evidence which identified the supplier of advertising.

The Court established that a contract existed between the producer of advertising and 'Tele 2'. In accordance with that contract, the producer could start the execution of the project only after having received the written approval of 'Tele 2', or after 'Tele 2' had assented to the modification proposals made by the producer. Since the advertising was made in concert with 'Tele 2', this enterprise was found liable for the final advertising project.

HELSINKI

Borenius & Kempainen
Yrjönkatu 13 A
FI-00120 Helsinki, Finland
Tel. +358 9 615 333
Fax +358 9 6153 3499
www.borenius.com

ESPOO

Borenius & Kempainen
Innopoli 2, Tekniikantie 14
FI-02150 Espoo, Finland
Tel. +358 9 2517 7285
Fax +358 9 6153 3499
www.borenius.com

TAMPERE

Borenius & Kempainen
Keskustori 1
FI-33100 Tampere, Finland
Tel. +358 3 214 9111
Fax +358 3 222 6002
www.borenius.com

TALLINN

Luiga Mody Hääl Borenius
Pärnu mnt 15, Kawe Plaza
EE-10141 Tallinn, Estonia
Tel. +372 6 651 888
Fax +372 6 651 899
www.lmh.ee

RIGA

Liepa Skopiņa Borenius
Lacplesa str. 20a
LV-1011 Riga, Latvia
Tel. +371 7 201 800
Fax +371 7 201 801
www.borenius.lv

VILNIUS

Regija Borenius
J. Jasinskio g. 16 A, 8th floor
LT-01112 Vilnius, Lithuania
Tel. +370 5 264 9555
Fax +370 5 260 8327
www.regija.lt



BORENIUS GROUP