

Deemed Transfer or Not Deemed Transfer?

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In the course of doing business in Latvia, companies sooner or later may face the necessity to carry out some type of reorganization or so called "transfer of an undertaking" processes provided in the Commercial law of Latvia.

Besides share acquisition, one of the alternatives often used in business acquisition transactions is merger. Reorganization is sometimes used as a way of business restructuring in cases when it is necessary to legally separate one companies' business type from another. It is also possible to make an acquisition by way of "transfer of an undertaking", i.e., alienation or acquisition of the assets and liabilities belonging to the business, without carrying out a reorganization as defined under the Commercial law.

There is some complexity to choosing the most appropriate way of restructuring for each particular situation. Tax consequences need to be considered carefully, and care must be taken in the drafting of the resulting legal documentation. Both "reorganizations" and "transfers" of an undertaking are governed by the Commercial law, in force since 2002. Although the law has been around for about four years, some legal ambiguities still exist and are only in the process of being resolved.

One example is the question of what happens with the rights and liabilities arising from certain agreements after a reorganization or business transfer has taken place.

The Commercial law provides that the company which has acquired the business as a result of reorganization or a simple undertaking transfer transaction, also acquires all of its assets and liabilities in accordance with the relevant business transfer or reorganization agreement.

This means that in cases when the reorganization or transfer of undertaking is used to acquire a business, the agreements relating to that part of the business are transferred to the acquirer of the business automatically, merely on the basis of the agreement according to which the transfer of business is carried out. In these cases there is at least theoretically no need to conclude any additional

agreements on novation or assignment of obligations. The acquisition of rights and obligations has taken place on the basis of the respective agreement on reorganization or transfer of undertaking, which is governed by the corresponding provisions of the Commercial Law.

On a practical level, however, there have been situations in real life when not all institutions or third parties apply these provisions of the law identically. It is not unheard of, during the course of business restructuring, to come across a perception of some state institution representatives that a transfer of liabilities can take place via conclusion of additional transfer agreements, and that transfer of rights and liabilities cannot occur solely on the basis of a reorganisation agreement or any other type of agreement of sale or transfer of business.

There may be some clarity ahead in all of this however, with decisions in proceedings No PAC-1411-06 and No PAC-1431-06 by the Civil Cases Department of the Supreme Court of Latvia. Both proceedings deal with the rejection of re-registration of lease rights in the Landbook under the name of a company which has acquired several businesses by way of reorganization. The judges of the Riga City Landbook department declined re-registration of lease rights arising from different lease agreements, and instead required submission of the consent of the respective lessor for such re-registration, thus ignoring the fact that the acquirer had automatically acquired the lease rights from under the process of reorganisation.

The Supreme Court overruled the decisions of the Landbook judges and pointed out that in these cases the transfer of rights and obligations had taken place on the basis of the law pursuant to the provisions of the Commercial Law.

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