

Estonia: Europe's Delaware?

While the rest of the EU drags its heels in terms of business law reform, Estonia is committed to becoming the new breeding ground for entrepreneurs. Minister of Justice REIN LANG and former Minister JÜRI RAIDLA outline their plans to achieve the optimum legal infrastructure

Estonia has systematically reformed its legal system since the 1990's. But although its normative framework is now modern and functional, the time has come to consider the next steps. To this end, a working group¹ was established in the autumn of 2005 to assess the performance of our legal system in light of our top policy priority of facilitating enterprise. Based on their work, a document was prepared entitled „Entrepreneur's Law – Action Plan for Improving the International Competitiveness of the Entrepreneurial Legal Environment” (the “Action Plan”).² The Action Plan began a process for steadily improving Estonian legal policy and helping to create over time a legal environment comparable to that of the U.S. State of Delaware for the facilitation of enterprise and the efficiency of legal infrastructure.

ACTION PLAN OBJECTIVES

The European economy has grown only modestly over recent years, for reasons well known. Compared to the US, employment and productivity in economic growth is too low and investments seem to be moving out of Europe. The EU has been looking for opportunities to improve Europe's global competitive position and a number of short-term and long-term strategies have been developed for that purpose.

Meanwhile however, Estonia's economic growth has been impressive, reaching 9 per cent in 2005, and exceeding 11 per cent in 2006. The average economic growth over the last ten years has been 6.1 per cent. Only Ireland with 7.8 per cent has been able to show higher figures, while the EU's average has been 2.3 per cent. Thus, we have managed to compete successfully so far but need to analyse pragmatically the reasons for our success and shortcomings to further strengthen our competitive position.

Legal environments affect competitiveness. A state that can shape the most enterprise-friendly legal business environment will reap the greatest benefits in terms of tax revenue and jobs created. This requires the clear will of legislators and governments to make the business environment attractive so that enterprises consider changing their corporate seat and/or relocating at least some of their operations to the more favourable country.

¹ The working group consisted of the undersigned, Professor Paul Varul, Dr. iur. Martin Käerdi, of-counsel of RoschierRaidla Tallinn office, Lecturer at the University of Tartu, and Urmas Volens, LL.M., Deputy Secretary General for Legal Policy, Ministry of Justice.

² See <http://www.just.ee/19426>.

EU law endorses this in principle as a key benefit of the union, but in reality, it has not functioned well enough. In recent years, European law has enhanced entrepreneurs' possibilities to change their corporate seat. But an enterprise's decision whether to relocate depends on its overall assessment of the costs of doing so compared to the benefits arising from the relocation. This means a comparative assessment of substantively different business laws between countries and non-legal issues (such as the availability of qualified labour force, the availability of raw material, the location of the state, transportation facilities, etc).

Implementing our Action Plan improves the dialogue about free movement and thus about European policy in general. It also improves the cost/benefit ratio of relocating in Estonia. Here we profile key action plan targets and some results.

I. CORPORATE LAW

Our corporate law is largely limited by EU legislation. Therefore we support and will implement all innovations from the EU.

Within the current framework, we need to attend quickly to the issue of the so-called distance management of companies registered in Estonia. This will improve the possibilities of using electronic means to document corporate decisions and give corporate notices.

We should also further improve access to and use of electronic data in commercial registers. Based on recommendations from the Action Plan, as of 2007, it is now possible to found an Estonian company over the internet in approximately half an hour without having to leave the computer. But without a European-wide identity standard, use of this service is still limited. To solve this problem, Estonia intends, during Slovenia's presidency, actively to support the presidency's plan to find a pan-European solution to this problem.

Small to medium-sized enterprises (SMEs) are the main drivers of economic growth and job creation. We should therefore evaluate the impact of all current Commercial Code provisions on SMEs taking into account their need for more flexibility and simplicity.

II. ECONOMIC ADMINISTRATIVE LAW

Entrepreneurs often find it difficult to identify what licences, approvals and registrations are required for them to operate. All such regulations constitute restrictions on the constitutional freedom of an enterprise. An entrepreneur should have the right to engage in economic activities without such interference, unless the risk of harm to the public justifies restriction. Therefore economic administrative law, especially the field of activity licences and registrations, should be completely revised. In cases where a restriction is justified, all matters related to it should be subjected to detailed and common principles that should be gathered under one legal instrument.

III. LABOUR LAW REFORM

Estonian labour law is not consistent with current realities. It sees the employment relationship as something static that can be forcefully preserved even if economic prerequisites have vanished. This can largely be attributed to the use of labour law to solve social problems in large-scale production at the expense of employers. In Estonia, where most companies have less than ten employees, such a concept of employment relationships cannot function.

Surveys show that the more flexible the labour market and the law regulating it, the lower the rate of overall unemployment and the higher the rate of economic growth. On the other hand, liberalisation of labour law should not significantly weaken the social security of employees. We should find a reasonable middle way of providing enterprises with the possibility to react quickly to market situations and still provide employees with sufficient protection. Overall, individual and collective labour law need sweeping reforms.

IV. REORGANISATION PROCEEDINGS

Currently, bankruptcy proceedings usually end with the liquidation of the enterprise. Under Estonian law, it is possible during bankruptcy proceedings to reach a compromise with creditors and continue operations, but this requires the express consent of the creditors and such compromises are reached very rarely. Reorganisation proceedings have been introduced in many countries in addition to or as a part of bankruptcy proceedings. International organisations (such as the World Bank and the European Union) also recommend their adoption and implementation. Therefore, reorganisation proceedings should be made a realistic alternative to liquidation proceedings.

V. CONCILIATION PROCEDURES

Despite a new Code of Civil Procedure that was introduced at the beginning of 2006, judicial proceedings will remain a relatively slow and expensive method of commercial dispute resolution. Conditions could be improved by using conciliation bodies. These bodies would mediate disputes and approve settlement agreements (or the agreements thus reached would be approved by simplified judicial proceedings) so that the agreement becomes subject to compulsory execution. The competence of current bodies of extrajudicial dispute settlement (including the labour dispute committee) should be revised. As a rule, these bodies should be organised as conciliation committees.

VI. INTELLECTUAL PROPERTY LAW

Reasonable regulation of intellectual property issues is crucial for maintaining a positive business environment. Issues regarding patents, utility models, etc are also increasingly important for smaller enterprises. Therefore, intellectual property regulation should be

analysed to test among other things, the consistency of intellectual property regulation with the rest of private law.

VII. BUILDING, PLANNING AND THE ENVIRONMENT

Building and planning regulations and procedures are not sufficiently comprehensive or effective. In the area of building law, not even an elementary level of consumer protection exists. For example, building development companies are often liquidated quickly after a project is completed in order to avoid liability for defects. A comprehensive review is needed.

Since summer of this year, a working group has been set up to prepare the Environmental Code, starting from the General Part of the Environmental Code, which will be followed by the Special Part.

VIII. STATE AND LOCAL GOVERNMENT PROPERTY

Based on Action Plan recommendations, a new Public Procurement Act was adopted at the beginning of 2007. This promotes more competition in the provision of goods and services financed from public funds.

Other provisions regulating the distribution of public goods should be revised, including rules on exploitation of state or local government property by persons in private law to address transparency and efficiency concerns. Regulation of the participation of public law entities, especially state and local governments, in private law relationships also needs review. A distinction should be maintained between the regulation of entry into such relationships, and implementation of the relationships. Entrepreneurs should not have to follow special rules just because they enter an agreement with a public sector entity.

IX. TAXATION OF SELF-EMPLOYED

Estonian tax law is among the simplest in Europe. Anyone can electronically submit their annual tax returns in a matter of minutes. However, regulations governing taxation of self-employed persons should be revised to allow the deduction of expenses from income and the payment of social tax by self employed persons (as it does for other entrepreneurs). In view of the principle of equal treatment, it is highly doubtful that tax treatment should vary based on selection of a business form.

X. STATE FEES

State fees should compensate the state for costs arising from performing services. The new Estonian State Fees Act follows this principle.

XI. A CLEARER BUSINESS PENAL LAW

As of 2007, amendments to the penal law significantly improved treatment of business issues. Going forward, only acts that prejudice the public interest should be punishable. Where private interests are violated, other judicial remedies, such as compensation for damage, should be applied. A sanctions policy also should reduce the element of revenge and stigmatisation of the offender. Grave offences, however, should be clearly punishable.

XII. NOTARIAL AND LEGAL SERVICES

Notaries currently handle only certain aspects of documenting commercial transactions. They should become “points of contact” in founding new entities. This would facilitate start up by centralising needed services in a single location.

Some providers of legal services have been excluded from regulation. It is thus possible to provide legal services whether or not the service provider has higher education in law. The Action Plan proposes improving the availability and quality of legal services.

We should further strengthen the capacity of Estonian courts to efficiently and reliably handle financial and corporate matters.

CONCLUSION

The Action Plan is not the product of a debating club. After discussion and review, the Ministry of Justice submitted the plan to the Estonian government and specific tasks were agreed on with set deadlines for draft legislation. Several initiatives and proposals already have been successfully implemented and things are moving apace. Since the beginning of 2007 when the long-distance management portal was introduced, over one-fifth of new companies in Estonia have been founded via the Internet. Hopefully, ongoing implementation of the “entrepreneur’s law” will provide Estonia with the most competitive business environment in Europe.

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