

focus

on legalities

Dear reader,

In the last issue of **focus** I explained the structural differences of the boards of Estonian and Swedish limited liability companies.



In this issue I will try to explain to you why a Management Board Member is not employed.

This is again an issue that I have to deal with a lot, both due to foreigners' not knowing Estonian law and surprisingly enough, Estonians too are not so familiar with the legal relationship between a company and its management board members either.

I will try to guide you through the legal rules as well as explain the logic behind the system.

Employment protection laws

Let's start with the logics behind employment law. The Estonian Employment Contracts Act (Est: Töölepingu seadus) is a law aimed at protecting employees from random and unfair treatment from the employer. A company cannot dismiss employees as it wishes, but every termination from the employer's side needs to have a legal ground as specified in the Employment Contracts Act. Such grounds may be redundancy, a breach of contract from the employee's side, long-term illness and so on.

If there is a legal ground for termination, a notice period and usually severance pay obligations must be observed. In addition to the Employment Contracts Act, there are several other legal acts aiming at giving employees rights and protection that the employer must follow, such as rules regarding vacation and salary payments. An employer must provide its employees with written employment contracts. The management board member signs these as the employer.

A position of trust

A management board member is not just any other employee with whom to sign an employment contract. A management board member is elected to his/her position by the shareholders or the supervisory board (depending on the structure of the company). This position is a position of trust as the

management board member is executing the day to day work of the company and should follow the instructions and wishes of the shareholders/supervisory board in doing so.

The shareholders have a just cause to be able to freely choose who this person should be.

To be a management board member includes a lot of responsibilities under law. For example, all signatory powers lie with this person and he or she must lead and organise the day-to-day work including the bookkeeping, prepare the annual reports and so on. Usually the remuneration paid to a management board member reflects the level of responsibility.

In case the owners (or the supervisory board, depending on the organisation of the company) would lose its trust in this person, or for any other reason believes it is better that someone else fulfils these responsibilities, it is often crucial that they can smoothly and quickly make a change of the board members.

As can be understood from the above, in a situation like this, the owners should not be forced to justify the dismissal with the legal grounds as is the case for an employee. You cannot say that there is a case of redundancy or any fault of the management board member has been made.

LEGAL NEWS

Some remarks regarding pension

A large number of employees of SCCE members are Swedes who have started their working careers in Sweden and then worked for some years in Estonia. SCCE received some questions regarding pension rights; when do you qualify for pension in Estonia if you only have worked here for some years? Has the system changed since Estonia joined the EU?

The SCCE Council decided to take a look at this issue. A letter was sent to the Estonian Social Insurance Authority (Est: Sotsiaalkindlustusamet). Here is a summary of what we learned:

Under the Estonian system, a person needs to work for 15 years to qualify for pension. Since Estonia became an EU member in 2004, the following system applies. ▶

The legal bases

The Employment Contracts Act states in its § 7, section 10) that “The Employment Contracts Act does not apply to: /.../ 10) the members of the boards of legal persons and foreign companies’ Estonian branch managers /.../. So, if the relationship between a company and its management board member is not regulated by the Employment Contracts Act, which act is?

The answer is twofold. First of all, the Commercial Code (Est: Äriseadustik) that states the rights and obligations of the board member, but the contractual relationship between these parties is regulated by the Law of Obligations (Est: Võlaõigusseadus). If there would be no other agreements between the parties the following would apply:

- the management board member shall receive a fair compensation for his/her work;
- the management board member has no right to vacation or vacation pay;
- the management board member has no working hours;
- the management board member can be dismissed upon a decision by the shareholders or the supervisory board (depending on the structure of the company) at their own discretion;
- there is no notice period or no severance pay payable upon termination.

Service Agreement

Due to the above, it is common that the parties will make a written agreement between them to regulate the issues of remuneration, vacation rights, notice periods and severance pay. Such an agreement is often referred to as a Service Agreement or Management Board Member Agreement. Due to the nature of the assignment to be a management board member, the company should always reserve its right to dismiss a board member at its own discretion. Please note that there are some formal requirements as when it comes to who can sign the Service Agreement on behalf of the company.

Is there any situation when a Management Board Member should have an employment agreement?

Looking at the Estonian case law, it is clear that there are some circumstances when a management board member also should have an employment contract. This is the case for example when he or she in addition to the managing duties also fulfils other tasks that would fall out of the definition what a board member normally would do. This is the case when a board member also is doing the bookkeeping for the company. In such a case, it can be argued that the management board member should have an employment contract covering these tasks only.

The reality

In my work I have seen all kinds of strange combinations of management board member contracts. Sometimes there is only an employment agreement, sometimes both a service agreement

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and an employment agreement with different conditions and sometimes no written agreements at all.

As long as the business goes well and the shareholders do not have any wishes to change the board composition, there are usually no problems anyway. But if there are some changes, the situation is likely to become complicated.

How to avoid future problems?

If you by reading this article realise that there might be some uncertainties with the management board member contracts in your company, I suggest to raise this issue before any problems have started. It is always easier to agree to a new correct contract while the parties still want to continue their co-operation. Later, it may be impossible.

Up until some years ago, many thought that it was better to have an employment contract than a service agreement as employees are better protected under law. To have an agreement that does not fit with the legal relationship and thus not with the intention of the law, is a bad idea that leads to long and costly disputes.

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