GETTING THE DEAL THROUGH

Mergers & Acquisitions

in 61 jurisdictions worldwide

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Russia

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1 Types of transaction

How may businesses combine?

Russian law provides for two forms of business combination: mergers and consolidations. The difference between the two is that in a merger two or more companies form a new merged company and are liquidated themselves, while in a consolidation one company accepts one or more companies which are liquidated, but the accepting company continues its existence.

However, due to many technical and legal constraints neither mergers nor consolidations are popular forms of business combination in Russia. Most businesses combine in the form of a sale and purchase of shares or participatory interests.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

The principal sources of M&A law are:

- Civil Code of the Russian Federation regulates the basic governance framework;
- Federal Law No. 14-FZ 'On limited liability companies' dated 8 February 1998 (as amended) (the LLC Law) covers limited liability companies;
- Federal Law No. 208-FZ 'On joint-stock companies' dated 26 December 1995 (as amended) (the JSC Law) covers open and closed joint-stock companies;
- Federal Law No. 39-FZ 'On Securities Market' dated 22 April 1996 (as amended) regulates trade in securities (the Securities Law); and
- Federal Law No. 135-FZ 'On Protection of Competition' dated 26 July 2006 (as amended) regulates antitrust protection (the Competition Law).

3 Governing law

What law typically governs the transaction agreements?

Although the Russian legal framework is becoming more and more friendly to M&A transactions (eg, it now recognises shareholders' agreements, it refers disputes regarding sale and purchase of shares or participatory interests to business courts rather than courts of general jurisdiction, etc), the law predominantly regulating M&A transactions in Russia is English law. The main reason is that Russian law is unclear as to the concepts of representations, warranties and indemnities. Another reason is that new Russian legislation is often still untested in courts, and the transaction parties are therefore unwilling to use it.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

Depending on the scale and nature of the transaction the following filings might be applicable:

- antimonopoly clearance in accordance with the Competition Law;
- special clearance for acquisition of assets or companies in strategic sectors in accordance with Federal Law No. 57-FZ 'On Foreign Investments Into Companies Strategic for Defence and Security of the State' dated 29 April 2008;
- any form of reorganisation requires filing with the Unified State Register of Legal Entities;
- any transaction involving issue of shares requires filing with the Federal Service for the Securities Markets;
- a public company shall perform relevant disclosure filings with the stock exchanges;
- M&A transactions involving companies in certain businesses are subject to specific regulations; for example, mergers of banks are to be reported to the Central Bank of Russia and might be prohibited by this body; and
- any transfer of a participatory interest in a limited liability company is subject to notarisation and, therefore, to notary fees.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

If a merger or combination takes place, the companies involved in the transaction shall disclose information on its basic terms to their creditors. To do so, the companies may publish this information in a Registration Bulletin available to the public.

Companies that have issued tradable instruments (ie, all joint-stock companies and limited liability companies having issued tradable bonds) are obliged to disclose information on any merger or consolidation, as well as on changes in its shareholding structure, if anyone obtains more than 5 per cent of its shares or increases its participation above 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent or 75 per cent.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

A shareholder must disclose ownership of over 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent or 75 per cent of any joint-stock company. A shareholder must also disclose any changes in its ownership which lead to increase or

decrease of its shareholding above or below any of these thresholds. Failing to do so may result in an administrative fine of up to 500,000 roubles.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Current Russian legislation provides a limited amount of duties of directors and controlling shareholders within several specific forms of business restructure, including mergers, accessions, split-ups and spin-offs of companies. Since the legislation provides only formal procedures for such forms of reorganisation, the legal duties of shareholders and managers are connected to stages of reorganisation. For example, in the case of a merger of two JSCs a board of each JSC shall put to the vote at the respective shareholders' meeting a decision to participate in a merger. Shareholders shall make a general decision to participate in the merger, approve the merger agreement and transfer act in respect of the assets, nominate members of the board for the newly created company, and the management shall then notify creditors of the company about the planned merger, apply to the registration bodies in order to register the merger, etc.

In practice, however, business combinations are also more complicated than simple mergers or spin-offs, and therefore directors, managers and shareholders may have quite different duties depending on the combination and on the nature of the participating companies.

If a company participating in the business combination is a private or medium-sized company where shareholders play the most important role (as is the case for the majority of companies in Russia), shareholders may even combine the functions of shareholders and management of the company. It is clear that if such company participates in a business combination, its shareholders will have to organise and develop (or participate in the development of) the combination and then control each stage and procedure of the combination. In large public companies directors and management play more important roles, organising and performing the combination; however, as a rule, general decisions to undertake M&A transactions are made only by the majority shareholders.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

The following approval rights belong to the shareholders:

- approval of a company's reorganisation in any form (such decision requires a three-quarters majority of the votes of the attending shareholders in a joint-stock company and a unanimous decision in a limited liability company);
- approval of transfer of participatory interest by a participant of a limited liability company to other members or (except for a sale, in which case a right of first refusal applies) to third parties if such approval is required by the charter of the company; and
- approval of a large-scale transaction, acquisition or sale by the company of shares or other assets.

Shareholders have certain appraisal rights in the case of in-kind contributions to the charter capital of the company and in the case of reorganisations in the form of mergers or consolidations.

9 Hostile transactions

What are the special considerations for unsolicited transactions?

There are no special rules as to unsolicited transactions. Russian law, however, recognises hostile transactions as unlawful ones (corporate raiding). In the last year a specific legislation was enacted against corporate raiding. The new rules include notarisation of transfer of participatory interests in limited liability companies.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed? What are the limitations on a company's ability to protect deals from third-party bidders?

Break-up fees and reverse break-up fees are not regulated by Russian law. A contract between parties may theoretically provide for such measures, which will be most probably construed by a Russian court as a form of penalty. The parties need to bear in mind that contractual penalties may be decreased by the court.

11 Government influence

Other than through relevant competition regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations, including for reasons of national security?

Mergers and acquisitions always mean concentration of business and capital, which increases a risk of monopolisation. Therefore, the state bodies intend to control the most important M&A transactions and transactions which may possibly provide a threat to national security. However most of restrictions concerning business combinations are provided by applicable legislation rather than by government agencies (without regard to antitrust bodies).

Generally such restrictions may be divided into three main groups:

- general corporate regulations and restrictions provided by corporate legislation, influencing structure of any M&A transaction;
- special regulations influencing business combinations involving specific businesses (banking, insurance, investment funds, etc); and
- regulations and restrictions concerning transactions with participation of foreign companies and individuals (certain restrictions on shareholdings in strategic businesses such as oil and gas, television broadcasting, restrictions on ownership of agricultural land, air transport businesses etc).

Therefore, if the parties to a transaction do not violate applicable legislation, it is not likely that any governmental agency would provide restrictions concerning the completion of a business combination.

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

There are no established rules or restrictions regarding the contents of tender or exchange offers, so parties to a transaction are free to include any conditions they may find desirable, provided, however, that such conditions shall not violate legislation provisions applicable to respective business combination. Tender or exchange offers are usually just on offer to negotiate possible transactions and not binding offers for the party addressing them, therefore such offers as a rule contain very general terms and conditions regarding planned transactions. This is fully applicable to cash acquisitions as well, so the financing may be conditional if it is acceptable for the parties.

13 Financing

If a buyer needs to obtain financing for a transaction, how is this dealt with in the transaction documents?

In cases where a buyer needs to obtain financing, such situation as a rule is reflected in the transaction documents, including both

Update and trends

We are pleased to note that Russian corporate legislation in general (including provisions regulating M&A transactions and aspects) continue to develop despite the credit crisis and other economic problems. Existing laws are being updated in order to answer the new demands of businesses and new laws are being enacted. Thus, the government is acting to fill the old gaps in legislation that made it impossible to conclude shareholders' agreements according to Russian law. Now, both participants of LLCs and shareholders of JSCs may conclude shareholders' agreements and thus formalise their relations under Russian law to an extent impossible as recently as the beginning of 2009. We believe that corporate legislation will continue to develop, contributing the M&A sphere.

Unfortunately, the credit crisis has affected Russia, like most countries, and caused a general fall in the economy and, as a consequence, the amount of M&A transactions. It is therefore hard to fully estimate the role of positive amendments to the legislation. Recently, however, there has been a relative increase in business activity noted, so we assume that in near future there will be enough practice to analyse the effectiveness of the amendments and to make further proposals.

preliminary agreements and term-sheets regarding the transaction, as well as definitive documentation. There are no established or even recommended requirements how to formalise such situation in transaction documents, and usually separate documents are executed between the buyer and the source of financing, and separate documents are executed between the buyer and the seller. The fact that the buyer has to attract financing may be reflected in the documents between the buyer and the seller or not. As a rule, however, comprehensive documents between the buyer and the seller (such as share purchases and sale agreements or shareholders' agreements) contain references on provisions of the respective financing.

14 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

Minority stockholders of Russian-based companies may be squeezed out; however, the procedure and actions of majority stockholders shall differ on condition of a form of the company where they hold shares.

In a Russian-based limited liability company it is very difficult and sometimes impossible to squeeze out minority stockholders if they do not agree to quit the company and if their obligation to quit on certain conditions was not provided by the stockholders' agreement concluded by all stockholders.

In a Russian-based joint-stock companies minority shareholders generally may be squeezed out using dilution processes, such as increase of the charter capital by issue of additional shares. If additional shares are issued within the amount of declared shares provided by the charter, a simple majority of voices is enough to make the decision. If the charter of the company has to be altered in order to increase the amount of declared shares, a special majority of three-quarters is required.

The JSC Law in certain conditions provides a majority shareholder of an open joint-stock company (a type of a joint-stock company that is allowed to place additional shares through a public offering, and whose shares may be publicly traded, unlike closed joint-stock companies) owning more than 95 per cent shares with a possibility to buy out the rest of the shares from minority shareholders for a fair market price. If they receive the respective offer, such minority shareholders shall be obliged to sell all their shares in the company to the majority shareholder.

15 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Although recently Russian legislation acknowledged shareholders' agreements both for limited liability companies and for joint-stock companies, there is still a lack of regulation and lack of court practice in this sphere. Therefore, most M&A transactions concluded in Russia, even if the target is a Russian company, tend to be cross-border so that the parties can choose foreign law to be applicable to the transaction. In these cases the transaction is usually structured in such a way that the holding companies are situated outside Russia, and operational companies are within the Russian borders. The parties to the transaction usually become shareholders of the holding companies and conclude a shareholders' agreement formalising their mutual rights and liabilities. As noted above, there are minor restrictions for foreign companies owning shares in Russian companies; however, they are applicable mostly where the target company is involved in mineral resources development or is acknowledged by the law as having strategic importance for national security.

Thus, in cross-border transactions the parties have to combine within the framework of the single transaction the laws of several jurisdictions, including general rules and more specific rules covering activities of the parties to the transaction and the target company. All issues related to international treaties, double taxation, dispute resolution shall be closely examined and coordinated by the parties. The positive issue is that unlike in the past, currency control became unessential due to general liberalisation of the currency legislation.

16 Waiting or notification periods

Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations?

Russian corporate legislation provides many waiting and notification periods specific for various business combinations. Different periods are set up for internal corporate actions, reorganisations and state registration, exercising of rights of shareholders (first refusal, etc.), share transfers. The parties intending to conclude an M&A transaction shall be aware of such periods before planning the transaction, since such periods depending on the nature of a transaction may summarily be quite significant. For example, waiting periods applicable for a transaction including the merger of several companies with different organisational forms may be at least three months in total.

17 Sector-specific rules

Are companies in specific industries subject to additional regulations and statutes?

Russian corporate legislation is structured in a vertical way with the Constitution and the Civil Code on top, the next stage being specific federal laws regarding organisational forms, then industry-specific federal laws and laws, and with various subordinate acts at the bottom.

Specific industries subject to special regulations are:

- banks (Law No. 395-I 'On Banks and Banking Activity');
- insurance (Law No. 4015-I 'On Insurance Activity in the Russian Federation');
- communication service providers (Federal Law No. 126-FZ 'On Communications');
- mass media (Law No. 2124 'On Mass Media'); and
- investment funds (Federal Law No. 156-FZ 'On Investment Funds'); etc.

Special regulations may complicate the transaction since they are usually aimed to secure public rights and interests of the state, so careful study of all industry-specific acts applicable to the target company is inevitable before structuring the transaction.

18 Tax issues

What are the basic tax issues involved in business combinations?

Parties to a transaction may face some difficulties when implementing complex business combinations, connected not only to present and future taxation, but also to historic tax risks of the target companies, which could have implemented tax schemes in order to avoid paying VAT, corporate profit tax or payroll taxes. VAT and withholding tax issues often require complex solutions, frequently with the participation of local consultants and auditors.

There have been attempts by the legislator to provide advantages to investors, for example recent exemptions for dividends on strategic investments. Applicable taxes and tax issues differ slightly depending on the type of deal (acquisition of shares or assets), and likewise there are different methods for tax optimisation and decreasing tax risks. In the case of share transactions, the parties may decide to bring the transaction to a foreign jurisdiction, often offshore. This may provide a possibility not only to enjoy the advantages of a shareholders' agreement governed in accordance with Western legal principles, but also to decrease taxation connected directly with the transaction, primarily corporate profit tax, and to further use Russia's network of double-tax treaties. In an asset deal, it is not possible to use offshore deal structures so the overall taxation will be comparatively higher and include 18 per cent VAT and 20 per cent corporate profit tax for the seller. However, in order to escape historic tax risks of the old company the asset deal may sometimes be preferable.

19 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

Russian labour legislation, represented first and foremost by the Labour code of the Russian Federation, does not provide any specific employee benefits in a business combinations, however it guarantees the rights of the employees of the company participating in the M&A process. Thus, a change of the company's owner shall not be a basis for termination of labour agreements with employees (except in the case of the CEO of the company, who may be dismissed by the new owner). Reorganisation of the company will also not be a basis for termination of labour agreements; the surviving or newly created company shall be an assignor of the restructured company and it becomes an employer for the employees of the reorganised company. However, in the case of a transfer of all assets of the company, labour agreements with the company's employees may be effectively terminated. Liquidation of the company within the framework of a business combination always means termination of labour agreements with the employees.

20 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

In accordance with the Federal Law 'On Insolvency (Bankruptcy)', implementation of any bankruptcy procedure (supervision, financial rehabilitation, external management, bankruptcy management) in respect of a target company significantly limits the actions of such company and its management. Thus, starting from the first stage of the bankruptcy process, the target company cannot freely dispose of its assets, may not be reorganised and cannot establish or become a shareholder of subsidiary companies.

The CEO of the target company may be dismissed by the competent arbitration (commercial) court at the request of a court-appointed manager. With the implementation of further procedures, court-appointed managers and the creditors' meeting shall have increasing control over the activities of the target company.

If the target company is engaged in bankruptcy procedures but is still expected to be a part of a business combination, the investor must consider that in order to stop the respective procedures the target company will have to pay off or restructure the indebtedness and a number of additional formalities must be accomplished to obtain full control over the target company and its activities.

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