Russia

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

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1. INTRODUCTION

The M&A market in Russia and relevant legislation have experienced remarkable changes due, in part, to the financial power of purchasers. M&A transactions are now mostly set up as a restructuring and consolidation of assets of target companies, and the structure of M&A transactions ranges from multi-staged to simpler forms.

This guide outlines typical steps and features of M&A transactions in Russia.

2. A BRIEF DESCRIPTION OF APPLICABLE CORPORATE AND OTHER LEGISLATION

Typically, M&A deals are executed in the form of share sale and purchase agreements (SPAs), governed by the law selected by the parties to the transaction. The practice is that SPAs (especially those including Russian M&A as a part of a global deal) are often governed by English law, providing more options for the parties involved (certain limitations must be taken into consideration when choosing the law to govern an SPA).

Notwithstanding the governing law negotiated, the parties to the SPA should duly respect the mandatory rules of the Russian law applicable to share transactions in a Russian target company. The terms of the SPA violating the mandatory provisions of the Russian law will be null and void, and the rules of the Russian law will be applicable.

In the review hereof, M&A deals should be considered as an acquisition of shares (or the so-called 'participatory share') in a target company which is either a joint stock company (public or non-public corporation) (JSC) or a limited liability company (LLC).

The following civil laws of Russia set the basic terms for corporate relations within a Russian target company:

- The Civil Code of the Russian Federation, Part One as of 30 November 1994, No. 51-FZ, Part Two as of 26 January 1996 No. 14-FZ (Civil Code).
- Federal Law On Limited Liability Companies as of 8 February 1998, No. 14-FZ (Law on LLC).
- Federal Law On Joint Stock Companies as of 26 December 1995, No. 208-FZ (Law on JSC).
- Federal Law On Protection of Competition as of 26 July 2006, No. 135-FZ (Antitrust Law). The Antitrust Law has meaning in the context of M&A deals, in that it provides for the obligation to obtain approval of the transaction by the Federal Antimonopoly Service of the Russian Federation (FAS).
- Federal Law On Foreign Investments into the Business Entities of Strategic Importance for the Country's Security Protection and Defence Support as of 29 April 2008, No. 57FZ (Strategic Law). The Strategic Law is important in the context of M&A deals since it establishes a rule according to which any acquisition of certain amount of shares or participatory shares above the established thresholds in the strategic companies [1] or otherwise acquisition of corporate control over strategic companies is subject to special preliminary approval by the Government Commission chaired by the Prime Minister of

[1] 'Strategic companies' are those holding certain important licences, such as cryptographic equipment, related to weapons, nuclear materials, drugs and some other security sensitive types of licences. In addition, strategic companies include those who hold mining licences over the deposits of federal importance (those deposits containing rare minerals or gold, silver, oil, gas and some other minerals in substantial amounts determined by specific thresholds).

Russia;

- Federal Law 'On Foreign Investments in the Russian Federation' as of 9 July 1999, No. 160-FZ (Foreign Investments Law). Since 30 July 2017, for the purposes of country's security protection and defence support, the Foreign Investments Law provides for the discretionary right of the Chairman of the Government Commission to escalate any M&A transaction involving foreign investments to the Russian entities (regardless of its status as a strategic entity) and to make it subject to special preliminary approval by the Government Commission in accordance with the Strategic Law provisions.

The Civil Code is the basic law which sets the requirements for execution of commercial transactions and the basic terms of corporate relations in a target company. Ongoing modernisation of the Civil Code is being conducted at present. The most remarkable amendments for Russian corporate law and M&A sphere were introduced through the reform of civil law carried out in 2017. Some examples of the most significant amendments to the Civil Code effective from 2017 are listed below:

a) recognition of corporate relations as being governed by civil law (the general provisions of the Civil Code governing civil transactions are applicable for corporate relations until it contradicts with the specific nature of corporate relations);
b) provisions regarding the procedure for making and execution of decisions of the general meetings of shareholders/participants, and grounds for invalidation of the decisions;
c) amended provisions regarding invalidity of transactions (introduction of the estoppel principle, and voidability rather than nullity of a transaction violating law requirements) and statute of limitations;
d) new provisions regarding irrevocable powers of attorney as an additional way to secure obligations;
e) the good faith concept as a fundamental legal principle governing civil relationships;
f) diversity of legal instruments for structuring M&A transactions available to parties, namely option agreements, representations on circumstances (referred to as warranties), indemnities, waiver mechanism;
g) provisions, prescribed by the Civil Code on precontractual liability in case of bad faith negotiations and opportunity to conclude a negotiation agreement;
h) new provisions regarding settlements through escrow agents;
i) capability of certain types of corporate disputes to be resolved through arbitration administered by the arbitration institutions accredited according to the specific procedure.

Following the changes listed above, in 2017 and 2018 new rules on approval of so-called 'extraordinary transactions' (major transactions and related party transactions) were implemented. This also affects the M&A transactions landscape due to the necessity to gain certain corporate approvals by the parties entering into the SPA.

The Law on LLC was significantly amended, effective in 2009. The amendments affected the terms and structure of an SPA. The Law on LLC and the Law on JSC now entitle JSC shareholders/LLC participants to enter into shareholders' agreements/participants' agreements (SHA). Previously such agreements were not enforceable since most of the rights of shareholders/participants were limited by the mandatory provisions of Russian law. The possibility of entering into enforceable shareholders' agreements under Russian law is a step forward in bringing Russian law in line with common global practice, as the conclusion of an SPA when acquiring less than 100 per cent of shares/participatory shares is often associated with the conclusion of an SHA.

According to the amendment of the Civil Code with regard to conflict of law rules with effect in 2013, an SHA with at least one foreign person may be governed by a foreign law – in particular,

English law – save for the mandatory rules of the law of incorporation of a target company regarding:

a) status of the target company as a legal entity;
b) legal entity form;
c) requirements for the name of a legal entity;
d) creation, reorganisation and liquidation of a legal entity, including succession;
e) substance of the legal capacity of a legal entity;
f) procedure for the acquisition by a legal entity of civil rights and the assumption of civil obligations;
g) internal relations, including the relationship of a legal entity with its shareholders or participants;
h) ability of a legal entity to meet its obligations; and
i) responsibility of the founders (participants or shareholders) of a legal entity for its obligations.

The Antitrust Law sets restrictions for M&A deals which may have influence on the state of the Russian market. The mentioned restrictions require the parties to apply for approval of the M&A deal by the FAS when the type of the transaction meets listed criteria in the Antitrust Law, and when the aggregate value of assets of the companies of the parties and groups of persons involved in the M&A deal exceeds the thresholds set in the Antitrust Law.

Meanwhile, Covid-19 neither had any negative impact on the conducting of M&A transactions in Russia nor dramatically changed the regulation of the M&A deals or joint ventures. The most significant change was connected with the temporary decision of Russian governmental bodies enabling corporations to hold all general meetings of shareholders/participants (even annual general meetings at which the financial results of the company are approved, which must generally be held in the presence of the participants in accordance with the mandatory provisions of Russian law) by absentee voting in 2020–2021.

To conduct an M&A transaction with shares/participatory shares in a Russia-located target company, it is essential for the parties to duly consider all the provisions of the Russian law which are mandatory and applicable to the SPA.

a) Corporate procedures should be observed by the seller and the purchaser prior to the SPA execution, including due notification to the target company and shareholders, obtaining due corporate consents or spousal consents (applicable if the seller or the purchaser under the SPA is a married natural person), and observance of pre-emptive rights/obtaining waiver of rights from a target company and shareholders.
b) The SPA should be made in the form prescribed by the law, otherwise the SPA will be void (the written form of the SPA, notarised form of the SPA in respect of the participatory shares in an LLC, etc).
c) Russian law prescribes when title to the shares/participatory shares will be deemed transferred to the purchaser and prescribes for the due certification of the title of the new owner of the shares/participatory shares.
d) Collateral under the SPA should be granted in accordance with the Russian law.
e) The requirements for state control over M&A transactions should be duly observed, otherwise the deal is at risk of being disputed by state authorities and the parties can be deemed liable for an administrative offence.

Russian law provides no limits for the parties to select the applicable governing law for the SPA. However, there are significant arguments for the parties to execute the SPA under Russian law, since there are many factors and terms which will be otherwise obligatory. Moreover, for M&A transactions in respect of participatory shares in a Russian LLC, it is best to have the SPA governed

by Russian law to comply with notary requirements, as notary officers are not familiar with foreign law and may not notarise the SPA. Even in cases where the parties choose foreign law to govern their relations under the SPA, they still need to enter into a so-called local transfer agreement **(**transfer agreement**)**. This is part of the SPA and reflects substantial provisions of SPA, but, unlike the SPA, is governed by Russian law and aims at certification by the notary and actual transfer of the title to participatory shares.

3. STRUCTURE OF M&A TRANSACTIONS

M&A transactions in Russia are made with due regard to global business practice. Mandatory requirements of Russian law are in line with the international M&A practice and should be taken into account when structuring the specific transaction.

Table 1 shows the differences in dealing with shares/participatory shares in a target company which is an LLC, a non-public JSC or closed JSC (CJSC).

Table 1: Dealing with shares/participatory in a target company

Step number	**Step name**	**Substance of the step for the target LLC**	**Substance of the step for the target CJSC or non-public JSC**	**Notes**
1	Execution of confidentiality agreement	A confidentiality clause may be introduced as a part of letter of intent (term sheet)/preliminary agreements/SPA.		The confidentiality agreement usually covers, *inter alia*, the rules of disclosure of the information investigated within the due diligence, normally being sensitive commercial information of the seller and the target company. In practice, access to such data may be granted to the purchaser's management, employees involved in the transaction, advisers and financing banks.
2	Execution of exclusivity agreement	An exclusivity clause may be introduced into letter of intent (term sheet)/preliminary agreements/SPA.		
3	Execution of letter of intent/term sheet	The common rule is that a term sheet made in the form of a preliminary agreement becomes effective and binding for the parties at the moment of and conditioned upon its due notarising. For some time now, the court practice has changed and the Russian courts have taken the view that preliminary agreement on acquisition of participatory shares should not be notarised.		Practically, execution of the letter of intent/term sheet does not lead the parties to the obligation to enter into the transaction (execute the main agreement). This does not exclude that confidentiality clauses and exclusivity clauses are binding on the parties to the term sheet. Russian law deems the letter of intent binding for the parties if it is signed in the form of a preliminary agreement. Parties to a preliminary agreement are obliged to enter into the main agreement (SPA) on terms set out in the preliminary agreement. The avoiding party may be forced to enter into the main agreement by the court.
4	Due diligence of a target company	Depending on the substance of M&A transaction, key issues/information which are essential for the deal may be subject to due diligence and will precede the parties entering into the transaction.		Results of the due diligence are considered in the SPA (and are reflected in representations on circumstances (warranties) and indemnification clauses or correction of purchase price mechanisms).
5	Drafting and negotiating the terms of the SPA	Results of due diligence and the subsequent obligations of the seller to correct deficiencies in the target company are usually introduced as conditions precedent in the SPA (or the parties may adjust the purchase price based on due diligence results and the risks to the purchaser revealed).		

6	Observance of requirements for prior state control over the transaction	Applying to FAS for prior consent to the acquisition if thresholds are met. The SPA should contain the clause which confirms due clearance of the transaction or states the parties' obligation not to proceed with the transaction until due permissions are obtained.	This step should normally precede signing the SPA, provided the timeframes of the transaction allow the parties to undergo due clearance of the transaction prior to its execution. Otherwise, the parties may use the option to introduce clearance with the FAS/other state authorities as conditions precedent of the SPA, which leads to suspension of all the respective provisions and obligations of the parties under the SPA until the date due permissions of state authorities are obtained.
7	Strategic investment clearance[2]	Applying to the Government Commission chaired by the Prime Minister of Russia for prior consent to the acquisition of shares/participatory shares in the charter capital of the strategic companies if thresholds are met, or establishment of control over strategic companies, or if the Chairman of the Government Commission escalates the transaction using its right under the Foreign Investments Law. The SPA should contain the clause which confirms due clearance of the transaction or states the parties' obligation not to proceed with the transaction until due permissions are obtained.	This clearance is of discretionary nature. This means it can be granted or refused without any good reason if the Commission comes to the conclusion that the transaction may do harm to national security. Direct and indirect acquisition by a foreign investor of the control in respect of Russian legal entity having strategic importance might be subject to clearance with the Russian state authorities under the strategic investment legislation.

[2] Depending on the nature of the activities carried out by the target company or its licences, further/other consents or approvals granted by governmental authorities may be required. For instance, acquisition of more than 10 per cent percent of shares in a credit organisation requires the preliminary approval of the Central Bank of the Russian Federation.

8	Signing the SPA	The SPA shall be made in writing by executing one document and be notarised to the extent it is aimed at disposal of the participatory shares. Where the SPA only establishes framework relations of the parties and conditions precedent to be satisfied to proceed with the closing, notarisation of the SPA is not obligatory. Signing of the SPA does not constitute transfer of the title to the purchaser. The title to the participatory shares transfers to the purchaser at the date of insertion of the corresponding entry into the Unified State Register of Legal Entities (USRLE).	The SPA shall be made in writing with no notarisation required for its effectiveness. Signing of the SPA does not constitute transfer of the title to the purchaser. The transfer order shall be executed by the seller. The transfer order and a copy of the SPA should be handled to the registrar of the target company for execution of entry in the register of shareholders of the target company, which is the moment of the transfer of the title to the purchaser. Meanwhile, only basic principles governing transfer of ownership to the shares are prescribed by law. Details for carrying the procedure may differ depending on the rules of each registrar.	
9	Fulfilment of conditions precedent of the SPA	Conditions precedent may deal with the following fields of obligations of the parties: a) Actions of the seller to correct deficiencies of the target company within the terms set in the preliminary agreements or in the SPA (eg, increase of the authorised capital of the target company, increase of net assets value, adjustments of statutory documents and competence of management bodies of the target company, replacement of management bodies, etc); b) Observe mandatory corporate procedures in the target company as per Russian law (eg, obtaining corporate consents, obtaining waivers of pre-emptive rights, etc); c) Observe mandatory requirements for undergoing state control over M&A transaction prior to its execution, obtaining due permissions of state authorities for transaction execution (see Sections 6 and 7 of the table).		
10	Settlements under M&A transaction	It is normal practice that settlements are made at the closing of the transaction, upon the transfer of title to the shares/participatory shares in the target company to the purchaser (since this is the essence of the transaction). Please see Section 11 of the table. Settlements may be executed through the escrow agent or letter of credit.	Recent changes to Russian legislation, including banking regulations, revealed an opportunity of settlements under the M&A transaction through the escrow account with a bank or another person acting as an escrow agent. From 1 June, 2018 new amendments in the Civil Code re. escrow arrangements came into force. Please see below in Method of Payment section.	

11	Closing activities, including settlements under the transaction	Parties may sign a reconciliation certificate which states that parties deem performance completed and have no further financial claims to each other. Closing activities may include: a) Transfer to the purchaser of hard copies of documents which are essential for certification of title, or title to the shares; b) Mutual effort of the parties on due certification of the title of the shares in the target company; c) Payments under the SPA; d) Release of collaterals provided by the parties who guaranteed due performance under the transaction.	Signing of a reconciliation certificate is not mandatory.	Settlements are made in any form negotiated by the parties.
12	Actions after closing. Observance of requirements for the state control after completion of the M&A transaction	Execution of exclusivity (non-compete) clauses by the parties (obligation of the seller not to conduct business in the territory of the main business activity of the target company). Performance of post-closing obligations, which may be specified in the SPA. Purchase price correction depending on risk review, specific representations on circumstances. Post-transaction anti-trust notification (currently applicable only to intragroup transactions). Post-transaction notification of the Government Commission chaired by the Prime Minister of Russia on acquisition by a foreign investor of more than 5 per cent of shares/participatory shares in the charter capital of a strategic company.		

3. PRE-AGREEMENT DOCUMENTS TO BE EXECUTED PRIOR TO SIGNING

3.1 Negotiations

According to the amendments to the Civil Code effective since 2015, parties are free to conclude an agreement on conducting negotiations. The negotiation agreement may specify the requirements for good faith conduct of negotiations, establish the procedure for allocating costs for negotiations and other similar rights and duties. The negotiation agreement may establish a penalty for violation of the provisions stipulated therein.

According to current civil legislation, even in the absence of an agreement on conducting negotiations, acting not in good faith with regard to the commencement, conducting and withdrawal of negotiations is prohibited and that the non-breaching party is entitled to claim damages in an amount that allows to repair the status quo as if the non-breaching party had never entered into such negotiations.

It should be noted that conditions of the agreement on conducting negotiations limiting the liability for intentional unfair actions of the parties to the agreement in comparison with the Civil Code are null and void.

3.2 Confidentiality agreement

Execution of a confidentiality agreement is optional for the parties. However, given that at the negotiation stage the parties have no commitments, nothing in writing, and that any party is free to withdraw from the deal at any time,[3] it is essential for the parties to secure the confidentiality of information which may have significant commercial value and restrict its disclosure to non-authorised parties.

Signing of a confidentiality agreement is aimed at clarifying that the information received within the M&A negotiations may be used only for evaluating and negotiating the transaction. The confidentiality agreement may contain provisions regarding the parties' undertakings on non-disclosure of the (1) information investigated within the due diligence; and (2) the status and facts relating to the negotiation process. Typically, if the transaction is terminated before the closing date, all the documents containing confidential information should be destroyed or returned to the disclosing party.

3.3 Exclusivity agreement

The purpose of the exclusivity agreement is to limit the respective party (usually the seller) from negotiating the sale of the subject shares/participatory shares with other third parties. It is unreasonable for the purchaser to expend time and money for an extensive due diligence if the seller is not fully committed to negotiating with that purchaser.

The effective term for the exclusivity agreement may range from 30 days to three months. The exclusivity agreement may contain a break-up fee provision, similar to that in the preliminary agreement or the SPA.

[3] Provided that the negotiations are terminated at a time where the other parties cannot fairly rely on the negotiations not being terminated. According to current court practice, if the negotiations are terminated on a stage where the other parties can fairly expect that the agreement will be concluded, the terminating party is liable for damages caused to the other parties due to the unpredictable termination of negotiations

3.4 Term sheet (letter of intent)

The term sheet (also called the letter of intent, memorandum of understanding or heads of agreement) contains the major preliminary terms of the SPA. Typically, the term sheet covers issues as follows:

a) the substance of the SPA (defining the subject shares/participatory shares in the target company);
b) the purchase price for the shares/participatory shares (fixed price or the mechanism to determine it);
c) conditions precedent and terms for execution of conditions precedent;
d) the terms for entering into the SPA and the break-up fee;
e) order of payment; and
f) closing conditions and closing date.

Under Russian law, the execution of the term sheet leads to no obligation on the parties to enter into the transaction and execute the SPA, provided the term sheet does not state otherwise. This does not exclude that confidentiality clauses and exclusivity clauses in the term sheet will be binding. Generally, confidentiality clauses and exclusivity clauses are included in the term sheet.

The parties may also enter into a so-called preliminary agreement that aims at describing the obligations of the parties to enter into the main agreement (the SPA) on the terms defined in the preliminary agreement. The evading party to a preliminary agreement may be forced to enter into the main agreement by a court.

3.5 Due diligence of the target company

Due diligence of the target company is aimed at determining the legal and financial status of the target company and the respective risks the purchaser may bear. Due diligence results may strongly affect the purchase price for the target company, adjustment mechanisms, the list of the seller's guarantees, representations on circumstances (warranties), and indemnities under the SPA. Timely due diligence is essential for incorporating the risks of the purchaser in the transaction.

Due diligence survey may cover any of the following:

a) legitimate and effective establishment of the target company, due state registration with tax authorities;
b) due payment of the authorised capital of the target company; for a JSC, due issuance of shares in the target company, and due registration of the results of the shares issue;
c) disposability of shares/participatory shares in the target company (no encumbrances, pledges, options, etc);
d) due certification of title of the seller to the shares/participatory shares in the target company;
e) due certification of the title of the target company to its assets (eg, real estate, movable assets, intangible assets and intellectual property);
f) structure, competence and due assigning of authorities of management bodies of the target company;
g) effectiveness of state permissions and licences for conducting business activities of the target company;
h) due follow up of corporate documents of the target company;
i) financial status of the target company and sufficiency of net assets value;
j) the client database of the target company;

k) due maintenance of commercial activities of the target company;
l) substantial obligations and liabilities of the target company;
m) creditor indebtedness of the third parties to the target company;
n) tax compliance;
o) labour law compliance;
p) environmental law compliance;
q) antitrust compliance; and
r) any litigation which the target company is party to and the amount of potential monetary obligations of the target company.

The results of the due diligence and any obligations of the seller to improve the condition of the target company and/or correct deficiencies will be introduced as conditions precedent and price correction instruments in the SPA.

4. SHARE SALE AND PURCHASE AGREEMENT

Generally, Russian law deems a sale and purchase agreement as valid, provided the subject matter of the agreement is duly defined and the agreement contains express wordings for all the substantial terms of sale required by law. Otherwise, the agreement is considered as not concluded. Notwithstanding the fact that parties often choose foreign law to govern their relations under the SPA, the 2017 civil law reform has significantly changed the trend as the majority of SPAs on the acquisition of Russian companies are now governed by Russian law, as Russian law now provides for a wide range of instruments for structuring transactions in line with global standards.

4.1 Defining the subject matter of the SPA

The SPA should expressly identify the target company and the shares/participatory shares which are subject to sale:

a) Participatory shares in an LLC can be identified by the rate and the nominal value.
b) Shares in a JSC can be identified by the type, category, nominal value, registration number of issue.

The SPA is the basis for the tax authorities and the registrar (custodian) of the target company to execute transfer of title to the shares from the seller to the purchaser, so the SPA should contain full information on the subject of the deal.

In light of the Covid-19 pandemic, it has become crucial for target companies to maintain their operations, obtain investment support, reduce costs and risks of default due to interruption of their activities, and optimise the functioning of production processes. In practice this is achieved by merging with other market players and attracting investors, including banks and state corporations. From 2020, a significant growth of cash-in M&A transactions can be observed in Russia, where the investor acquires the shares/participatory shares through increasing the charter capital of the target companies, rather than through classic purchase of shares/participatory shares (cash-out), or a combination of these two schemes.

4.2 Defining the substantial terms of the SPA

The following issues are deemed substantial by Russian law and are considered in the practice of the parties when negotiating the M&A transaction.

4.2.1 Purchase price

Normally, the parties negotiate and set out in the SPA a fair price[4] (the market price) for the participatory shares/shares. The law encourages the parties to procure an estimation of the market price for the shares by an independent appraiser. This is helpful for the parties to decrease the risk that the transaction may be disputed on the grounds of unfair price (non-equal consideration) and failure to fulfil legal requirements.

However, the market price can hardly be estimated for shares/participatory shares in a non-public (non-listed) company. Moreover, sellers may offer target companies with negative net asset values for sale, which may make it difficult to determine a fair price for the shares/participatory shares.

To justify the transaction before state tax authorities and to avoid the risk that the transaction may be disputed, parties should seek to set the purchase price to correspond with the imputed price for the shares/participatory shares in the target company. The imputed price is calculated on the basis of the 'net asset value per share ratio' method. In particular, this method will provide for fair figures which are legally justified and can be deductible for tax purposes.

The currency of payment and payment method should also be determined by the parties in the SPA to ensure due secure settlement.

Servicing banks usually require the setting of the currency of payment. In-country payments are regularly made in rubles (RUB). International payments are deemed foreign currency transactions and are subject to currency control: parties should observe the legal requirements and provide the bank with the appropriate documentation for conducting international payments.

4.2.2 Method of payment

Payments may be structured to occur prior to the transfer of shares/participatory shares or after. However, full prepayment is a unique practice. Prepayment may be done by the purchaser under the preliminary agreement to confirm its intent to enter into the SPA. However, according to current court practice, the provision of a prepayment in a significant amount (exceeding 40–50 per cent of the purchase price) can lead to the recognition of the preliminary agreement as being the SPA. In such a case, the parties use the concept of a security deposit instead.

In practice, the method of payment is negotiated by the parties with the aim of ensuring that payment is made by the purchaser solely against the duly performed obligations of the seller (payment to the escrow account or payment by a letter of credit usually works for this).

A classic option for settlement in M&A transactions is the escrow agent facility. An escrow agent facility will provide that the purchase price will be deposited to an escrow account and will be further transferred to the seller's account, upon the seller providing the escrow agent with the documents agreed upon by the parties (documents which evidence the facts essential for the purchaser in the SPA, eg, due transfer and certification of the title to the shares/participatory shares to the purchaser). Until adoption of amendments to several Russian laws, which came into force on 1 July 2014, the Russian legislation provided no regulation for engaging an escrow agent; the escrow agent facility only worked on a good faith basis and was not enforceable under Russian law. Therefore, the parties conducted payments through a foreign escrow agent and entered into an escrow agent facility agreement under the foreign law.

[4] It should be noted that in M&A deals conducted in Russia standard mechanisms for calculating and making adjustments to the purchase price under the SPA, such as: earn-out, completion accounts, locked box, leakage etc, are also used.

From 1 July 2014, Russian law recognised an escrow account as a type of general bank account, albeit not for its special purpose to account and block funds of one party in order to release them to another party based on conditions specified in the escrow agreement. Only the bank was recognised as a person eligible to be an escrow agent in the escrow account schemes.

Without detailed legislation, and notably without comprehensive banking regulations, it was challenging for the M&A practice to use the construction of an escrow account. However, after several years, certain banks and notaries have come up with practical approaches towards escrow accounts and now successfully provide their escrow agent services.

From 1 June 2018, the amendments in the Civil Code introduced the novelty of an escrow agency agreement – regulating not only issues related to the transaction on the escrow account, but generally determining status, rights and liabilities of the parties to the escrow agency agreement. At the present time, any persons (eg, notaries or even law firms) are entitled to act as escrow agents and pursuant to Russian regulation of escrow schemes also movables such as securities (both certified and not) may become transferrable under an escrow scheme.

In practice, both for in-country and international transactions, the parties may conduct payments through:

a) Opening a letter of credit issued in favour of the seller: this option is similar to settlement through an escrow agent and provides guarantees to both parties. The seller is assured that the purchaser has sufficient money in the bank account, while the purchaser will be assured that the bank will authorise the payment to the seller solely against the documents due.
b) Transfer of rights to shares by a depositary through blocking operations on a seller's deposit account.

The deposit account is opened after providing the depositary with the evidence of transfer of the purchase price.

4.2.3 Conditions Precedent

Conditions precedent may deal with the following obligations of the parties (usually the seller).

a) Actions of the seller to eliminate the deficiencies of the due diligence (eg, increase of the authorised capital of the target company, increase of net assets value, adjustments of statutory documents and competence of management bodies of the target company, replacement of management bodies, etc).
b) Observance of mandatory corporate procedures in the target company as per Russian law (eg, obtaining corporate consents, obtaining waivers of pre-emptive rights, etc).
c) Observance of mandatory requirements for undergoing state control over M&A transaction prior to its execution and obtaining due permissions of state authorities for the execution of the transaction (see Section 7 of Table 1).

The parties should determine the terms for execution of the conditions precedent and liability for (or consequences of) failure to fulfil the conditions precedent.[5] The exact term for fulfilment of the conditions precedent and the consequence of their non-fulfilment is subject to the negotiations of the parties.

[5] For example, parties usually draft clauses devoted for the consequences of non-fulfilment of the conditions precedent, or part thereof, in such a manner that one of the parties (whether the seller or the purchaser) can unilaterally terminate the SPA or prolong the long-stop date at its discretion, if certain conditions precedent are not fulfilled prior to the long-stop date chosen by the parties.

In connection with the conditions precedent, the Law on LLC distinguishes between an SPA directed at setting up the obligation to conclude a transfer agreement (the obligation agreement or *обязательственный договор*) and an SPA directed at the transfer of the title to the participatory shares (the transfer agreement or *распорядительный договор*).

Only the transfer agreement is required to be certified by the notary in order to be effective: it serves as the foundation for the transfer of the title to the participatory shares in a LLC, and the filing of the application to the federal tax service making the entry into the USRLE that reflects the transfer of title from the seller to the purchaser.

Unlike the transfer agreement, the obligation agreement (provided that it does not contain elements of the transfer agreement or provisions directed at the transfer of the title to the participatory share) is not the ground for making entries into the USRLE. However, it sets forth the general framework of parties' relations, contains basic M&A mechanisms (representations on circumstances, indemnities and conditions precedent). As it is common for sophisticated transactions, accompanied by extensive due diligence, to provide for a number of conditions precedent that shall be fulfilled in order to prepare the target company to be transferred to the purchaser, the parties are willing to divide the moment of entering into the binding SPA and the moment of the transfer of the title to the participatory shares. Hence, the combination of the obligation agreement and the transfer agreement has become a useful tool for structuring M&A transaction towards LLCs.

4.2.4 Representations on circumstances and indemnities

Representations on circumstances (*заверения об обстоятельствах*) of the parties to the SPA are given in relation to the substantial (attributive) characteristics of the subject matter of the SPA. This is done by the parties to confirm that no party is under a misunderstanding regarding the subject matter of the SPA and the SPA is not void on this ground.

A possible way to enforce the representations on circumstances under Russian law is to prescribe a separate indemnification for the breach of each mentioned representation. A way to solve this problem in the SPA is to provide contractual damages (the known pre-estimate damages) or penalty for the breach of representations on circumstances by the seller (with no option of forcing the seller through the court to fulfil the listed representations on circumstances in kind). However, damages arising from the breach of representations on circumstances are hard to prove. According to Russian law, a breach of non-material representations on circumstances gives a party the right to claim damages, whereas a breach of material representations on circumstances additionally entitles a party to rescind the agreement. Meanwhile, the parties usually divide material and non-material representations on circumstances in the SPA.

In practice, the list of representations on circumstances is provided by the seller to the purchaser and covers the following:

a) the target company was duly established;
b) the shares/participatory shares of the target company are duly issued and paid, and there is no defect in the title concerning the shares/participatory shares;
c) the target company is the owner of all its assets: real estate, movable property, objects of intellectual property (trademarks, patents, etc) and there are no encumbrance in relation to the assets; if such encumbrance exists, it should be indicated separately;
d) the target company executes all obligations, prescribed under its licences;

e) the target company executes its obligations in due time and in an appropriate way;
f) the indebtedness of the third parties to the target company can be collected within the time limit prescribed in the appropriate agreements;
g) the target company complies with all requirements of the legislation;
h) the target company pays taxes and other obligatory payments in full and in time; and
i) other representations.

Practically, representations on circumstances are checked during due diligence of the target company. The purpose for providing representations on circumstances is that they are an opportunity to minimise the risks of the purchaser in the acquisition of the target company by establishing liability of the seller for potential legal and financial risks of the purchaser.

According to Russian law, indemnification clauses (*возмещение потерь*, which literally translates as 'compensation for losses') gives the right to compensate losses arising from the occurrence of agreed circumstances that are not related to the breach by a party of the obligations under the SPA.

4.2.5 Limitations of representations on circumstances

The seller's liability for potential losses of the purchaser in the SPA for undue representations on circumstances (given in bad faith and incorrect) can be limited in the SPA by stipulating the following:

a) The seller is not liable for unconformities listed in the disclosure letter that is provided to the purchaser along with the signing of the SPA or provided to the purchaser on another date agreed upon by the parties as the secondary disclosure letter.
b) The seller is not liable for the losses of the purchaser if the amount of such losses is less than any fixed amount (*de minimis*) or in part of excess of a fixed amount.
c) The seller is not liable for losses of the purchaser if the claim of the purchaser is brought after the expiration of a limitation period (normally, limitation periods differ depending on the nature of representations on circumstances being breached – tax, title and others).

The construction of the representations on circumstances should be worked out carefully under Russian law. For example, the limitation to bring a claim within a fixed term can be recognised as null and void for restricting a statutory limitation period. According to mandatory provisions of Russian legislation, a statutory limitation period and the procedure for its calculation cannot be changed by the agreement of the parties. However, there are still instruments in Russian law that allow for reaching the parties' intention and to minimise a conflict with mandatory provisions of Russian legislation.

It will be reasonable for the purchaser to additionally demand (1) an indemnification[6] for the occurrence of the circumstances that may have a negative impact on the deal (loss of title, existence of encumbrances, tax claims, revocation of licences, etc), or (2) the retention of part of the purchase price until the expiration of the term for bringing claims.

In December 2018, it was expressly confirmed by the Supreme Court of the Russian Federation that representations on circumstances may be given not only by the direct sellers, but also by a third party who has a legitimate interest in the execution of the contract to which the representations on circumstances relate (for instance, the beneficiaries of the target company).

[6] It should be noted that the concept of making warranties on an indemnity basis is hardly enforceable in Russia.

5. CLOSING

Closing activities are conducted as the final stage of an M&A transaction aimed at confirming that the obligations of the parties are duly performed.

If the payment of the purchase price is defined as a simple bank transfer, upon all obligations of the seller being fulfilled, its payment will be deemed to be the closing step of the transaction. However, the payment of the purchase price is an essential activity of the deal, so it is often secured by collateral which will be released at the final stage of the deal or structured through the escrow facility.

As an affirmation of closing, the parties can sign a reconciliation certificate which states that the parties deem the performance complete and have no further financial claims to each other. In current M&A practice, the signing of such a certificate is quite rare.

6. ACTIONS AFTER CLOSING

Commonly, the seller undertakes not to conduct activities (as an employee, consultant, owner or otherwise) which compete with the main business of the target company (non-competition agreement) and not to solicit employees of the target company or to draw over clients, suppliers and purchasers of the target company (non-solicitation agreement).

Non-competition agreements and non-solicitation agreements are hardly enforceable in Russia due to labour and antitrust considerations. In the meantime, the parties may be guided by antitrust clarifications, while setting forth the time limitations, territory and nature of the competing business.

7. DISPUTES ARISING FROM M&A TRANSACTIONS

Generally, disputes arising under the SPA in respect of a Russia-located target company may be brought before the arbitrazh (state commercial) courts under the provisions of the Russian Code for Arbitrazh Procedure (the Code).

However, according to the amendments of the arbitration laws effective from 1 February 2017, some corporate disputes (including the disputes arising under the SPA or SHA in respect of a Russia-located target company) may be referred to the arbitral tribunal on the basis of the arbitration agreement. The revised arbitration laws distinguish between three categories of corporate disputes: arbitrable, arbitrable with limitations and non-arbitrable.

Arbitrable

As a general rule, corporate disputes (eg, ownership over shares/participatory shares in charter capital, including disputes arising from SPAs, establishment of encumbrances over shares/participatory shares and its enforcement) are arbitrable if administrated by a permanent arbitral institution accredited with the Ministry of Justice of the Russian Federation in accordance with normal arbitrational rules. It is not required that the seat of the arbitration is in Russia.

Arbitrable with limitations

Limited arbitrability disputes (eg, disputes related to establishment, reorganisation and liquidation of legal entities, claims of shareholders/participants for recovery of damages caused to a legal

entity, invalidation of the transactions, invalidation of the decisions of governing bodies of a legal entity, and issuance of securities, which are internal corporate disputes) are arbitrable subject to the following conditions:

a) the proceedings are administrated by a permanent arbitral institution seated in Russia and accredited with the Ministry of Justice of the Russian Federation under special procedure;
b) under approved arbitration rules for corporate disputes; and
c) the arbitration clause is entered into by all shareholders/participants, by the company itself and by the parties that are the claimants or respondents in a dispute.

However, there is a contradiction between the Code and Law on International Commercial Arbitration (the Law): under the Code, it is necessary to comply with the requirements stated above, whereas under the Law it is enough to conclude an arbitration agreement between the parties of the SHA.

Non-arbitrable

Non-arbitrable disputes relate to convening general shareholders'/participants' meetings; buy-back and compulsory buy-out of shares by JSCs or PJSCs,[7] voluntary, mandatory and competitive offers, and buy-out of shares by shareholders, or exclusion of participants from LLCs.

7.1 Arbitration institutions

The International Commercial Arbitration Court (ICAC), the Maritime Arbitration Commission at the Russian Federation Chamber of Commerce and Industry, the Russian Arbitration Centre at the Russian Institute of Modern Arbitration, the Arbitration Centre at the Russian Union of Industrialists and Entrepreneurs (RSPP), and some other Russian arbitration institutions are recognised as permanent arbitration institutions by law. However, only the ICAC, the Russian Arbitration Centre at the Russian Institute of Modern Arbitration and the Arbitration Centre at RSPP have the competence for corporate disputes, so they are entitled to consider internal corporate disputes.

Foreign arbitration institutions will be allowed to operate in Russia only if they obtain a permit from the Russian Government. Otherwise, arbitral awards administered by a foreign arbitration institution and rendered in the territory of Russia are deemed to be ad hoc awards. As mentioned above, a necessary condition for recognition and enforcement of arbitral awards for all categories of corporate disputes is the rendering of an eligible award by a permanent arbitral institution. Ad hoc arbitration does not have such a status, as it is considered to be formed by the parties of arbitration agreement to resolve a particular dispute. Therefore, an ad hoc arbitral award rendered in a corporate dispute cannot be recognised and enforced in the Russian Federation.

The only requirement for foreign institutions (as compared to domestic arbitration institutions) for obtaining this permit is matching the criteria of possessing a 'widely acknowledged international reputation'. As of November 2021, the following foreign arbitration institutes are duly accredited under Russian law: the Vienna International Arbitral Centre, the Singapore International Arbitration Centre, the Hong Kong International Arbitration Centre and the International Chamber of Commerce. However, for the moment these arbitration institutes have not deposited the rules for corporate disputes, so they are not entitled to consider the internal corporate disputes listed above.

[7] Public joint stock companies, which superseded Open Joint Stock Companies according to the 2014 corporate legislation reform.