
Russia

Negotiated M&A Guide

Corporate and M&A Law Committee

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INTRODUCTION

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

The present Guide is aimed at outlining typical steps and features of M&A transactions in Russia.

A BRIEF DESCRIPTION OF APPLICABLE CORPORATE AND OTHER LEGISLATION

Typically, M&A deals are executed in the form of share sale and purchase agreement (hereinafter, the “SPA”), 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.

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) (hereinafter, the “JSC”) or a limited liability company (hereinafter, the “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 November 30, 1994 No. 51-FZ, Part Two as of January 26, 1996 No. 14-FZ (hereinafter, the “Civil Code”);
- Federal Law “On Limited Liability Companies” as of February 08, 1998 No. 14-FZ (hereinafter, the “Law on LLC”);
- Federal law “On joint-stock companies” as of December 26, 1995 No. 208-FZ (hereinafter, the “Law on JSC”);
- Federal Law “On Protection of Competition” as of July 26, 2006 No. 135-FZ (hereinafter, the “Antitrust Law”). The Antitrust Law has meaning in the context of M&A deals in that it provides the obligation to obtain an approval of transaction by the Federal Antimonopoly Service of the Russian Federation (hereinafter, the “FAS”);
- the Federal Law “On foreign investments into the business entities of strategic importance for the country’s security protection and defense support” as of April 29, 2008 No. 57-FZ (hereinafter, the “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 entities or otherwise acquisition of corporate

control over Strategic entities is subject to special preliminary approval by the Government Commission chaired by the Prime-Minister of Russia.

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. At the present day ongoing modernization of the Civil Code is being conducted and several amendments have already been introduced. Some of the examples of amendments to the Civil Code already introduced include the following:

- (a) recognition of corporate relations as being governed by civil law;
- (b) amended provisions regarding making and execution of decisions of the general meetings of shareholders / participants, grounds for invalidation of the decisions;
- (c) amended provisions regarding invalidity of transactions (introduction of estoppel principle, 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) good faith concept as a fundamental legal principle governing civil relationships;
- (f) better choice of legal instruments available to parties namely option agreements, representations, indemnities, waiver mechanism;
- (g) new provisions regarding pre-contractual liability in case of bad faith negotiations and opportunity to conclude a negotiation agreement;
- (h) new provisions regarding settlements through escrow agent;
- (i) capability of certain types of corporate disputes to be resolved through arbitration.

The Law on LLC was significantly amended with effect 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 (hereinafter, the "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 shareholders agreements under Russian law is a step forward in bringing Russian law in line with common worldwide practice as conclusion of the SPA when acquiring of less than 100% of shares / participatory shares is often paired with conclusion of the SHA.

According to the amendment of the Civil Code with regard to conflict of law rules with effect in 2013, the 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: (i) status of the target company as a legal entity; (ii) legal entity form; (iii) requirements for the name of a legal entity; (iv) creation, reorganization and liquidation of a legal entity, including the succession; (v) the substance of the legal capacity of a legal entity; (vi) the procedure for the acquisition by a legal entity of civil rights and the assumption of civil obligations; (vii) internal relations, including the relationship of a legal entity with its

shareholders or participants; (viii) the ability of a legal entity to meet its obligations; (ix) responsibility of the founders (participants or shareholders) of a legal entity on its obligations.

Antitrust Law sets restrictions for M&A deals which may have influence on the state of the Russian market. The mentioned restrictions are aimed at requiring 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 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.

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, as follows:

- (a) Corporate procedures should be observed by the seller and the purchaser prior to the SPA execution (due notification to the target company and shareholders, obtaining due corporate consents, observance of pre-emptive right / obtaining waiver of right 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, notarized form of the SPA in respect of the participatory shares in an LLC, etc.);
- (c) The 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) Collaterals under the SPA should be granted as per the Russian law;
- (e) The requirements for the 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, as seen from the above, 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 notarize the SPA.

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.

The table below shows the differences in dealing with shares / participatory shares in a target company which is an LLC or a closed/non-public JSC.

No of Step	Name of the Step	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	Confidentiality clause may be introduced as a part of letter of intent (term sheet) / preliminary agreements / SPA. The seller should provide the purchaser with the disclosure letter.		
2	Execution of exclusivity agreement	Exclusivity clause may be introduced into letter of intent (term sheet) / preliminary agreements / SPA		
3	Execution of letter of intent / term sheet	<p>The common rule is that term sheet made in the form of preliminary agreement becomes effective and binding for the parties at the moment of and conditioned upon its due notarizing.</p> <p>For a current time the court practice has been changed and the Russian courts take an attitude that preliminary agreement on acquisition of participatory shares should not be notarized.</p>		<p>Practically, execution of letter of intent / term sheet does not lead the parties to the obligation to enter the transaction (execute the main agreement).</p> <p>This does not exclude that confidentiality clauses and exclusivity clauses are binding on the parties to the term sheet.</p> <p>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 the main agreement through the court.</p>
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 the transaction.		Results of the due diligence are considered in the SPA (and are reflected in representations and indemnification clauses or correction of purchase price mechanisms).

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
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 the 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 time frames of the transaction allow the parties to undergo due clearance of the transaction prior to its execution. Otherwise, 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.

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
7	Strategic investment clearance	<p>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. 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.</p> <p>Kindly note that 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.</p>		<p>Strategic companies are those holding certain important licenses, such as cryptographic equipment, related to weapons, nuclear materials, drugs and some other security sensitive types of licenses. In addition, strategic companies include those who hold mining licenses over the deposits of Federal Importance (those deposits containing rare minerals or of gold, silver, oil, gas and some other minerals in substantial amounts determined by specific thresholds).</p> <p>Both 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 investments legislation.</p>

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
8	Signing the SPA	<p>The SPA shall be made in writing by executing one document and notarized.</p> <p>Signing of the SPA does not constitute transfer of the title to the purchaser.</p> <p>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.</p>	<p>The SPA shall be made in writing with no notarizing required for its effectiveness.</p> <p>Signing of the SPA does not constitute transfer of the title to the purchaser.</p> <p>Transfer order shall be executed by the seller. 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.</p>	

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
9	Fulfillment of conditions precedent of the SPA	<p>Conditions precedent may deal with the following fields of obligations of the parties:</p> <p>(i) Actions of the seller to correct deficiencies of the target company within the terms set in the preliminary agreements or in the SPA (e.g. increase of the authorized 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.);</p> <p>(ii) Observe mandatory corporate procedures in the target company as per Russian law (e.g., obtaining corporate consents, obtaining waivers of pre-emptive rights, etc.);</p> <p>(iii) Observe mandatory requirements for undergoing state control over M&A transaction prior to its execution, obtaining due permissions of state authorities for transaction execution (please see Sections 6 and 7 of the table).</p>		
10	Settlements under M&A transaction	<p>It is a 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.</p> <p>Settlements may be executed through the escrow agent.</p>		<p>Recent changes of the Russian legislation including banking regulations revealed an opportunity of settlements under the M&A transaction through the escrow account where bank acts as an escrow agent.</p> <p>From June 01, 2018 new amendments in the Civil Code re. escrow arrangements come into force. Please see below in Method of Payment section.</p>

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
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		Signing of a reconciliation certificate is not mandatory.
		<p>Closing activities may include:</p> <ul style="list-style-type: none"> (i) Payments under the SPA; (ii) Release of collaterals provided by the parties who guaranteed due performance under the transaction; (iii) Notary certification of the SPA and submission by the notary of the application to tax authorities for registration of transfer of participatory shares. 	<p>Closing activities may include:</p> <ul style="list-style-type: none"> (i) Transfer to the Purchaser of hardcopies of documents which are essential for certification of title, or title to the shares; (ii) Mutual effort of the parties on due certification of the title of the shares in the target company; (iii) Payments under the SPA; (iv) Release of collaterals provided by the parties who guaranteed due performance under the transaction. 	Settlements are made in any form negotiated by the parties.

No of Step	Name of the Step	Substance of the Step for the Target LLC	Substance of the Step for the Target CJSC or non-public JSC	Notes
12	Actions after closing. Observance of requirements for the state control after completion of the M&A transaction	<p>Execution of exclusivity clauses by the parties (obligation of the seller not to conduct business in the territory of the main business activity of the target company).</p> <p>Performance of post-closing obligations, which may be specified in the SPA.</p> <p>Purchase price correction depending on risk review, specific representations.</p> <p>Post-transaction anti-trust notification (currently applicable only to intragroup transactions).</p> <p>Post-transaction notification of the Government Commission chaired by the Prime-Minister of Russia on acquisition by a foreign investor of more than 5% of shares / participatory shares in the charter capital of strategic company.</p>		

PRE-AGREEMENT DOCUMENTS TO BE EXECUTED PRIOR TO SIGNING

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.

However, it should be noted that according to current civil legislation even without agreement on conducting negotiations withdrawing

It is to note that conditions of the agreement on conducting negotiations limiting the liability for the unfair actions of the parties to the agreement compared with the Civil Code, are null and void. **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, it is essential for the parties to secure the confidentiality of information which may have significant commercial value and restrict its disclosure to non-authorized 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 (i) information investigated within the due diligence; and (ii) 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.

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 committed to negotiating with that purchaser.

The effective term for the exclusivity agreement may be from 30 days to 3 months. The exclusivity agreement may contain a break-up fee provision, similar to that in the preliminary -agreement or the SPA.

Term Sheet (Letter of Intent)

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

- (i) The substance of the SPA (defining the subject shares / participatory shares in the target company);
- (ii) The purchase price for the shares / participatory shares (fixed price or the mechanism to indemnify it);
- (iii) Conditions precedent and terms for execution of conditions precedent;
- (iv) The terms for entering into the SPA and the break-up fee;
- (v) Order of payment;
- (vi) Closing conditions, closing date.

Under Russian law, the execution of the term sheet leads to no obligation on the parties to enter 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 so called preliminary agreements which are aimed at describing the obligations of the parties to enter into the main agreement (SPA) on the terms defined in the preliminary agreement. The evading party to a preliminary agreement may be forced to enter the main agreement

(SPA) by a court.

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 effect the purchase price for the target company and the list of the seller's guarantees, representations and indemnities under the SPA, so timely due diligence is essential for incorporating the risks of the purchaser in the transaction.

Due diligence survey may cover any of the following:

- (i) Legitimate and effective establishment of the target company, due state registration with tax authorities;
- (ii) Due payment of the authorized capital of the target company. For JSC, due issue of shares in target company, and due registration of results of shares issue;
- (iii) Disposability of shares / participatory shares in the target company (no encumbrances, pledges, options, etc.);
- (iv) Due certification of title of the seller to the shares / participatory shares in the target company;
- (v) Due certification of the title of the target company to its assets (real estate, movable assets, intangible assets, IP);
- (vi) Structure, competence and due assigning of authorities of management bodies of the target company;
- (vii) Effectiveness of state permissions, licenses for conducting business activities of the target company;
- (viii) Due follow up of corporate documents of the target company;
- (ix) Financial status of the target company, sufficiency of net assets value. Tax compliance;
- (x) Client database of the target company;
- (xi) Due maintenance of commercial activities of the target company;
- (xii) Substantial obligations and liabilities of the target company;
- (xiii) Creditor indebtedness of the third parties to the target company;
- (xiv) Labour law compliance;

- (xv) Environment law compliance;
- (xvi) Antitrust compliance;
- (xvii) 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.

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.

The majority of SPAs on acquisition of Russian companies are governed by Russian law due to the wide amendments of Russian legislation and introduction of legal instruments standard for such type of transactions.

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:

- (i) Participatory shares in an LLC can be identified by the rate and the nominal value.
- (ii) 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 certify 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.

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:

Purchase Price

Normally, the parties negotiate and set out in the SPA a fair price (which is the market price) for the / participatory shares / shares. The law encourages the parties to ensure stimulation of the market price for the shares by independent appraiser. This is helpful for the parties to decrease the risk that the transaction may be disputed on the grounds of unfair price and failure to fulfill legal requirements.

However, the market price can hardly be estimated for shares / participatory shares in a non-public (non-

listed) company. Moreover, nowadays sellers may offer for sale target companies with negative net asset values, which may make it a difficult matter 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 “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. International payments are deemed foreign currency transactions and are subject to currency control which means that parties should observe the legal requirements and provide the bank with the appropriate documentation for conducting international payments.

Method of payment

Payments may be structured to occur prior to the transfer of shares / participatory shares or after. However, full pre-payment is a unique practice. Pre-payment may be done by the purchaser under the preliminary agreement in order to confirm its intent to enter into the SPA.

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 through to the escrow account, 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, e.g., due transfer and certification of the title to the shares / participatory shares to the purchaser).

Until adoption of amendments to several Russian laws entered into force on July 01, 2014, the Russian legislation provided no regulation for engaging an escrow agent and, in Russia, the escrow agent facility worked based on the good faith of the parties and was not enforceable under Russian law. Parties conducted payments through a foreign escrow agent and entered into an escrow agent facility agreement under the foreign law.

From July 01, 2014 Russian law recognizes an escrow account as a type of general bank account save 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 recognized as a person eligible to be escrow agent in the escrow account schemes.

Without detailed legislation and notably without comprehensive banking regulations it was challenging for business to use the construction of escrow account. However, after several years certain banks and notaries have come up with practical approach towards escrow accounts and now successfully provide

their escrow agent services.

At the same time, the institute of escrow continues its development in Russia. From June 01, 2018 new amendments in the Civil Code will come into force introducing the novelty – an escrow agency agreement regulating not only issues related to transaction on the escrow account, but generally determining status, rights and liabilities of the parties to the escrow agency agreement. It is also important to note two changes, which will come with the new legislation. To begin with, not only banks, but also any persons (e.g. the notary or even law firms) would be entitled to act as an escrow agent. The other important novelty is that not only money, but also movables such securities (both certified and not) may become transferrable under escrow scheme.

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

- Opening a letter of credit, issued in favour of the seller

This option is similar to settlements through an escrow agent, and provides guarantees to both parties. The seller is assured that the purchaser has sufficient money on the bank account, while the purchaser will be assured that the bank will authorize payment to the seller solely against the documents due.

- Transfer of rights to shares by a depositary through blocking operations on a seller's depo-account.

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

Conditions Precedent

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

- (i) actions of the seller to eliminate the deficiencies of the due diligence (e.g., increase of the authorized 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.);
- (ii) observance of mandatory corporate procedures in the target company per Russian law (e.g., obtaining corporate consents, obtaining waivers of pre-emptive rights, etc.);
- (iii) observance of mandatory requirements for undergoing state control over M&A transaction prior to its execution, obtaining due permissions of state authorities for transaction execution (please see Section 7 of the Table hereof).

The parties should determine the terms for execution of the conditions precedent and liability for failure to fulfill the conditions precedent.

Representations and Indemnities

Representations (in Russian – “заверения об обстоятельствах” that literally translates as ‘representations regarding circumstances’) 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 in order 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. The possible way to enforce the representations 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 by the seller (with no option of forcing the seller through the court to fulfill the listed representations in kind). However, damages arising from the breach of representations are hard to prove. Please note that according to Russian law breach of non-material representations gives a party the right to claim damages whereas breach of material representations additionally entitles a party to rescind the agreement.

In practice the list of representations is provided by the purchaser and covers the following:

- The target company was duly established;
- 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;
- 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;
- The target company executes all obligations, prescribed under its licenses;
- The target company in due time and in an appropriate way executes its obligations;
- The indebtedness of the third parties to the target company can be collected within the time limit, prescribed in the appropriate agreements;
- The target company complies with all requirements of the legislation;
- The target company pays taxes and other obligatory payments in full and in time;
- Other representations.

Practically, representations are checked in the course of due diligence of the target company. The purpose for providing representations is that they are an opportunity to minimize 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 clause (in Russian – “возмещение потерь” which literally translates as “compensation for losses”) gives the right to compensate losses arising from the occurrence

of agreed circumstances and not related to the breach by a party of the obligation under the SPA.

Limitations of Representations

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

- 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;
- The seller is not liable for the losses of the purchaser if the amount of such losses is less than any fixed amount or in part of excess of a fixed amount;
- 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.

The construction of the representations should be worked out carefully under Russian law. For example, the limitation to bring a claim within a fixed term can be recognized null and void as restricting a limitation period.

According to mandatory provisions of Russian legislation limitation period and the procedure for its calculation cannot be changed by the agreement of the parties. It will be reasonable for the purchaser to demand (i) indemnification for the breach of representations from the ultimate beneficiaries of the target company, or (ii) retention of part of the purchase price until the expiration of the term of bringing claims.

CLOSING OF M&A TRANSACTION

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

If payment is defined as a simple bank transfer, upon all obligations of the seller being fulfilled, payments will be deemed to be the closing step of the transaction. However, 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 state of the deal, or structured through the escrow facility.

As an affirmation of closing, parties could sign a reconciliation certificate which states that the parties deem the performance complete, and have no further financial claims to each other.

ACTIONS AFTER M&A TRANSACTION 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). Please note that non-competition agreement and non-solicitation agreement are hardly enforceable in Russia.

DISPUTES ARISING FROM M&A TRANSACTION

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

However, according to the latest amendments of the arbitration laws effective from February 01, 2017 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 three categories of corporate disputes: arbitrable (1), arbitrable with limitations (2), and non-arbitrable (3):

- 1 As a general rule, corporate disputes (e.g. 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 permanent arbitral institution (in accordance with normal arbitral rules and not necessary in Russia);
- 2 **Limited arbitrability** disputes (e.g. disputed 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, issuance of securities) are arbitrable subject to the following conditions:
 - by the permanent arbitral institution seated in Russia;
 - under approved arbitration rules for corporate disputes;
 - if arbitration clause is entered by all shareholders / participants and by the company itself.
- 3 **Non-arbitrable** (e.g. disputes related to convening general shareholders' / participants' meetings; buy-back and compulsory buy-out of shares by JSC or PJSC¹, voluntary, mandatory, and competitive offers and buy-out of shares by shareholders; exclusion of participants from LLC).

As of the present moment, the International Commercial Arbitration Court (hereinafter, the "ICAC") and Maritime Arbitration Commission at the Russian Federation Chamber of Commerce and Industry are recognized as permanent arbitration institutions. In addition, recently the ICAC has adopted new rules for corporate disputes, effective from February 01, 2017.

¹ PJSC stands for Public Joint Stock Companies, which came to substitute Open Joint Stock Companies according to corporate legislation reform in 2014.

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.

The only requirement for foreign institutions (as compared to domestic arbitration institutions) for obtaining this permit is matching the criteria of possessing “widely acknowledged international reputation”. To our knowledge, foreign arbitration institutions have not applied for a permit for the time being.

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