

Russia

MERGERS AND ACQUISITIONS UNDER RUSSIAN LAW AND PRACTICE: GENERAL OVERVIEW



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The implementation of market reforms in Russia led to the appearance of previously unused economic instruments and legal institutions. Most of them were connected with new types of legal entities, since such legal entities in particular were considered a major tool for reforming the economy. The history of their use in Russia during the last 11 years reveals a number of further stages of development. Initially, new forms of legal entities served only private business development and privatization. Later they were used for the creation or consolidation of independent organizations, medium- or large-scale business structures, including vertically integrated ones. Today one can see a tendency in the Russian economy towards the geographical, industrial and inter-industrial expansion of many companies that survived the 1998 financial crisis. Good examples include JSC "Oil Company," "Lukoil" and JSC "Severstal". In this respect resolving issues associated with mergers and acquisitions (M&A) is becoming more and more important in Russia. For example, we recently advised on an acquisition by a leading telecommunications company of a major regional cellular operator in the south of Russia.

Issues relating to M&A come as no surprise to lawyers practising in Russia. M&A activity was quite high during the establishment or consolidation of medium- and large-scale businesses (mostly through acquisitions), although during that period the goals pursued and methods employed often differed from those used now. Many vertically integrated companies, especially in the mining sector, used M&A not only for their own consolidation but also to optimize their assets, including sales of surplus holdings. While advising a major Russian oil company, we not only observed these processes from within but also actively participated in them inter alia through cooperation with international law firms representing foreign clients.

What should a foreign entity, contemplating M&A as an instrument for implementation of its business plans in Russia, consider from a legal point of view?

Although corporate regulation in Russia has achieved some success, it is still in need of further development, including in the field of M&A. So far there is no specific legislation regulating all the issues arising out of M&A. They are instead regulated through provisions existing in various branches of law: civil, corporate, securities, anti-monopoly, tax, accounting, employment, administrative and financial. Many of the regulations have a different level of specification. Moreover, Russian law has not yet acquired a special legal terminology that satisfies all the requirements of M&A participants. All this may create some difficulties in practice for private as well as public bodies. Moreover, the latter often try to comply with requirements only relevant to them and ignore the rest. As a result, in practice, private persons involved in specific

projects, and not public bodies tend to see the problems in their entirety. M&A deals are considered in their entirety and interrelation only during the implementation of specific projects.

Russian case law regarding M&A is only just becoming clear. For instance, the number of published resolutions passed by the Presidium of the Russian Higher Court of Arbitrage on specific cases related to mergers barely exceeds 10. Academic interest in questions of M&A has arisen only recently, so solutions of many complicated problems are only just starting to be discussed in periodicals and treatises.

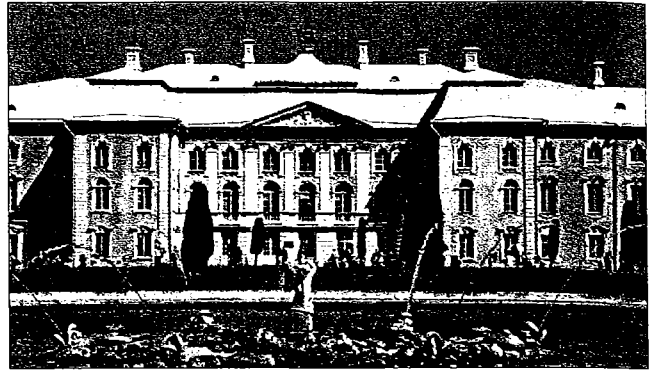
However all these problems are well known in Russia and efforts to resolve them are taking place. In 1995, serious changes relating to M&A were introduced into the Law "On Competition and Restrictions of the Monopolistic Activity on the Commodities Markets". After 1998 other laws relating to M&A, such as "On State Registration of Legal Entities"; "On Limited Liability Companies"; "On Protection of Competition on the Capital Services Market"; the Russian Tax Code; and the Russian Labour Code were passed in Russia and in 2001 significant changes were introduced into the Law "On Joint Stock Companies".

Considerable efforts to create proper regulation of M&A have been made by the Russian Ministry for Antimonopoly Policy and Support of Entrepreneurship and the Federal Commission for the Securities Market. The latter, for instance, passed Resolution of February 12 1997 No 8 on approval the standards of issue of shares and bonds and their prospectuses during reorganization of business entities. It also introduced changes to "Standards of Issue of Shares on Establishment of Joint Stock Companies, Additional Shares, Bonds and their Prospectuses" approved by Resolution No 19 of the Federal Commission for the Securities Market, September 17 1996 (as amended on November 11 1998).

Only professional lawyers experienced in advising on M&A projects are capable of understanding all the legal nuances, and keeping track of constantly changing legislation.

The situation is made harder by the fact that applicable regulations may exist on the federal level as well as at regional and local levels. On the regional and local levels there are also problems caused by local social, economic and environmental factors.

The following Russian peculiarity relating to M&A should not be overlooked: during the whole Soviet period, including the late 1980s and early 1990s, serious changes took place in the Russian economy in respect to large-, medium- and small-scale state enterprises that at face value appeared as a process of mergers and acquisitions, but were implemented through administrative rather than market methods. Traditionally, administrative factors and procedures played a significant role in creating



large business structures and they continue to be important today. Moreover, sometimes these factors and procedures, together with the influence of public authorities, are used in bad faith or even in violation of the law.

It is necessary to state that M&A deals in Russia are often carried out through aggressive legal means, so the development of legal mechanisms which could oppose hostile take overs is very important for Russia. It is all the more crucial as Russian regulations do not always provide the defending party with effective legal means of protection.

Unfortunately, in addition to administrative resources, Russian courts of general jurisdiction as well as other law enforcing bodies are also sometimes unduly used as the means to resist take overs or to help their speedy implementation. Imperfections in Russian procedural legislation and the slow work of supervisory agencies give unscrupulous people wide opportunities for abuse.

These three problems are quite serious, and we have encountered them in practice. Over the last four years we have advised a small but fast-developing independent oil company in the north of Russia that has successfully resisted attempts by the biggest Russian oil company to obtain control or acquire it.

Only experienced Russian law firms with a good reputation and extensive experience are able to offer lawful ways to deal with these issues: the absence of adequate regulation of M&A in Russian law requires reference to more general provisions contained in Russian legislation, and experience in how the Russian courts interpret them. Thorough consideration of domestic theoretical works while deciding complex issues, knowledge of Russian public and local bodies, Russian courts and Russian realities in general are also needed. The cooperation of Russian and international law firms in projects involving foreign persons is necessary both in the interests of foreign participants in M&A deals and to ensure that Russian law firms have the right qualifications for the job.

To conclude, M&A in Russia is not terra incognita, rather it is a widely used and very effective tool which can be successfully used for business by Russian as well as foreign companies.