Top 10 Legal Developments in Russian M&A for 2017

The international law firm Debevoise & Plimpton LLP presents an overview of the most significant legal developments in Russian M&A for 2017.

Debevoise & Plimpton

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1. Changes Relating to Major and Interested Party Transactions

On January 1, 2017, significant amendments to the legislation on joint stock companies and limited liability companies in respect of regulation of major and interested party transactions became effective. These amendments are intended to reduce the administrative burden on companies and simplify the process of execution of major and interested party transactions.[1]

Major Transactions

The most significant amendments with regard to major transactions include the following:

- **Ordinary course of business defined.** Similar to the previous regime, a transaction is not a major transaction and, therefore, does not require corporate approval unless it falls beyond the scope of the ordinary course of a company's business. From January 1, 2017, a definition of "*transaction within the scope of the ordinary course of business*" became effective. These are transactions executed by a company or any other entities conducting similar business (regardless of whether or not the company has done such transactions previously), if such transactions do not lead to termination of the company's business, change in the type of this business, or substantial change in the scale of this business.
- **List of exemptions expanded and clarified.** In particular, the following do not fall under major transactions regime: (i) the transfer of rights to property in the course of reorganisation of a company (including consolidation agreements and merger agreements)[2]; (ii) transactions made on the basis of a pre-approved preliminary agreement; and (iii) standard form agreements concluded on the terms and conditions similar to those of other standard form agreements of the company.
- **Approval of terms and conditions of a major transaction became flexible.** A resolution for approval of a major transaction may include, *e.g.*, (i) minimum and maximum values for the terms of the transaction or the procedure for their determination; (ii) alternative versions of the terms of the transaction; (iii) approval of execution of similar transactions; and (iv) approval of execution of the major transaction subject to concurrent execution of several transactions. In addition, a resolution for approval of a major transaction does not need to specify a party to, and beneficiary of, the transaction if they cannot be determined at the time of the approval of the transaction.
- **Effective period of the resolution approving the transaction determined.** The resolution approving a major transaction may specify the term of validity of such resolution. If the term is not specified, the consent for execution of the transaction will be valid for one year after the date of its adoption unless a different period follows from the terms and conditions of such transaction or other circumstances under which such consent was given.

1 These amendments were discussed in detail in a separate Client Update by Debevoise & Plimpton LLP, *see* https://www.debevoise.com/insights/publications/2016/09/changes-to-the-regulation-of-major-and-interested.

2 Prior to January 1, 2017, a similar exemption applied only to interested party transactions.

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- **Opinion on the major transaction required**. The opinion on the major transaction must include information on the likely consequences of the major transaction and evaluation of its rationale. The board of directors or the sole executive body if the company has no board of directors adopts such opinion. If the value of the transaction exceeds 50% of the book value of the company's assets and, therefore, such transaction requires approval of the general shareholders' meeting, the opinion on the major transaction must be circulated to shareholders as part of the materials for the general meeting.
- **Financial parameters of major transactions clarified**. The new version of the law clarifies details of transaction that are compared with the book value of a company's assets to ascertain whether it qualifies as a major transaction (in particular, in the event of alienation of property, transfer of property for temporary possession and/or enjoyment, transfer of intellectual property rights, or acquisition of shares or other securities convertible into shares).

Interested Party Transactions

The most significant amendments with regard to interested party transactions include the following:

- **Mandatory approval of interested party transactions no longer required**. An interested party transaction requires prior approval of the board of directors or the general shareholders' meeting only if (i) the sole executive body; (ii) a member of the management board or the board of directors; or (iii) shareholders who own at least 1% of voting shares request such approval. A company must notify members of the management board and the board of directors, and shareholders in certain circumstances about a proposed transaction. Such notice must be done at least 15 days prior to the date of execution of the transaction.
- **Threshold for approval of a transaction at the shareholders' level raised**. Approval of an interested party transaction falls within the scope of responsibility of the general shareholders' meeting if it involves property, the value of which amounts to 10% or more of the book value of the company's assets (before the amendments this figure was 2% or more).
- **Concept of affiliation replaced with the concept of control for determination of interest in a transaction**. The control exists where a person has the right, directly or indirectly, to dispose more than 50% of votes at general meetings or elect the sole executive body or more than 50% of the collective management body of the controlled entity.[3] Therefore, the replacement of "affiliation" by "control" reduces the number of persons that may be deemed to be interested parties in the transaction. In particular, shareholders who own 50% or less of voting shares are no longer qualified as interested parties (unless there are other grounds for exercising control).[4]
- **Public institutions no longer qualify as controlling persons**. The Russian Federation, constituent entities of the Russian Federation and municipal bodies are not deemed controlling persons and, therefore, are not deemed interested parties to a transaction.

3 Stricter rules apply to the concept of control for (i) joint stock companies included in the List of Strategic Enterprises approved by Decree of the President of the Russian Federation No. 1009 dated August 4, 2004; (ii) joint stock companies in which 50% or more of shares are owned by the Russian Federation; and (iii) joint stock companies in which the Russian Federation holds a "golden share".

4 Prior to January 1, 2017, shareholders who owned, together with their affiliates, 20% or more of voting shares were deemed to have interest in the transaction.

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Interested Party Transactions (Continued)

- **List of exemptions expanded and clarified.** In particular, the following do not fall under requirements for interested party transactions: (i) transactions in the ordinary course of business, provided that the company has executed numerous similar transactions on similar terms over an extended period of time and such transactions are not interested party transactions; (ii) transactions made on the basis of a pre-approved preliminary agreement; (iii) standard form agreements concluded on the terms and conditions similar to those of other standard form agreements of the company; (iv) transactions relating to offering (including by subscription) of shares or securities convertible into shares of the company; and (v) transactions involving property, the price or book value of which does not exceed 0.1% of the book value of the company's assets, provided that the value of such transactions does not exceed the limits established by the Bank of Russia.[5]
- **Approval of terms and conditions of a transaction became flexible and ability to determine validity period of resolution approving the transaction granted**. These amendments are similar to those discussed above in respect of major transactions.
- **Public companies now required to prepare a report on interested party transactions for their annual shareholders' meetings**. This report must be signed by the sole executive body of the company and approved by the board of directors and the company's audit commission.
- **Requirements for provision of information by persons that may be deemed interested parties to a transaction became more stringent**. If a person who may be deemed an interested party to the transaction is in breach of the duty to inform the company of the onset of the relevant circumstances, then its fault in causing damages to the company through such transaction is presumed. In June 2017, the Bank of Russia published guidelines with the requirements as to the procedure and form of notices to be given by persons who may be deemed interested parties to a transaction.
- **Non-public companies can modify the procedure of approval of interested party transactions**. The charter of a non-public company may establish a different procedure for approving interested party transactions or provide that the provisions of the law relating to interested party transactions do not apply to such non-public company altogether.

Similar rules generally apply to limited liability companies.

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5 The limits established by the Bank of Russia became effective in May 2017, *e.g.*, for the companies with the book value of assets not exceeding RUB 25 billion, such limit is RUB 20 million.

2. Changes Relating to Access of Shareholders to Corporate Records

On July 30, 2017, amendments to corporate laws relating to the access of shareholders to corporate records entered into force.

Prior to the amendments all shareholders regardless of their shareholding had a right of access to any information that the company must keep under applicable law and internal regulations (apart from accounting documents and minutes of meetings of the management board which were available only to shareholders who owned at least 25% of voting shares).

Starting from July 30, 2017, the scope of information available to shareholders of non-public companies depends on the number of voting shares held by them. For example, shareholders who own less than 1% of voting shares have access only to the key documents of the company. Shareholders who own 1% or more of voting shares have, as previously, access to any information that the company must keep, apart from accounting documents and minutes of meetings of the management board (these documents are available only to shareholders who own at least 25% of voting shares, however, the charter may provide for a smaller shareholding required for access to such documents).

Similar to non-public joint stock companies, the scope of information available to shareholders of public companies depends on the number of voting shares held by them. However, unlike non-public companies, shareholders of public companies who own 1% or more of voting shares have access only to a limited scope of documents rather than all information kept by the company as it was envisaged previously.

Participants of a limited liability company have, as before, access to all information that the company must keep under applicable law and internal regulations and such access (including to accounting documents) is granted to all participants regardless of their share in the charter capital.

There are separate provisions that clarify the procedure for granting access to information:

- A number of documents (including information on major and interested party transactions, minutes of the board meetings, appraisal reports in respect of major and interested party transactions) are provided to shareholders who own less than 25% of voting shares only if a business purpose for their request is specified; this requirement does not apply to limited liability companies;
- The law contains grounds on which the company may deny access to information (*e.g.*, if the requested documents relate to a period more than three years prior to the date of the request, if the documents are requested once again during the period of three years or if the requested document is made publicly available on the website or was disclosed pursuant to the securities market laws);
- Documents containing confidential information are provided to a shareholder/participant provided that it signs a confidentiality agreement on the terms identical for all shareholders/participants;
- The charter of a non-public company may provide for other terms and procedure for granting access to information (including a minimum shareholding required for access to certain documents).

In addition, due to potential expansion of the U.S. sanctions, the Russian Government is entitled to stipulate when companies may not disclose or provide information in respect of major and interested party transactions or may limit such disclosure/provision of information, and identify persons in respect of whom companies may limit the disclosure/provision of such information.

3. Restrictions on Acquisition of Russian Assets by Offshore Companies

On July 1, 2017, the law came into force providing for further prohibitions and restrictions on participation of offshore companies and entities controlled by them (the "offshore companies") in acquisition of strategic companies[6] and in privatisation of state and municipal property.[7]

An offshore company is a legal entity incorporated in a jurisdiction or territory appearing on the list approved by the Ministry of Finance of the Russian Federation. Such jurisdictions and territories include, *inter alia*, Belize, the British Virgin Islands, the Cayman Islands, Panama, the Isle of Man, the Seychelles, Guernsey and Jersey.

Acquisition of Strategic Companies

Offshore companies are treated the same as foreign states and international organisations in respect to acquisition of strategic companies. It means that offshore companies may not:

- Acquire 25% or more of votes in strategic companies using subsoil sites of federal importance (the "strategic subsoil user");
- Acquire more than 50% of votes in other strategic companies;
- Otherwise establish control over strategic companies; or
- Acquire fixed production assets of a strategic company, the value of which represents 25% or more of the book value of its assets.

In addition, offshore companies may acquire the right to dispose, directly or indirectly, (i) more than 5% of the total votes of a strategic subsoil user or (ii) more than 25% of the total votes of any other strategic company, or other means of blocking the decisions of its corporate bodies only subject to prior approval of the Governmental Commission on Oversight of Foreign Investment in the Russian Federation (the "Governmental Commission").

The ownership interest is calculated on an aggregate basis for all foreign states, international organisations and offshore companies along with any entities controlled by them.

As a general rule, the new rules do not apply to relations involving offshore companies that arose prior to the effective date of the amendments.

Participation in Privatisation

The provisions regarding privatisation prohibit acquisition of state or municipal property by offshore companies. This prohibition does not apply to acquisition by an offshore company of a state-owned or municipally owned land plot if the offshore company owns immovable property located on such land plot, provided that such property is not an unauthorised construction.

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6 A strategic company means a Russian business company conducting activities of strategic importance for national defence and security as defined in Article 6 of Russian Federal Law No. 57-FZ on Foreign Investment in Business Companies of Strategic Importance for National Defence and Security, dated April 29, 2008 (the "Strategic Law").

7 These amendments are discussed in detail in a separate Client Update by Debevoise & Plimpton LLP, *see* https://www.debevoise.com/insights/publications/2017/07/acquisition-of-russian-assets.

4. Increased Control of Transactions of Foreign Investors

On July 30, 2017, important amendments to the procedure of conducting transactions by foreign investors in respect of Russian business companies became effective.[8]

The amendments expand the range of transactions involving foreign investors subject to prior approval of the Governmental Commission by supplementing the list of strategic activities described in Article 6 of the Strategic Law. In particular, the new strategic activities include that of an operator of an e-trading platform for procurement for state and municipal needs.

The Russian Prime Minister (ex officio Chairman of the Governmental Commission) received broader powers. He may require that any transaction involving a foreign investor in respect of any Russian companies (including those that are not strategic companies) be made subject to approval by the Governmental Commission even if such approval is not required pursuant to the Strategic Law.

In addition, the Governmental Commission itself got broader powers. When approving a transaction involving a foreign investor in respect of a strategic company the Governmental Commission may impose any obligations on such foreign investor as it may consider appropriate for national defence and security reasons. The law previously provided for an exhaustive list of such obligations.

In addition to administrative penalty provided by the law earlier, the above amendments introduce additional liability for foreign investors for failure to notify the antimonopoly authority (FAS) upon acquisition of 5% or more of shares/participation interests in a strategic company. Such foreign investors cannot vote at the general meeting of the participants of a strategic company until they receive a notification from the FAS confirming proper performance of the notification obligation.

8 These amendments are discussed in detail in a separate Client Update by Debevoise & Plimpton LLP, *see* https://www.debevoise.com/insights/publications/2017/07/russia-to-increase-control.

5. Introduction of Escrow Agreement into Law

In July 2017, a bundle of amendments to the Russian Civil Code relating to financial transactions was adopted that will take effect on June 1, 2018. These amendments to the law include provisions on escrow agreement that has particular importance for the M&A market. The escrow agreement will enable simultaneous performance of cross-obligations, which is often critical for the structuring of M&A deals.

Under the escrow agreement, the depositor agrees to deposit property with the escrow agent for the purposes of performance of the depositor's obligations to transfer such property to another party in whose favour the deposit is made (the beneficiary). The escrow agent, in turn, agrees to ensure safekeeping of such property and transfer it to the beneficiary when events set forth in the agreement are triggered.

The depositor retains the title to the property until the events constituting grounds for its transfer to the beneficiary are triggered and after that the title transfers to the beneficiary. The deposited

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Introduction of Escrow Agreement into Law (Continued)

property may not be subject to enforcement, attachment or relief for the debts of the escrow agent or the depositor. The beneficiary's right to claim the transfer of the deposited property by the escrow agent may be subject to seizure for the beneficiary's indebtedness.

The escrow agreement is similar to the escrow account agreement introduced in the course of the Russian Civil Code reform in 2014. However, unlike the escrow account agreement which relates to monetary funds only the property deposited under the escrow agreement may include any movable things (including cash, certificated securities or documents), non-cash money and uncertificated securities. Besides, entities other than a bank can act as an escrow agent under the escrow agreement.

The escrow agreement must be notarised except where non-cash money or uncertificated securities are deposited. Unless otherwise provided by the agreement, the escrow agent is paid a remuneration fee.

It is permitted to enter into a mutual escrow agreement providing for deposit of property to be transferred by the parties to each other.

6. Transfer of List of LLC Participants to Russian Notary Chamber

On July 1, 2017, amendments to the laws on limited liability companies came into force enabling the general meeting of participants of a limited liability company to adopt a resolution on delegation of maintaining and keeping of the register of the company's participants to the Federal Notary Chamber. If such resolution is adopted, the list of participants is included in the register of lists of participants of the unified notary information system (the "register").

The apparent advantage of such transfer is higher reliability and accuracy of information for both the participants of the company (especially minority participants) and counterparties, investors and other third parties. Additional administrative costs can be seen as a drawback as a notary fee is charged for making entries in the register and issuing extracts from it.

If the list of participants of the company is transferred to the Federal Notary Chamber, the sole executive body and participants of the company are responsible for informing the notary about the interests owned by the participants and any changes of the name or location of participants.

7. Changes Relating to Assignment of Rights

The above reform of the Russian Civil Code in respect of financial transactions has brought about amendments to certain provisions on assignment. In particular, the following amendments will become effective from June 1, 2018:

- The debtor will be required within a reasonable time after notification about assignment to inform the new creditor of any grounds for objections to the assigned claims about which the debtor is aware. Otherwise, the debtor will not be able to refer to such objections later. Therefore, it is strongly recommended for the debtor to immediately inform the new creditor of any potential objections and issues related to assigned claims upon being notified about the assignment.
- The assignment agreement may provide that the original creditor is exempt from liability for invalidity of assigned claims arising from the agreement related to business activities of its parties provided that such invalidity was caused by circumstances about which the original creditor was not aware or could not have been aware or that were disclosed to the new creditor.

In addition, on December 21, 2017, Ruling of the Plenum of the Supreme Court of the Russian Federation No. 54 on Certain Issues of Application of the Provisions of Chapter 24 of the Civil Code of the Russian Federation on Substitution of Parties to an Obligation based on a Transaction was adopted to provide guidance on many issues related to assignment of claims and transfer of the debt. In particular, it covers the moment of transfer of claims, assignment of future claims, certain aspects of admissibility of assignment, various types of transfer of the debt, assignment of contract, certain procedural issues, etc.

8. Changes Relating to Revocation of Powers of Attorney

On January 1, 2017, amendments to the Russian Civil Code took effect providing for the following procedure of revocation of powers of attorney:

- If a power of attorney is notarised, its revocation must be notarised;
- If a power of attorney is issued in writing, its revocation may be notarised or made in writing.

The key advantage of notarised revocation (including revocation of a power of attorney issued in writing) is that expedited procedure of revocation is applied and a presumption is created that third parties have been made aware of such revocation commencing on the day following the day of notarised revocation.

However, given the court practice on similar matters, revocation of a power of attorney and presumed awareness of third parties do not relieve the principal from its obligation to notify (i) its agent and (ii) third parties in respect of whom the principal knows that the agent acted under the power of attorney that the power of attorney has been revoked.

As of January 1, 2017, the Federal Notary Chamber provides free online access to its database at http://reestr-dover.ru/ permitting to verify:

- The authenticity of notarised powers of attorney, including information on their revocation;
- The information on notarised revocation of powers of attorney issued in simple written form.

9. Risk of Reduction of Break-Up Fee

The Supreme Court of the Russian Federation elaborated on its earlier position that denial of the claim for a break-up fee in full or in part is possible in exceptional circumstances if it is proved that the amount of such fee is clearly disproportionate to the adverse consequences caused by repudiation of the agreement and that the right to demand its payment was exercised deliberately in bad faith. This position is based on Article 10 of the Russian Civil Code providing for discretion of the court to deny a person protection of his/her right, in full or in part, in the event of abuse of right (deliberately bad faith behaviour).

In its Ruling dated June 28, 2017 in Case No. 309-ES17-1058 the Supreme Court emphasised that the payment of the break-up fee must ensure the balance of interests of the parties. The principle of freedom of contract does not relieve the parties from the obligation to act reasonably and in good faith taking account of rights and lawful interests of each other.[9]

9 In this case the lessee sought to recover unjust enrichment from the lessor in connection with early repudiation of the lease, including the balance of the prepaid rent for the entire period of the lease. Under the terms of the lease, the lessee lost its right to claim the prepaid rent for 15 years of the lease term in the event of early repudiation of the lease (*i.e.*, early termination of the lease by the lessee was in fact permitted for a fee).

10. Further Improvement of Electronic Document Flow for State Registration of Legal Entities

On October 30, 2017, amendments were adopted to the laws on state registration of legal entities, which will become effective on April 29, 2018. These amendments, among other things, are aimed at further development of electronic document flow for state registration of legal entities.

Electronic documents used for this purpose must be signed with enhanced encrypted and certified digital signature.

Starting on October 1, 2018, any person will be entitled to use the official website of the registering authority to request receiving information on filing of documents with the registering authority in respect of a particular legal entity. The registering authority will be required to provide such information by e-mail to the address specified in the request on the next business day after the receipt of documents in respect of such legal entity.

As of October 1, 2018, if the application for state registration is denied due to an incomplete set of documents or improper execution of documents the applicant will have three months to file correct documents without paying any additional state registration fee. The applicant will not be required to file documents that the registering authority already has in connection with the rejection of application for state registration.

Please do not hesitate to contact us with any questions.

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