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I OVERVIEW OF M&A ACTIVITY

Since 2012, M&A activity involving Russian businesses has remained muted with an occasional headline transaction, such as the US$55 billion acquisition of TNK-BP by Rosneft in 2013, which remains the largest takeover in Russian history. Total Russian M&A activity (inbound, outbound and domestic) increased in 2016 to US$39.2 billion, 77 per cent higher than 2015. Russian inbound M&A increased by 72 per cent to US$19.8 billion, the highest level since 2012; outbound M&A involving Russian acquirers increased 63 per cent to US$16.5 billion, the highest level since 2007. Two transactions involving Rosneft accounted for much of both the inbound and outbound totals: a consortium formed by the Qatar Investment Authority and Glencore purchased a 19.5 per cent shareholding in Rosneft for US$10.8 billion in the largest privatisation sale ever by the Russian Federation; and a Rosneft-led consortium agreed to acquire a 98 per cent interest in the Indian-based Essar Oil company for US$12.9 billion.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The Civil Code of the Russian Federation, 3 federal laws on particular forms of legal entities (such as joint-stock companies (JSCs) 4 and limited liability companies (LLCs) 5) and the Securities Market Law 6 constitute the fundamental framework of the federal legislation governing the legal status of Russian companies and their securities, as well as relations between a company and its shareholders and among shareholders. This framework is hierarchically

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1 Scott Senecal and Yulia Solomakhina are partners and Ekaterina Abrossimova is an associate at Cleary Gottlieb Steen & Hamilton LLC.
2 Source: Thomson Reuters. In this chapter, Russian M&A activity refers to acquisitions of businesses in Russia by foreign investors (inbound M&A); outside Russia by Russian investors (outbound M&A); and in Russia by domestic investors (domestic M&A), irrespective of the place of incorporation of their holding structures. All data and references to legislation are as of 4 July 2017.
subject to the Constitution of the Russian Federation, which by its own terms has direct effect in Russian law, and to ratified international treaties of the Russian Federation. This framework is further complemented by:

- legislation setting forth restrictions on economic concentrations affecting the Russian markets generally (competition law) and on various forms of control over assets in particular industries, including banking, insurance and the media, as well as industries deemed ‘strategic’ in Russia;
- procedural and enforcement legislation relevant, for example, in the context of shareholder remedies and the resolution of corporate disputes; and
- subordinate normative acts of various federal authorities of the Russian Federation, including decrees of the President and regulations of the government and the Central Bank of the Russian Federation (CBR), which implement federal legislation.

Russia is a civil law country, implying that its legal system does not rely on judicial precedent. However, court rulings can in practice have a normative effect and are often of persuasive authority, especially rulings by higher courts.

The legal framework for M&A activities in Russia has recently been subject to major reforms, both in institutional and substantive respects. Although the majority of expected changes in the legislation have been implemented, their practical effect has not yet been fully tested in Russian courts. Currently, there are three central developments:

- the ‘de-offshorisation’ reform (which is still being implemented), principally concerning Russian taxation regulations, which are having a substantial effect on the structuring of asset holdings and M&A transactions for domestic buyers;
- the reform of the Civil Code, the Joint-Stock Company Law and the Limited Liability Company Law, including a major reform in 2016 of the regulatory regime of interested party transactions (IPTs) and major transactions; and
- the arbitration law reform.

In an earlier reform, in 2014 the Supreme Commercial Court (SCC) was merged into the Supreme Court, which thus took over the SCC’s prior function as the ultimate court to decide commercial disputes. Resolutions of the Supreme Court made in the form of a resolution of the Plenum summarising court practice related to a particular issue or area of law or a resolution of the Presidium in an individual case are the main sources of judicial guidance for resolution of commercial disputes.

In parallel with the institutional court reform, there has been a substantive reform of arbitration rules resulting in the codification and clarification of rules on arbitrability of civil law disputes, including the submission of corporate disputes to arbitration. Prior to the reform, the arbitrability of certain disputes was governed by various laws that were inconsistently applied in practice. Moreover, corporate disputes, including disputes arising out of share purchase agreements and shareholder agreements, were largely considered as non-arbitrable by the state courts. The new rules should override the past court practice. For example, the new rules clearly state that civil law disputes are generally arbitrable,

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7 See Sections IV and IX, infra.
8 See Section VIII.
9 See Section III.
subject to specific exceptions established under federal laws, including bankruptcy disputes, certain non-arbitrable corporate disputes (discussed below), privatisation disputes, public procurement disputes, administrative and public law disputes, and employment disputes.

Broadly speaking, disputes in connection with foreign investments into Russia are arbitrable provided further that any ‘corporate disputes’ in respect of a Russian company (such as disputes relating to the creation, management of and participation in a company) can only be arbitrated by an arbitration panel seated in Russia and administered by a permanent arbitration institution licensed by the government. For most categories of corporate disputes to be arbitrable under the new rules, all of the shareholders of a company, the company itself and any other party involved in a dispute must be a party to an arbitration agreement entered into after 1 February 2017. This is a difficult condition to satisfy, unless the arbitration clause is incorporated into the company’s charter (which possibility is expressly contemplated by the law, except that such is expressly not possible in respect of a public JSC or a JSC with over 1,000 shareholders).

At the same time, there is an exhaustive (but broadly worded) list of non-arbitrable corporate disputes, including disputes:

- relating to convocation of general shareholders’ meetings;
- arising from notarial certification of transactions with interests in LLCs;
- challenging actions of state and municipal bodies, public authorities or governmental officials;
- arising from tender offers to shareholders of Russian public JSCs;
- arising from the acquisition and buy-back by a company of its own shares;
- involving Russian ‘strategic’ companies (including disputes arising from a shareholders’ agreement); or
- relating to the expulsion of shareholders of an LLC.

It remains to be seen how the courts will interpret the scope of non-arbitrable disputes.

Although one stated goal of this reform is to improve the Russian investment climate, investors may not have the same level of confidence in Russian domestic arbitration institutions as they have in long-established international arbitration institutions, which to date have not received licences to carry out arbitrations in Russia. According to public reports, as of April 2017, several leading international arbitration institutions such as the International Chamber of Commerce, the Singapore International Arbitration Centre and the Swiss Chambers Arbitration Institution were studying whether to apply for a licence, while the Kuala Lumpur Regional Centre for Arbitration has filed an application. In addition, if the seat of the arbitration is in Russia, then this raises the possibility that Russian courts may review the result of the arbitration if a party seeks to annul an award, a prospect that may also trouble investors.

In terms of the form of M&A deals in Russia, privately negotiated deals, including auction sales, are prevalent, as Russian businesses tend to have one or several controlling or significant shareholders. Even in the context of acquiring companies publicly traded in Russia, non-solicited or voluntary public tender offers are rare.

At the same time, any acquisition of equities in a Russian public JSC is subject to Russian takeover regulations should the acquisition exceed certain thresholds. Generally, a person who, alone or together with its affiliates, has acquired more than 30 per cent of the

total number of ordinary and certain other voting shares (if any) of a public JSC must submit a mandatory bid for the remaining shares of such classes. The CBR supervises compliance with the takeover regulations, including in the form of an advance review of any mandatory bid for publicly traded shares. Furthermore, Russian takeover regulations provide for a possibility of squeezing-out minority shareholders once an acquiror’s stake exceeds 95 per cent of ordinary and certain other voting shares (if any) of a public JSC, subject to rules regarding how the 95 per cent threshold is accomplished, the timing of a squeeze-out and its price.

Finally, corporate shareholdings of Russian businesses have been commonly arranged as multiple-layer structures, where an offshore company (e.g., Cypriot or Dutch) holds Russian operational entities (first layer), while investors participate in that offshore holding company (second layer) or even at ‘higher’ layers of the holding structure. These structures historically emerged for a combination of reasons, including a possibility to benefit from (believed to be) flexible foreign law and legal institutions to govern relations between investors. Although Russian-law documentation is increasingly used for M&A transactions, foreign law, especially English law, still tends to govern significant M&A deals in Russia. It would not be surprising if greater ‘Russification’ of M&A occurs, spurred by the de-offshorisation reform-related changes in tax, as well as changes to corporate and civil law and the arbitrability of corporate disputes.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i 2012–2015 amendments to the Civil Code

The reform of the Civil Code from 2012 to 2015 stemmed from the 2008 initiative to revise the Civil Code 15 years after it was originally adopted. The reform has been implemented by ‘packages’ of amendments, the earliest in December 2012 and the latest in March 2015, including a package comprising the corporate law reform.

In terms of their scope, the 2012 to 2015 amendments of the Civil Code substantially affect the civil law regime of business activities with respect to Russian assets and entities.

11 Russian takeover regulations are concentrated in Chapter XI.1 of the Joint-Stock Company Law, as well as implementing acts of the CBR and its predecessor. Prior to the 2014 Civil Code amendments, the mandatory bid rule applied to any equity acquisition above a certain threshold in an open JSC, irrespective of whether its shares were publicly traded. Although the corporate form of an open JSC has ceased to exist, the mandatory bid rule continues to apply in certain cases to open JSCs that have not been transformed into a current corporate form, as well as to public JSCs.


16 The amendments to the Civil Code adopted as part of the reform described here gradually entered into force throughout 2013 and 2014, with some changes becoming effective on 1 June 2015.
The amendments touch upon core areas of Russian business law, such as:

- permissible corporate forms for commercial legal entities;
- corporate structure and governance;
- the validity of transactions and challenges thereto;
- the validity of corporate decisions;
- statutes of limitations;
- rules of agency and powers of attorney; and
- the basic concept of an ‘obligation’ that underlies any business relationship.

We discuss below some of the recent major changes relevant in the Russian M&A context. As with any similar overhaul of core business law regulations, the practical effects of these amendments will be better understood as courts apply their provisions. The Supreme Court has established guidelines on the amended Civil Code to be followed by lower courts.\(^\text{17}\)

**Reform of Russian corporate norms**

**General rules on corporate forms**

The Corporate Law Amendments have codified an earlier doctrinal division of business organisations into two main categories: corporate organisations and ‘unitary’ entities. Corporations may be established in the form of JSCs or LLCs, the most widely used types of business organisations, or other forms provided for by law. Unitary entities, an idiosyncratic form of non-corporate state-owned commercial enterprises, continue to be used in the non-privatised sectors of the Russian economy and represent a legacy of the Soviet legal system.

**Public and non-public companies**

As their most significant development, the Corporate Law Amendments distinguish public from non-public companies and establish two distinct regimes of corporate governance for each (superseding the prior distinction of ‘open JSCs’ from ‘closed JSCs’). Under the Corporate Law Amendments, a JSC can obtain the status of a public company if its equity instruments have been publicly offered or are publicly traded, or it has (regardless of its number of shareholders) voluntarily opted for the public company regime by stating such in its charter. All other JSCs and all LLCs are deemed non-public. The Joint-Stock Company Law subsequently defined the three-step process by which a JSC may obtain the status of a public company: execution of a listing agreement with a securities exchange, registration of a prospectus of securities with the CBR, and registration of amendments to the charter stating that the company is public and disclosure of the same in the public register of legal entities. In

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November 2015, the CBR further clarified the process for conversion from a non-public JSC to a public JSC and vice versa, and introduced related disclosure requirements in connection with that process.  

Non-public companies enjoy greater flexibility in structuring their corporate governance and regulation of internal procedures. In particular, non-public companies have certain discretion to redistribute default statutory powers between the general meeting of shareholders and management bodies, as well as to design their internal corporate structure. In addition, shareholders of a non-public company may agree to disproportionate distribution of their voting and other rights, provided that the respective rules are set forth in the charter or corporate agreements and disclosed in the public register of legal entities. Conversely, public companies must comply with mandatory rules of corporate governance.

**Expulsion of a shareholder**

The Corporate Law Amendments provide that a shareholder of a non-public company that has caused ‘material harm to the company’ or otherwise has ‘significantly complicated its business operations’ (including by violating his or her corporate duties through consistently failing to appear at general meetings voting on a CEO candidacy where his or her presence was needed for the decision to be adopted, or unreasonably pursuing a corporate conflict) may be squeezed out from the company for a fair value consideration upon a court ruling solicited by another shareholder. The concepts of ‘material harm to the company’ or causing ‘significant complications to business operations’ are not defined in the law, but similar concepts have already applied to LLCs where courts have construed them to encompass the above shareholder behaviour. In 2014, the Supreme Court warned lower courts as to the exceptional nature of the expulsion remedy in the context of an LLC with two 50 per cent shareholders, stating that it should not be a court-administered solution to a deadlock where neither shareholder has breached its corporate duties. In 2015, Plenum 25 of the Supreme Court further clarified that a court may not uphold a shareholder’s claim seeking the expulsion of another shareholder in circumstances where the claimant has violated his or her corporate duties.

**Restoration of corporate rights**

Building on SCC practice, the Corporate Law Amendments introduce a remedy of restoration of corporate rights that is different from the classic action of vindication (*replevin*) applied earlier by Russian courts to the restoration of illegally deprived share ownership. Under the new rules, a shareholder may reclaim shares that he or she has been illegally deprived of from any third party owning such shares (without regard as to whether the latter acquired the shares in good faith) so long as he or she pays the third party fair market consideration for such shares as set by court, possibly together with a recovery of such shareholder’s losses from those responsible for the original loss of the shares. However, the court has discretion to deny this claim if the third-party owner would be ‘unfairly’ deprived of its shareholding rights, or if such reclamation would cause ‘grossly negative social consequences’ or other negative effects significant for the public interest. In the latter case, the claimant would be entitled to a fair market consideration for the deprived ownership payable by the person who

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18 CBR Letter No. 06-52/10054 of 25 November 2015.
19 Determination of the Supreme Court No. 306-ES14-14 of 8 October 2014.
originally caused the loss of the shares. To date, the courts have clarified that in the event of illegal deprivation of shares, a claimant should seek as a remedy the restoration of corporate rights rather than any alternative remedy (e.g., invalidation of the corporate resolution or the registration record as a result of which the claimant was deprived of his or her shares).20

‘Two-key’ principle

The Corporate Law Amendments provide for the two-key principle, previously unknown in Russia, under which functions of the CEO may be exercised by several persons acting jointly or severally. A company applying this dual management structure must make an appropriate disclosure in the public register of legal entities. Plenum 25 of the Supreme Court has clarified that information in the public register of legal entities is *prima facie* evidence of the authorities of the individual or individuals entitled to represent the company and should prevail over any restrictive provisions of the company’s charter. The authorities of such individual or individuals to legally bind the company are presumed to be several and unlimited, unless otherwise clearly disclosed in the public register. Several major Russian public companies have already implemented a senior executive structure based on the two-key principle.

Corporate agreements

The amendments to the Civil Code now also provide for a general concept of ‘corporate agreements’, confirming and expanding upon rules regulating shareholder agreements that were introduced into Russian statutory law in 2009.21 In addition to a company’s shareholders, parties to a corporate agreement may now include creditors or other third parties aiming to protect their legitimate interests (however, the company itself cannot be a party). The company must be notified of the execution of a corporate agreement, while disclosure of its contents is generally discretionary. If a corporate agreement is entered into with regard to a public company, the company must disclose that such an agreement exists. Corporate agreements may provide for special voting arrangements, as well as restrictions on selling shares (which may include rights of first refusal, tag and drag, put and call options), but cannot oblige shareholders to vote in accordance with instructions of the company’s own management bodies.

According to the Corporate Law Amendments, a corporate decision may be declared void if it violates a corporate agreement to which all the company’s shareholders are parties. Furthermore, a shareholder participating in such a corporate agreement may demand that a company’s transaction in breach of a corporate agreement be voided if the other party to such transaction knew (or should have known) about the conflicting provisions of the corporate agreement.

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20 Determination of the Supreme Court No. 308-ES16-15069 of 7 March 2017; Ruling of the Commercial Court for the Moscow Region in Case No. A40-156605/13 of 18 May 2016.

21 Article 32.1 of the Joint-Stock Company Law, as amended by Federal Law No. 119-FZ of 3 June 2009; a similar provision has existed in respect of LLCs since 1 July 2009.
Legal reform of IPTs and major transactions

As part of the continuing corporate law reform and as a result of ongoing lobbying efforts by large Russian holdings, the concepts of interested party transactions (IPTs) and major transactions have been refined and narrowed in scope. Since 1 January 2017, an IPT is limited to transactions between a company on the one hand, and a member of the supervisory or management board, a CEO, a person controlling the company or a person entitled to give mandatory instructions to the company, or any of his or her spouse, parents, children or siblings, or persons under his or her control, on the other. In the case of a ‘strategic entity’ (the list of such strategic entities is set forth by presidential decree) or any entity controlled by the Russian Federation, a person is also deemed to be interested if such person and its controlled persons hold over 20 per cent of the voting shares or otherwise have a right to control over 20 per cent of a management body of a company. By contrast, for non-strategic, non-state-controlled entities, the test is now one of control. The previous approach to an IPT for any company was significantly broader, as it was based on ‘affiliation’, which included, among other things, a 20 per cent equity stake in an entity (so that a transaction between a company and its 20 per cent shareholder had been an IPT). The rules defining a transaction as an IPT for reasons of cross-management remain unchanged (e.g., where a person (or his or her specified family member) is a common member to the board of directors or management board of both companies that are party to the transaction).

The new IPT rules exclude any *de minimis* transaction with the value of less than 0.1 per cent of the total unconsolidated balance sheet assets of the company under Russian accounting standards. A board of directors is now authorised to consent to an IPT having a value below 10 per cent of the balance sheet value of the company’s assets (significantly increased from the previous threshold of 2 per cent). An IPT exceeding the 10 per cent threshold requires the consent of the majority of disinterested shareholders attending a shareholders’ meeting. Previously, the IPT rules required the consent of the absolute majority of all non-interested shareholders, whether attending a meeting or not, which sometimes proved impractical for Russian companies with a large shareholder base. A non-public company may generally waive the application of the IPT rules or establish a different set of rules in its charter. The annual report of a Russian company now needs to list all IPTs executed in that year.

Since 1 January 2017, the new major transaction rules have limited the scope of transactions requiring consent as major transactions by excluding transactions in the ‘ordinary course of business’. According to a common view of Russian legal practitioners, this is a very broad exception, permitting Russian companies to effectively take the position that no consent is required for a particular transaction if such transaction is in line with the past practices of such company, or indeed of other companies (even of much larger size) in the same business.

The new rules change the grounds for a successful challenge of IPTs or major transactions. Courts now should uphold a transaction if a claimant fails to prove the actual or constructive knowledge of the counterparty to such transaction that such transaction was an IPT or major transaction, required a corporate consent, or both. In line with the prevailing court practice, the new rules on IPTs codify that an IPT may be invalidated only if a claimant

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22 The CBR may set forth a lower threshold for an IPT approval. Currently, the CBR sets such lower thresholds by its Direction No. 4335-U of 31 March 2017 ‘On Establishment of Thresholds for Amounts of Transactions by Joint Stock Companies and Limited Liability Companies Exceeding Which Such Transactions May Be Deemed Interested Party Transactions’. 

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proves damages to the company. However, according to the new rules, such damages are presumed if, in the absence of a corporate consent, at a claimant’s request, the management has failed to provide evidence that the transaction does not violate the company’s interests (which evidence may be that such transaction is made on terms that are not materially different from market terms).

ii Recent amendments to the Joint-Stock Company Law

On 1 July 2016, the amendments to the Joint-Stock Company Law relating to procedures for convocation and conduct of general shareholders’ meetings came into effect. These procedures apply to annual meetings of Russian JSCs in 2017. As a result of the amendments, various deadlines for convening annual and extraordinary meetings, delivery of notices to shareholders and record dates were shortened. Such shortening was triggered by the introduction of various methods of digital communications with shareholders, including e-mail and text messages, and the possibility of completing voting ballots online and participation via videoconference, provided the same are permitted by the company’s charter.

Furthermore, each JSC (whether public or non-public) is now required to maintain its shareholders’ register with a Russian-licensed registrar, and such registrar becomes an important player in assisting the company to hold shareholders’ meetings, pay dividends, buy out shares and conduct tender offers or squeeze-outs. As a general rule, the company would send information through the registrar and make any payment (whether as dividend or share price) to an account specified in the registrar’s records (or, in absence of such records, to a notary’s deposit). In the event of a tender offer, if a shareholder accepts the terms of a tender offer, the registrar would block the respective shares in exchange for payment to be made by the offeror pursuant to the tender offer. Those shareholders who do not hold shares directly through a licensed registrar would receive the same information and payments channelled through their nominee holder (or a chain of nominee holders).

Another significant amendment to the Joint-Stock Company Law is that a non-public JSC may now issue preferred shares with substantial voting rights, or even voting rights equal to rights attributable to ordinary shares or other additional rights, and any such rights may be conditional on the occurrence of certain triggering events. Preferred shares with ‘extended’ rights must be approved by all shareholders voting in favour to establish them by an amendment to the company’s charter.

iii Recent amendments to the Limited Liability Company Law

The Limited Liability Companies Law, as amended on 29 December 2015, establishes the priority of information on participants in an LLC contained in the public register of legal entities. This principle is backed up by the new rule that the transfer of a participation interest as certified by a Russian notary only becomes effective upon registration with the public register following the notary’s electronic submission regarding the transfer. Although the Law requires that registration be made within three business days, in practice it may take up to one week (or even longer). In addition, the Russian tax authorities have been given the power to verify information in respect of a transfer before entering such information into the public register (previously, a notary’s verification was deemed sufficient). Therefore, some buyers of participation interests in Russian LLCs now insist on only making payment upon
the registration of the transfer with the public register (even though the seller has effectively surrendered control of such participation interests upon the notarisation of the transfer), or when the parties agree to escrow arrangements.

Another substantial amendment to the Limited Liability Companies Law is the opportunity for an LLC to adopt a model charter (which the regulators have not yet promulgated) designed to speed up and streamline the registration of a new company with the local tax authorities. The use of a model charter should also simplify the due diligence of a company that has adopted the model charter.

iv Liability of officers and directors in Russia

The starting point for directors’ and officers’ liability under Russian law is a long-standing basic statutory rule that a corporate officer or director must act in the interests of the company reasonably (a duty of care) and in good faith (a duty of loyalty), and in the case of a breach of any such duties, must compensate for the damages caused, upon a claim of the company itself or, in certain cases, of a company's shareholder. Russian law contains no rules concerning the indemnification of directors by the company, and prohibits the elimination or limitation of a director’s liability for breaches of the duty of loyalty in the case of non-public companies, and for breaches both of the duty of loyalty and the duty of care in the case of public companies. Despite the fact that Russian law provides for a possibility of derivative actions by a minority shareholder on behalf of a company, in practice such actions have been rare, in part due to difficult procedural hurdles.

In its 2013 guidance to lower courts, the SCC formulated a Russian analogue of the ‘business judgement rule’ and its limits. Recognising normal entrepreneurial risk, the SCC stated that the mere fact of a company’s losses is not in itself evidence of managerial bad faith (a breach of the duty of loyalty) or unreasonableness (a breach of the duty of care), and that the courts should not second guess the commercial sense of managerial decisions. The SCC noted, however, that entering into transactions with a conflict of interest should not be considered a general commercial risk. The SCC also stated that, as a rule, the burden of proving bad faith, unreasonable actions and losses falls on the claimant (while the respondent officer or director should provide explanations as to the cause of losses). Notably, the burden of proof can shift to the officer or director where he or she fails to act reasonably before the court, for example, by failing to provide corporate documentation or other relevant evidence to the court.

Effectively building on SCC practice, the Corporate Law Amendments provide that an officer or a director shall be liable for a failure to act in good faith or reasonably, including if his or her actions (or inactions) were inconsistent with common business practices or normal entrepreneurial risk. The Corporate Law Amendments also extend the standard of good faith and reasonable behaviour, as well as the liability regime, to persons who have the de facto ability to determine the activities of a legal entity. This change has been viewed as a tool for piercing the corporate veil in appropriate circumstances, although to date there are no reported court cases that have applied it as such. In addition, the Corporate Law Amendments expressly prohibit a waiver of liability of officers and directors of a public

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24 Article 53.1 of the Civil Code (in effect from 1 September 2014).
company for a breach of duties, but allow them to waive liability for a breach of the duty of care of officers and directors of a non-public company. A waiver of liability for deliberate actions or liability of a person who has the *de facto* ability to determine the activities of a legal entity is generally prohibited.

Further, in its 2013 guidance, the SCC formulated a list of presumptions of managerial bad faith and unreasonableness, where the burden to prove the opposite shifts to the manager. The SCC explicitly stated that an act effectively in the interests of one or several shareholders, but to the detriment of the company, is not an act in the best interests of the company.

The SCC’s resolution incorporates further guidance for officers and directors on the importance of proper procedure in decision-making and creating an adequate system of controls. In this regard, the SCC noted that officers and directors may be liable for damages caused as a result of a failure to establish an appropriate governance system within their company. According to the SCC, this can be assessed by the court, for example, taking into consideration the scale of the company’s business, usual commercial practices, and the officer’s or director’s personal involvement in his or her duties and his or her performance. In 2014, in a ruling against a CEO for inappropriate delegation of the CEO’s powers, the SCC stated that the delegation of all powers of the CEO without any justification or regard to the character or scale of business cannot be deemed reasonable and consistent with standard business practice, and re-emphasised the importance of senior officers’ immediate and personal involvement in the management of a company, supervision of subordinates and maintaining the governance structure appropriate for the scale of the business.25

The general limitation period of three years applies to claims against directors. The limitation period commences at the moment when the claimant learns or should have learned about the breach and the identity of the respondent. A shareholder may file a claim even if he or she was not a shareholder at the time of the breach, and in such case the statute of limitations commences at the time when the shareholder’s predecessor learned or should have learned about the breach. When a claim is brought against a CEO, the limitation period is considered to have commenced at the moment when the company, through a new CEO, could learn about the breach, or when a controlling shareholder learned or should have learned about the breach.

To note one recent court case, a district court held a former CEO liable for the penalties paid by the company of which he was CEO resulting from violation of an order of a regulatory authority imposed on the company.26 The court also concluded that a newly appointed CEO who had been in the office for less than a month before the inspection that revealed the company’s violation of an order could not have cured the violation in such a short period of time and was not liable.

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25 Resolution of the SCC No. 9324/13 of 21 January 2014. In this case, damages in an amount of 100 million roubles were assessed against the CEO personally for a failure to act in good faith and reasonably.

v Representations and warranties, indemnities and pre-contractual liability under the amended Civil Code

In an effort to make Russian law more attractive as the governing law for M&A transactions, the amended Civil Code introduces concepts intended to approximate ‘representations’ and ‘indemnities’ under Anglo-Saxon jurisprudence (no distinction is made between representations and warranties as exists under English law).

Under the amended Civil Code, representations are defined as a separate undertaking to confirm certain circumstances important for the execution, performance or termination of a contract (whether the phrase ‘execution, performance or termination’ delimits the possible scope of representations is unclear). The amended Civil Code sets forth the following (expressly non-exhaustive) six examples of matters on which representations can be given:

- the authority to execute the contract;
- the subject matter of the contract;
- the compliance of the contract under applicable law;
- the existence of required licences and permits;
- the financial condition of the party; or
- representations relating to a third party.

A breach of representations may result in both a claim for damages or a claim for termination (but not rescission) of the contract if the representations were material to the party receiving such representations (while the law also allows that a contract may exclude the termination remedy). Separately, a contract may be found invalid in the event of fraud or fraudulent misrepresentation relating to untrue representations.

The amended Civil Code establishes that a party giving representations is liable for its breach if it induced its counterparty to rely on such representations (or had reasonable grounds to believe that its counterparty would do so). If the grantor of representations is engaged in a commercial activity, or representations are given in the context of a corporate agreement or a share purchase agreement, the grantor of representations is liable for the breach, irrespective of his or her knowledge that representations were untrue (it is unclear what effect a ‘to the best of knowledge’ qualification to the representation would have). In these circumstances, it is also presumed that the grantor of representations knew that the counterparty would rely on the representations. The effect of the new concept of representations in the context of an M&A transaction is yet to be tested in Russian courts (although there are certain limited and contradictory precedents in which claimants try to invoke the concept of representations).

In November 2016, the Supreme Court emphasised that representations have a contractual origin similar to obligations to perform an action or abstain from an action (e.g., an obligation to transfer assets, perform works, provide services, contribute capita, or pay money). In Plenum 54, the Supreme Court states that a party may be liable for the occurrence or non-occurrence of certain circumstances, including circumstances that are independent of such party’s behaviour, in the case of false representations in pursuing a commercial activity, and may be required to pay damages as a result. As such, the Supreme Court, whose position is authoritative for lower courts, gave support for the use of representations in the context of commercial transactions.

The amended Civil Code defines an ‘indemnity’ as an obligation to pay losses resulting from the occurrence of circumstances described in the contract and not relating to a breach of the contract. The amended Civil Code sets forth two (expressly non-exhaustive) examples of matters on which indemnities can be given: claims asserted by a third party or governmental
authority against the party (or a third party) and losses arising from the impossibility to perform the contract (e.g., a specific indemnity in respect of pre-closing tax obligations might be given: since the Civil Code states that an indemnity does not relate to a breach of contract, it would seem to be the case that an indemnity is not restricted to matters of performance). An indemnity is permitted in the context of a commercial transaction entered into by companies (or individual entrepreneurs), or in the context of a corporate agreement or a share purchase agreement. The amended Civil Code stands for the proposition that Russian courts may not decrease the amount of indemnity specified by the parties in the contract (unless it is proved that the claimant deliberately increased losses), which is different from the approach to contractual penalties.

Plenum 7 of the Supreme Court states that an indemnity should relate to the ‘execution, performance or termination’ of a contract, which might suggest that a third party (such as a sponsor or a subsidiary) who does not have a justified relation in the ‘execution, performance or termination’ of the contract may not give an indemnity. According to the Supreme Court, the party claiming under the indemnity should prove that losses have been incurred or would be necessarily incurred as a result of a particular circumstance described in the indemnity. While the amended Civil Code refers to ‘tangible losses’ (a phrase otherwise unused in the Civil Code) being recoverable under an indemnity, in contradistinction to damages arising from a breach of contract, the ruling in Plenum 7 of the Supreme Court seems to blur that distinction. Moreover, the Supreme Court has instructed lower courts that where an indemnity undertaking is ambiguously drafted, courts should disregard the indemnity and apply standard contract damages (which have always been difficult to prove in Russian courts). Aside from Plenum 7, there are but limited and contradictory precedents in which claimants have tried to invoke indemnities.

Finally, the amended Civil Code has introduced the concept of pre-contractual liability for bad faith conduct in negotiations, such as the presentation of incomplete or untrue material information, or the sudden and unjustified termination of negotiations that could not be reasonably expected by the other party. Damages in such cases are costs relating to negotiations and a loss of the opportunity to engage with a third party. Although there are precedents in which claimants invoked the provision setting out pre-contractual liability, Russian courts have so far refused to award damages in the context of negotiations.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i 2016 overview

In 2016, inbound deals where foreign investors acquired Russian assets accounted for US$19.8 billion, approximately 50 per cent of total Russian M&A activity by value in the year. In 2016, inbound deals were principally driven by investors located in the British Virgin Islands, China, India, Switzerland27 and the Middle East. Some inbound deals are likely to be Russian money ‘round-tripped’ via offshore structures and reinvested in Russia. In 2016, outbound deals where Russian investors acquired foreign assets amounted to US$16.5 billion in aggregate, and domestic M&A activity to US$2.9 billion.28

27 Source: Thomson Reuters.
28 Ibid.
ii Legal regime for foreign investments in Russia

Russian law generally promotes foreign investments in the Russian economy, but also imposes certain limitations and restrictions on such investments. Russia is a party to over 80 bilateral and multilateral treaties (approximately 65 of which are currently in force) that guarantee fair and equitable treatment, national and most-favoured nation treatment, repatriation of investments and profits, and protection against expropriation without adequate compensation. These and other guarantees are further provided in the Foreign Investments Law.

In 2008, Russia enacted the Foreign Strategic Investments Law, which established a special clearance procedure (outlined below) for foreign investments into companies engaged in, currently, 45 strategic activities, which can be grouped into the following categories:

a geological survey and exploration and production of subsoil of federal significance;
b weaponry, cryptography, eavesdropping devices and other similar devices;
c nuclear production and radiation safety;
d aerospace and aviation;
e ‘natural monopolies’, including pipelines to transport gas, oil and petroleum products, power stations, railways, airports and seaports;
f companies dominant (under the Competition Law) in a particular market;
g the fishing industry;
h television and radio broadcasters dominant in a particular region of Russia, certain large telecommunication providers (excluding the internet), and large printing and publishing companies;
i activities that ‘actively influence’ hydro-meteorological and geological processes;
j pathogens of infectious diseases; and
k transportation security.

Key FSIL requirements, restrictions and exemptions

Under the FSIL, the acquisition of control by a foreign investor (or a group of affiliated persons to which the foreign investor belongs), directly or through third parties, over a Russian strategic company is generally subject to an advance approval by a special governmental commission chaired by the Prime Minister (FSIL Commission). In addition, the FSIL applies to acquisitions of rights of ownership, possession, or use of fixed production assets comprising 25 per cent or more of the balance sheet value of assets of a Russian strategic company; and any arrangements enabling foreign investors to obtain rights to determine corporate decisions of such a company.

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29 Source: investmentpolicyhub.unctad.org/IIA/CountryBits/175#iiaInnerMenu.
Subsequent approval is required if a change of control happens as a result of the buy-back or redemption of shares, conversion of preferred stock into voting shares or for similar reasons, and an application seeking the subsequent approval must be filed within three months of the relevant triggering event.

The FSIL also requires foreign investors to notify the Federal Antimonopoly Service of Russia (FAS), which administers the clearance procedure under the FSIL, of any direct or indirect acquisition of 5 per cent (or more) of voting rights in a Russian strategic company or the completion of any transaction that was cleared by the FSIL Commission in accordance with the FSIL within 45 days of such acquisition or transaction.

The FSIL expressly prohibits sovereign states or entities under their control (such as sovereign wealth funds) to acquire direct or indirect control over a Russian strategic company, or rights of ownership, possession, or use of fixed production assets representing 25 per cent or more of the balance sheet value of assets of the relevant strategic company. The FSIL Commission cannot waive this rule. Within these limits, minority sovereign investments into the equity of strategic companies are allowed, subject to prior approval, if the relevant equity thresholds on the aggregated basis are exceeded. These thresholds may be as low as 5 per cent of shares with respect to strategic mining companies, but generally the threshold applies in respect of any acquisition of shares whereby sovereign or sovereigns would hold over 25 per cent of all shares (but in no case over 50 per cent, which is prohibited). The FSIL explicitly requires aggregation of sovereign ownership (i.e., the ownership of the sovereign wealth fund of country A and the sovereign wealth fund of country B would be aggregated).

Following the trend of de-offshorisation, the FSIL was amended on 1 July 2017 to provide that an offshore company registered in blacklisted jurisdictions as per the list maintained by the Ministry of Finance of Russia (an ‘offshore company’) and that an investor controlled by such offshore company is effectively equated to a sovereign investor under the FSIL. As such, the rule of aggregation now applies to offshore companies and sovereigns together, as does the requirement for FSIL approval for such offshore company or investor. The list of black-listed jurisdictions extends to 40 jurisdictions, including the Bahamas, Bermuda, the BVI, the Cayman Islands, the Channel Islands, Gibraltar and Panama. Cyprus, the Netherlands and Luxemburg (jurisdictions in which holding companies of Russian businesses are often organised) are not on the list.

Moreover, the FIL extends the application of the FSIL approval requirements to sovereign investments in a non-strategic Russian company irrespective of the value of its assets or revenues if the sovereign acquiror would exercise, directly or indirectly, more than 25 per cent of the voting rights in such non-strategic Russian company, although the FIL remains silent on whether foreign sovereign investors may acquire control over a Russian non-strategic company (if such approval is given).

There are several exemptions from FSIL jurisdiction. With respect to most strategic targets, no clearance is needed when the foreign investor already controls the target by virtue of an FSIL-cleared investment. However, in the case of a ‘strategic mining company’ (i.e., a company with a licence for a subsoil field of federal importance), that exemption is narrowed to the situation in which the foreign investor already holds over 75 per cent of the voting rights of the target. Separately, if the state holds over 50 per cent of the voting rights of the

34 Order of the Ministry of Finance of Russia No. 108n of 13 November 2007 ‘On Approval of the List of States and Territories Providing Beneficial Tax Treatment and (or) Not Disclosing and Sharing of Information in Conducting Financial Operations (Offshore Zones),’ as amended.
target, the foreign investor can make its further investment without FSIL clearance as long as such further investment does not change the voting power of the state in the strategic target; however, this exemption is unavailable for investments into strategic mining companies by sovereign acquirors. Another exemption establishes that where a foreign acquisition vehicle is used that is ultimately controlled by a Russian citizen and tax resident with no dual citizenship, no FSIL clearance is required.

**Notion of control under the FSIL**

The FSIL uses a robust definition of control, and is based on ‘the substance over form’ approach permitting Russian regulators to consider all circumstances of a particular case rather than simply relying on pre-established thresholds. In analysing a proposed or current holding structure for a Russian strategic target, FAS applies the same rules to determine ‘control’ at each level above the target. In addition to clear-cut situations such as the acquisition of over 50 per cent of voting shares or the right to appoint over 50 per cent of the members of the management bodies of a strategic target, control may exist in other, less obvious situations. Under the FSIL, control may also exist where a foreign investor has less than 50 per cent of votes, but the allocation of votes is such that the foreign investor is still able to determine the decisions of a strategic company. For example, in *FAS v. Telenor et al*, FAS asserted that the largest, 40 per cent shareholder (Telenor, the telecommunications conglomerate controlled by Norway) had control over publicly traded VimpelCom, one of the largest Russian telecom companies, despite the fact that there were other shareholders with significant shareholdings in VimpelCom. Further, according to published guidelines by FAS, there is no *de minimis* (safe harbour) equity threshold (e.g., 10 per cent), and control might be acquired with no equity stake. So far, there is no official interpretation by FAS regarding whether there is ‘control’ of a foreign state or a foreign private investor in a scenario of ‘joint control’ (i.e., where a foreign state or foreign private investor holds equivalent rights in a 50/50 joint venture with another investor (that, in the case of a foreign state, is not another foreign state investor)). Moreover, a lower threshold of ‘control’ expressly applies for strategic mining companies: the ability (directly or indirectly) to control 25 per cent of a mining company’s votes, and any subsequent acquisition of shares in a strategic mining company, is subject to additional prior approval, unless the relevant size of the stake to overall equity does not increase.

**Clearance process**

The FSIL clearance process comprises two stages. At the initial stage, FAS determines whether the applicant would acquire control (or whether a sovereign or offshore company would cross the relevant threshold of ownership) over a strategic entity as a result of a reported transaction. Upon the results of the initial review, two alternative options are possible. If FAS determines that either control would not be acquired (or the threshold not crossed) or that the target is not strategic, it should inform the applicant that FSIL approval is not required.

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35 Ruling of the Moscow Commercial Court in Case No. A40-57614/12-56-542 of 24 April 2013, upheld by Resolution of the Ninth Commercial Appellate Court of 28 September 2012.
37 FSIL Guidelines, Item 3.
Alternatively, if FAS determines that the applicant would acquire control over a strategic entity (or the threshold would be crossed), FAS follows a standard, full-scale review, and the application is referred to the FSIL Commission.

In the case of a standard, full-scale review, while processing applications, FAS liaises with other agencies, including the Federal Security Service and the Ministry of Defence, which shall provide their opinions to the FSIL Commission regarding the proposed transaction from the perspectives of state defence and national security. The FSIL Commission, however, makes the final decision. The FSIL does not establish specific criteria that should be applied by the FSIL Commission,38 which thus has full discretion in determining whether a transaction constitutes any possible potential threat to national security interests. The FSIL does not envisage any possibility for an applicant to participate in the approval process (other than making the filing and responding to follow-up requests by FAS), or any grounds to challenge the FSIL Commission’s decision. If the transaction is approved by the FSIL Commission, it may be consummated within the term specified in the decision. This term can be prolonged by a decision of FAS upon the applicant’s request.

While the statutory deadline for an application review is three months (which may be extended to six months in exceptional cases), in practice the FSIL approval process can take longer. FAS will suspend its review of the related antitrust filing, and will not issue its approval under the Competition Law until the FSIL clearance is granted.

According to a FAS report on the status of competition in Russia for 2016, over 57 applications were submitted to FAS under the FSIL last year. Out of these applications, the FSIL Commission reviewed 22 applications and approved 21 of those applications (including 11 approvals issued subject to conditions set forth in mitigation agreements), while one application required additional review. FAS also returned 23 applications upon the finding that no approval was required, and two applications were returned due to failure to submit additional information requested by FAS. One application was withdrawn by the applicant due to the change in the applicant’s intention to enter into a transaction. As of 31 December 2016, 10 applications were pending consideration.39 So far, only one FAS decision premised on the FSIL has been challenged by an acquiror,40 and no decision of the FSIL Commission has been challenged.

**Violations of the FSIL**

Failure to comply with the FSIL can lead to severe consequences. A transaction consummated in breach of the FSIL filing requirements or a prohibition is void and may be unwound (in other words, the parties are returned to status quo ante). This may also potentially lead to voidance of any and all post-investment decisions of the shareholders or governance bodies of

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38 The FSIL merely requires FAS to check a number of factors with respect to a strategic target, such as whether it has IP rights in relation to technologies important for social, economic or national defence and security (critical technologies), a licence to conduct works using state secret data and other factors.

39 Source: fas.gov.ru/about/list-of-reports/report.html?id=1720.

the strategic company. Other potential consequences include the loss or suspension of voting rights\(^{41}\) attached to the acquired interest, and administrative fines of between 500,000 and 1 million roubles for companies.\(^{42}\)

FAS is authorised to prosecute FSIL violations. When applying to a Russian court to unwind an acquisition violating the FSIL, FAS usually applies – *ex parte* – for interim relief broadly aimed at blocking cash disbursements from the strategic company to the acquirer and its affiliates, preserving the existing management of the strategic company and prohibiting approvals of major and interested party transactions to be entered into by the strategic company.\(^{43}\) Moreover, litigation regarding Astrakhan Port shows that FAS also utilises a robust arsenal to obtain evidence supporting its position, such as intelligence reports by the Federal Security Service evidencing concerted actions by foreign companies aimed at obtaining control over the Russian strategic company. Interestingly, after FAS prevailed in court, FAS did not pursue an unwinding of the transaction but entered into a settlement with the acquirors, permitting them to sell Astrakhan Port to a Russian buyer or, subject to the FSIL Commission’s prior approval, to a foreign buyer within six months of the date of the settlement agreement.\(^{44}\) In June 2016, the acquirors sold shares in Astrakhan Port to a foreign investor who received the FSIL Commission’s prior approval.\(^{45}\) Recently, there was a similar precedent where FAS challenged the acquisition of shares in a strategic company by a foreign investor who failed to obtain the FSIL Commission’s prior approval, and they entered into a settlement agreement requiring the foreign investor to sell shares to either a Russian buyer or a buyer that had obtained the FSIL Commission’s prior approval.\(^{46}\) Finally, based on several cases, private parties may have a cause of action under the FSIL to unwind a transaction entered into in violation of the FSIL.\(^{47}\)

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As a result of a confluence of negative factors (e.g., the decline in global energy prices combined with international economic sanctions imposed on Russia in 2014, which led to rouble volatility and slow GDP growth, and ultimately resulted in a recession in 2015 and 2016), Russian M&A activity remained subdued. The energy and power industry remains

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\(^{41}\) Ruling of the Ninth Commercial Appellate Court in Case No. A40-124526/11-138-1056 of 21 June 2012, upheld by a Ruling of the Moscow Region Commercial Court of 24 September 2012.


\(^{44}\) Decision of the Astrakhan Region Commercial Court in Case No. A06-2683/2012 of 23 May 2014; the amicable settlement was approved by Resolution of the Povolzhsky District Commercial Court, Case No. F06-2666/2015 of 4 February 2016.

\(^{45}\) Source: fas.gov.ru/about/list-of-reports/report.html?id=1720.

\(^{46}\) Ruling of the Moscow Commercial Court in Case No. A40-243962/2015 of 24 February 2016.

\(^{47}\) See, for example, Resolution of Ninth Commercial Appellate Court in Case No. A40-40521/10-22-354 of 21 October 2010, upheld by Resolution of the Federal Commercial Court of the Moscow District of 21 February 2011 and Ruling of the Supreme Commercial Court of 22 June 2011.
the dominant sector in Russian M&A. In particular, in 2016, the consortium of the Qatar Investment Authority and Glencore Plc acquired a 19.5 per cent stake in Rosneft Oil Company, the largest Russian oil company, for US$10.777 billion. Rosneft separately acquired a controlling 50.0755 per cent stake in Bashneft, one of the largest Russian oil companies, for US$5.305 billion, and also led a consortium that agreed to buy a 98 per cent interest in Essar Oil, the second-biggest private refinery in India, for US$12.9 billion. The emergence of domestic M&A, combined with the new de-offshorisation concerns for domestic buyers and the substantial role of state-owned entities in M&A activity, as well as the corporate law reforms discussed above, has resulted in greater use of Russian law as the governing law in significant Russian M&A transactions, although English law remains predominant for cross-border transactions.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

The forms of financing M&A deals commonly used in major foreign markets also apply for a Russian M&A deal. Traditionally, the prevailing structures of equity holdings in Russian businesses, which involve multi-layer offshore holdings, as well as the financial infrastructure, including major Russian and Western investment banks working in the Russian market, provided the flexibility of using multiple financing instruments.

In 2013, market intelligence reported that 40 to 50 per cent of cash payments in Russian M&A deals that year were debt-financed (the remainder being financed predominantly with corporate cash). Debt financing tends to take the form of bank loans, sometimes in the form of leveraged buyouts (which require tax structuring). A notable trend is the active and large-scale involvement of state-affiliated banks in financing Russian M&A transactions due to a range of factors: their generally cheaper cost of financing, their proximity to M&A deals on the advisory side, the prevalence of state-affiliated buyers in the domestic market, and, specifically since 2014, limited foreign borrowing opportunities for Russian borrowers in light of the sanctions.

The private equity (PE) market in Russia is underdeveloped, as evidenced by its moderate size and the changing composition of the players that make PE investments in Russian assets from year to year. Prominent PE funds active in the Russian market include Baring Vostok, the Russian Direct Investment Fund (RDIF), Rosnano and the PE arms of Russian state-affiliated banks. Since 2014, the chilling effect of sanctions has dissuaded global PE players from making major new investments in Russia.

In recent years, government-backed sponsors (such as the RDIF and PE divisions of state-affiliated banks) have strengthened the domestic segment of PE investments in Russia.

48 Source: Thomson Reuters.
49 Source: www.rosneft.com/press/releases/item/185049.
50 Source: www.rosneft.com/press/releases/item/184047.
51 Source: www.rosneft.com/press/releases/item/184099.
52 Source: 'Review of M&A Deals – 2008–2013. Structure and Financing of Transactions' by OJSC Gazprombank, January 2014 (excluding the financing for the Rosneft/TNK-BP deals). More recent data are unavailable, although the percentage share of debt financing could have somewhat decreased, as borrowing opportunities for Russian entities had declined since 2014 due to sanctions.
53 Ibid.
The RDIF was created in 2011 to catalyse PE investments in the Russian economy, including by way of attracting foreign co-investors who would otherwise be reluctant to invest on their own. The RDIF seeks to arrange 1 trillion roubles of investment, of which the RDIF itself has invested or committed over 100 billion roubles, and its co-investors, partners and banks 900 billion roubles. In 2015, the Public Investment Fund (Saudi Arabia’s sovereign wealth fund) allocated US$10 billion to the RDIF for the purpose of investing in Russia’s infrastructure and agriculture, the largest announced co-investment to date. In 2016, the consortium of the RDIF, the Russia-China Investment Fund (established by the RDIF and China Investment Corporation) and certain Middle Eastern co-investors announced an agreement for an investment in Eurasia Drilling Company, one of the largest independent oil drilling companies in Russia.

VII EMPLOYMENT LAW

In Russia, executive compensation falls within the purview of employment law. In principle, the CEO of a Russian company can be dismissed at any time upon the decision of the corporate body that has the relevant competence under the company’s charter. Until recently, upon dismissal, the CEO of any Russian company was entitled under law to compensation equal to three average monthly salaries or, if greater, in the amount set forth in the CEO’s employment agreement. This is no longer the case for certain state-controlled companies and all banks operating in Russia, as explained below, and a question remains about whether other contractually agreed executive ‘parachutes’ could be curtailed in court.

Unlike in some other jurisdictions, executive compensation did not become a hot topic in Russia at the time of the financial crisis. However, a case that started in 2013 and that dealt with a ‘golden parachute’ of around 200 million roubles to the dismissed CEO of the state-controlled company Rostelecom drew attention. Certain shareholders of Rostelecom challenged the board’s decision on the payout. The Supreme Court sided with the claimants, stating, among other reasons for its decision, that compensation upon early termination must be consistent with its purpose (i.e., to be an adequate protection for an ex-CEO upon his or her loss of employment) and its amount should be well justified by the company.

In February 2014, the Russian legislature reacted to this case by passing a law that retroactively limited ‘golden parachutes’ to various categories of executives of companies over 50 per cent state-owned to three average monthly salaries. Possibly, the Russian courts may adopt a similarly restrictive approach to ‘golden parachutes’ for outgoing executives of non-state owned companies (particularly, those with public shareholdings), relying on the concepts of reasonableness, good faith and the best interests of shareholders.

55 Source: rdif.ru/Eng_Partnership.
56 Source: rdif.ru/Eng_About.
57 Source: rdif.ru/Eng_fullNews/1477.
58 Source: rdif.ru/Eng_fullNews/2405.
59 Decision of the Commercial Court of St Petersburg and the Leningrad Region in Case No. A56-31942/2013 of 2 December 2013, ultimately upheld by Determination of the Supreme Court No. 307-ES14-8853 of 30 March 2015. The dismissed CEO received the payout, but later returned around 75 per cent of it to Rostelecom.
Separately, new rules for compensation in the banking industry (both in its private and state-controlled segments) were adopted in 2013 and 2014. The CBR now has supervisory powers over executive compensation for all Russian credit organisations. The new rules oblige credit organisations to implement a system of compensation, including executive compensation, under which remuneration can be cancelled, reduced or clawed back in the case of a negative financial result of the entire organisation or an individual business segment.

VIII TAX LAW

In keeping with global trends, the Russian authorities have been looking to tax profits and revenues generated by Russian businesses but received by entities in offshore jurisdictions, and to otherwise discourage the use of offshore jurisdictions, in particular those perceived as lacking tax and ownership transparency. Historically, many Russian businesses have been held in corporate structures involving such jurisdictions. In December 2013, President Putin formally launched a de-offshorisation initiative. De-offshorisation has also been further spurred by sanctions so as to help lessen their impact and shield Russian assets.

In January 2015, the core part of the de-offshorisation tax package became effective in Russia. Although the de-offshorisation reform has to date been principally carried out with respect to taxation, it directly affects corporate aspects of structuring Russia-related M&A transactions (traditionally structured via foreign jurisdictions) and corporate holdings of Russian businesses and individuals to the extent they rely on foreign companies such as special purpose vehicles, trading or cash management companies.

From January 2017, each Russian legal entity must take all necessary actions to identify its beneficial owner or owners and submit supporting documents to the competent Russian authorities, including the tax authorities, at their request. In addition, each Russian legal entity must now disclose its beneficial owners in its financial statements. Furthermore, due to the active exchange of information between tax authorities of various countries, the level of transparency in international holding structures and operations has been increasing in recent years. As a continuing trend, Russian tax authorities and courts have become more active in applying the ‘look through’ approach with respect to taxation of dividends, capital, interest or other income received from Russian sources to determine an ultimate beneficial owner of such income, irrespective of the fact that such income may have been first received by another person acting as a conduit for such income. In a March 2016 case involving shares in Severstal, the largest Russian steel producer, the court disregarded the application of the Russia–Cyprus double taxation treaty in respect of the Cyprus companies holding shares in Severstal on the grounds that the ultimate beneficial owners de facto controlling such shares

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were companies registered in the British Virgin Islands, with which Russia does not have a double taxation treaty.\textsuperscript{64}

At the same time, Russian tax authorities are more often asserting a ‘substance over form’ approach. In a prominent case recently considered by the Supreme Court, it was held that a buyer effectively buying a business (by purchasing substantially all its assets and effectively running the business after the purchase, even though the purchase did not entail buying the shares of the company that had held the business) could be held responsible for the taxes that should have been paid by the seller of the assets (i.e., the company that had formerly held the business).\textsuperscript{65} In another case, the Russian tax authorities considered a ‘debt push down’ structure and found that interest under the loan used for the acquisition of a Russian target, in a scenario where following the acquisition the loan was transferred to the Russian target as a result of the merger of the purchaser (also acting as the original borrower of the loan) into the Russian target, was not deductible due to a breach of the thin capitalisation rules.\textsuperscript{66} Both cases show that the Russian tax authorities increasingly focus on the economic rationale behind transactions, and may integrate such transactions and view them as a single arrangement in light of the overall surrounding circumstances and timing.

On 7 June 2017, over 68 states, including Russia, signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, which, following its ratification by the Member States, will affect all Russian bilateral double taxation treaties, and consequently is expected to affect the structuring of Russian M&A deals.

In Russia, tax advice, including for major M&A deals, is typically provided by the ‘Big Four’ companies. We suggest readers review their alert memoranda (available on their websites regularly) on Russian tax law developments related to M&A activities.

\section*{IX \hspace{1em} \textbf{COMPETITION LAW}}

Russian competition law and practice, including merger control, have been developing rapidly over the past decade. After administrative reforms in 2004, the Russian antitrust regulator, FAS, has achieved substantial and visible results in the enforcement of Russian competition law and its evolution.\textsuperscript{67} Since the enactment of the Competition Law in 2006 (which replaced the 1991 law), there have been four major sets of amendments to the Competition Law.\textsuperscript{68} The fourth set of amendments, made in 2015, abolished the ‘register of legal entities with a market share in excess of 35 per cent of a particular goods or services market’ that FAS had previously maintained. Inclusion of a company in this register had

\begin{footnotesize}
\textsuperscript{64} Resolution of Federal Commercial Court for the North-Western Region Case No. A13-5850/2014 of 15 March 2016.

\textsuperscript{65} Determination of the Supreme Court No. 594-PEK16 of 16 January 2017.

\textsuperscript{66} Resolution of the Commercial Court for the Ural Region Case No. A50-17405/2016 of 16 June 2017.

\textsuperscript{67} For example, in recognition of this achievement, the \textit{Global Competition Review} rated FAS 17th globally out of 140. Meeting with FAS Director Igor Artemyev, 17 June 2014: eng.kremlin.ru/news/22494 (in English).

\textsuperscript{68} Federal Law No. 275-FZ ‘On Amending the Federal Law ‘On Protection of Competition’ and Other Legal Acts of the Russian Federation’ of 5 October 2015 introduced the fourth set of amendments, effective as of January 2016. Among other things, the amendments permit seeking a FAS opinion in respect of a potential transaction without a formal filing, with the aim to pre-agree the possible terms of the antimonopoly approval with FAS.
\end{footnotesize}
automatically triggered a requirement for FAS clearance for acquisitions where such company was a target or the acquirer itself (or part of the acquirer’s group). FAS eliminated the register under the thinking that the 35 per cent threshold was arbitrary, and that competition issues could arise both above or below that threshold.

The amended Competition Law now requires, with effect from 5 January 2016, prior clearance of a joint venture agreement relating to the Russian territory, provided the combined asset value of the parties to such agreement (or their group of persons) who are competitors exceeds 7 billion roubles or their combined annual revenues for the preceding calendar year exceed 10 billion roubles. Accordingly, it is now clear that a shareholders’ agreement at the level of a Cyprus holding company that holds a material Russian subsidiary should be submitted for clearance to FAS. While this requirement does not apply to shareholders’ agreements entered into before 5 January 2016, amendments to such an agreement from that date should be cleared.

Generally modelled on EU competition law, the merger control rules of the Competition Law require prior approval by FAS for the incorporation and merger of Russian business entities and the acquisition of equity in a business entity (Russian or foreign with substantial sales into Russia) above certain acquisition thresholds provided that an asset or revenue test is met. In practice, given that asset or revenue tests consider group assets of the acquirer and the target, FAS approval is almost always required if the acquirer takes over 50 per cent ownership at any level (including an offshore parent of Russian operating subsidiaries). For a minority investment, FAS approval is needed to acquire over 25 per cent of voting shares in a Russian JSC, over one-third of the interest in a Russian LLC or over 20 per cent of the target company’s assets. An investment constituting less than 50 per cent of equity in an offshore parent is not per se subject to FAS approval under the Competition Law (but now, as discussed above, a shareholders’ agreement in respect of such offshore parent would need to be cleared by FAS).

The general review period by FAS is 30 days following the submission of the complete application package. FAS may extend this period for an additional 60 days if it needs extra time to review a transaction and request additional information. FAS may do so if it believes that the transaction may restrain competition, for example, as result of the establishment or an increase of the ‘dominant position’ of the acquirer. The Competition Law also provides that FAS may extend the review period to set conditions precedent for its approval and set the deadline for their satisfaction. This deadline cannot be longer than nine months from FAS decision; in practice, FAS rarely sets conditions precedent. FAS may also suspend its review of an application pending the approval of the transaction under the FSIL if it finds that the transaction is subject to FSIL approval. Upon review, FAS may:

a clear the transaction without any conditions if there are no competition concerns;
b issue its approval subject to behavioural conditions or divestiture remedies; or
c withhold its approval if the transaction may lead to the restriction of competition, including as a result of the establishment or increase of the ‘dominant position’ of the acquirer; or if FAS was not provided with requested information or the information provided was inaccurate.

FAS will also withhold its antimonopoly approval if the requisite FSIL approval is not obtained.

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X OUTLOOK

The outlook for M&A activity in the Russian market in 2017 remains subdued. Sanctions imposed by the US, the EU and other jurisdictions continue to have a chilling effect both on foreign investment in Russia and Western financing to Russian businesses. In particular, ‘sectoral sanctions’ prohibiting debt and equity funding to many of Russian’s largest banks and oil and gas companies have, when combined with the decline of global energy prices, had a deleterious effect, amplifying over time, on the Russian economy, the Russian lending market, the rouble and Russian share prices. Significant foreign investment of a predominantly Western origin may await de-escalation of wider political tensions between Russia and the West. While significant Middle Eastern and Chinese investments were made in Russian businesses in 2016, such new sources of investments have not yet matched the deal flow of the buoyant Russian market of 2005 to 2007. Significant privatisation sales occurred in 2016 (including the privatisations of a 10.9 per cent stake in Alrosa, one of the world’s largest diamond producers; a controlling stake in Bashneft; and a 19.5 per cent stake in Rosneft), and more privatisations are expected in the next year (including possibly the selling of stakes in Aeroflot, Sovcomflot and VTB), which should result in significant transactions. Given the devaluation of the rouble, sustainable Russian assets may at some point again become attractive acquisition targets. However, buoyancy is likely to return to the Russian M&A market only when global energy prices turn bullish, which, as history suggests, they inevitably will.
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Scott Senecal has headed the Moscow office of the firm since 1996. Mr Senecal’s practice focuses on financial and corporate law. Mr Senecal is consistently cited as one of the leading lawyers in Russia by publications such as Chambers Global and The European Legal 500. Mr Senecal regularly advises on mergers and acquisitions transactions and joint ventures, representing foreign investors (both private equity and corporate) and Russian entities, such as TPG (including its investments in Lenta, the largest PE investment made into Russia to date), the Qatar Investment Authority (including the €10.2 billion purchase from Rosneft of a 19.5 per cent stake in Rosneft, the largest privatisation sale in the history of the Russian Federation), Sibur (including the sale of a 10 per cent shareholding in Sibur to the Silk Road Fund, part of the Chinese ‘Belt and Road’ Initiative, and the preceding 10 per cent purchase by Sinopec, two of the largest Chinese investments into Russia to date), and UTH Russia (including its acquisition of the CTC television network group). Mr Senecal has advised on many significant Russian securities offerings by Russian corporates and banks, such as the 2014 initial public offering of Lenta, and various equity and debt offerings over the past 15 years by Gazprom, Gazprom neft, Sberbank and VTB. In addition, he advises on syndicated loans and pre-export financings. Mr Senecal joined the firm in 1989, became counsel in 1999 and was elected partner in 2005. Mr Senecal received a JD degree, cum laude, from New York University School of Law in 1987. Mr Senecal is a member of the Bar in New York.

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