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Reforming Company Law and M&A Arbitration in Russia

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The Russian company law is contained in three main sources: in Chapter 4 of the Russian Civil Code, and two special laws – on joint-stock companies (AOs) of 25.12.1995 and on limited liability companies (OOOs) of 08.02.1998 – both based on the Civil Code.

The prevailing part of the company law contained in the Civil Code was amended by Federal Law of 5 May 2014 No. 99-FZ, which came into force on 1 September 2014. The new regulations brought some useful corporate governance tools aimed at improving the competitiveness of the Russian company law and the delocalization of the country's economy, such as general rules on shareholders agreements (SHA) or the "four-eyes" principle enabling the appointment of more than one executive director acting for a company.

The second extensive review of the Civil Code – now of its general rules on obligations and contracts – has marked another considerable shift in the development of the Russian company law, as we can see below, with particular emphasis on a legal framework for mergers and acquisitions (M&A) transactions. The amendments provided in the Federal Law of 8 March 2015 No. 42-FZ are enacted on 1 June 2015, and allow use of, among others, the following M&A structuring instruments:

Pre-Signing Negotiations and LoI

Unlike in many foreign jurisdictions, a "letter of intent" (LoI) does have some codified meaning under the Russian law now. Subsumed as an "agreement for procedure for negotiating" (sec 434.1 (4)), it could develop the newly specified statutory obligations to conduct negotiations in a good faith manner, and not to disclose confidential information.

Also, the LoI can determine procedure for the allocation of the costs incurred for due diligence, the exclusivity of negotiations between the parties, and set up other legally binding regulations, which breach can be remedied by agreed penalties. Moreover, the LoI clauses that restrict liability for the abortion of negotiations in bad faith, or for fraudulent disclosure are deemed void.

Disputes arising from LoI were previously mostly dealt with in arbitration rather than before courts. Among other things, there was a high risk of that courts would re-

qualify indicative conditions agreed in LoI in writing into a void preliminary agreement. Mandatory rules on preliminary agreements (sec 429 of the Civil Code in the previous version) have prescribed a duty of the parties to envisage all the material terms of and to comply with the form requirements for the prospective principal agreement. Due to this uncertainty it was easy to predict the negative outcome of proceedings for a claimant trying to enforce its claims under LoI before the commercial courts.

An example from arbitral practice which proves that arbitration has been less "hostile" towards the enforcement of LoI is *ICAC Award of 04.02.2011 No. 50/2010*. In this case, a potential Austrian purchaser of the target OOO claimed to refund the security deposit paid under the LoI since no principal share purchase agreement (SPA) had been concluded within 30 days' lock-out period. The International Commercial Arbitration Court at the RF Chamber of Commerce and Industry (ICAC) satisfied the claim, and denied a defence of the selling co-defendants referring to missing material terms (sec 429) in order to void the pre-contractual arrangement.

Injunction for Negative Obligations

When entering into an M&A agreement, the buyer may expect that existing customers will continue to deal with the target company. It is in its interest to protect its investment by making provisions prohibiting certain seller's activities, such as not to compete with or not to solicit the target customers.

In a famous *Lugana Handelsgesellschaft mbH v Ryazan Metal Ceramics Instrumentation Plant* case, the RF Supreme Commercial Court [VAS] granted the enforcement of a DIS arbitral award for the recovery of penalty and default interest as well as for the specific performance of claims to supply goods and disclose agreements entered into by a Russian supplier with alternative distributors in violation of a non-compete clause earlier agreed with an exclusive German distributor-claimant (*VAS Decree of 2.02.2010 No. 13211/09*).

In addition, the buyer may order the specific performance of such negative obligations under sec 393.6, and impose an effective court injunction against the party in breach. How it works abroad, is well illustrated by the interim injunction granted to Alfa-Access-Renova (AAR) consortium to support its claim filed with London-based SCC arbitration in 2011. In this way AAR initially prevented a new alliance sought by its co-shareholder (BP) with Rosneft in contravention with the SHA entered by AAR and BP and covering their joint venture TNK-BP formed in 2003.

Conditional Acquisition Contracts

Before closing an acquisition various approvals may be required. For instance, the SPA may be made conditional on antitrust or special "strategic" clearance, or a key customer providing its consent to the change of control. The previous court practice, which was ambiguous on such conditions precedent, which could be influenced by one party's actions (potestative conditions), is overridden by their legalization under sec 327.1.

The introduction of the corresponding "excuse of conditions by waiver" (sec 450.1)

made by a commercial partner, for whose benefit they were included and who can waive them before the long-stop date, allow more effective use of an M&A model admitting a gap between signing and closing.

Actually, the role of this small provision can hardly be overestimated for M&A transactions if earn out provisions, call and put options, drag along and tag along rights are remembered, all connected with use of potestative conditions.

Warranties

Where the seller is in breach of its disclosure duty by giving the buyer false or incomplete acknowledgement that a particular state of effect exists (warranty), it shall be liable vis-à-vis the buyer under sec 431.2 in the amount of the agreed penalty or damages incurred.

Warranties trigger most post M&A disputes. In the *Novolipetsk Still Mill (NLMK) v. Nikolay Maksimov* case, the Russian court, when deciding on setting aside the ICAC award (of 21.03.2011 No. 244/2009), referenced to, among others, the alleged inarbitrability of a corporate dispute. It acknowledged that the stocks seller (Maksimov) is in material breach of his disclosure duties under financial warranties, declared the SPA invalid, and awarded the restitution of unjust enrichment, including recovery of the paid purchase price (*Decrees of the RF Supreme Court of 09.04.2015 No. 305 ES15 1789 and of the Commercial Court of Moscow District of 17.12.2014 No. A40-26424/11-83-201*). Interestingly, the said ICAC award, which obliged the purchaser to pay the balance of the amount due and the default interest was successfully recognized in France (*Cour d'appel de Paris. Pôle 1 – Chambre 1. No. 12/15479, 01.04.2014*).

In another matter the VAS allowed enforcement of a foreign arbitral award on recovery of the liquidated damages resulting from the breach of warranties, and denied the debtor's reference to the alleged public policy violation by application of foreign law (Clause 5 of the VAS Information Letter of 26.02.2013 No. 156)

Conclusions

Nine of ten M&A disputes are voluntarily settled. They are rather rare today in international practice, and specifically before the Russian arbitral institutions. This is empirically supported by the fact that, while some of them are settled by the Russian domestic courts, most are still resolved by foreign institutions, such as LCIA, SCC, ICC or VIAC.

For instance, 2014 statistics published by the SCC shows that SPA-related disputes proudly peak at 38 out of 183 cases (20,8%) whereas Russians are the second nationality (26 cases), following the local (Swedish) parties, to appear before the SCC. Unfortunately, you will not find similar statistics regarding corporate disputes on sites of the Russian institutions. This mirrors a trend of the off-shore resolution of M&A disputes related to Russian target companies, particularly where all the parties to the transaction have assets off-shore, and there is no actual need for seeking the enforcement of an award in Russia. The mistrust towards the Russian courts, which should be employed at the stage of obtaining an execution writ, but do not display a

predictable stance towards arbitrability of corporate disputes, could be regarded as a main reason.

However, the commented amendments to the Civil Code could potentially build some culture of M&A arbitration in Russia. Also, one may expect that foreign partners would more readily consent to select the Russian law to govern disputes arising from the acquisition of Russian targets or, at least, where a foreign law is chosen, to accept the use of its mandatory rules on some company law issues, on which the party autonomy may be restricted.

The public policy defense against the enforcement of an award based on unfamiliarity with usual M&A instruments has a chance to irrevocably become obsolete. Improving the general background knowledge of M&A topics will support development of corporate arbitration in Russia.
The further important step on the development of M&A arbitration could be an approval of a modern and balanced arbitration law. On 1 July 2015, the Duma passed the respective laws in a first reading, which are focused on arbitrability and other aspects of arbitrating corporate disputes. However, this topic requires a more detailed consideration.

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