MERGERS AND ACQUISITIONS IN RUSSIA: FREQUENTLY ASKED QUESTIONS

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I. In which cases approvals of the governmental agencies are required for mergers and acquisitions in Russia?

   A. Approval of the Federal Antimonopoly Service

Under the Federal Law on Protection of Competition No. 135-FZ dated 26 October 2006 (the "Competition Law") the following transactions require preliminary approval of the Federal Antimonopoly Service (FAS):

1) the establishment of a company (either Russian or foreign) if its charter capital is paid with the shares and/or property of a Russian legal entity and the new company acquires as the result:
   a) more than 25%/50%/75% of the shares in a Russian JSC or
   b) more than ⅓ / 50% / ⅔ of the participatory interests in a Russian LLC, or
   c) where the company acquires more than 20% of the main production (fixed) assets and (or) intangible assets located in Russia (exclusive of most types of buildings and land plots) of another legal entity, if the aggregate asset value of the founders of the company (their group of persons)

and the total amount of assets according to the latest balance sheet of the founders of the company (their groups of persons) and of the entities whose shares or assets are being contributed to the charter capital (their group of persons) exceeds RUB 7 billion or the aggregate revenue earned

1 In the meaning provided for by the Competition Law
by the abovementioned entities from the sale of goods during the past calendar year exceeds RUB 10 billion;

2) merger of profit-making entities (except for financial organizations) or accession to a profit-making entity of one or more profit-making entities (except for financial organizations) if the aggregate asset value of the entities participating in the merger or accession and their group of persons exceeds RUB 7 billion or the aggregate revenue earned by the entities and their group of persons from the sale of goods during the past calendar year exceeds RUB 10 billion;

3) acquisition of more than 25%/50%/75% of the voting shares in a Russian JSC or more than ½/50%/⅔ of the participatory interests in a Russian LLC (the target company) where:
   - the aggregate book value of the assets of the acquirer together with its group of persons and the target company together with its group of persons exceeds RUB 7 billion and the balance sheet value of the total assets of the target and its group exceeds RUB 250 million; or
   - the aggregate revenue earned by the acquirer together with its group of persons and the target company together with its group of persons from the sale of goods over the past calendar year exceeds RUB 10 billion and the balance sheet value of the total assets of the target company and its group exceeds RUB 250 million;

4) acquisition of the rights to determine the commercial activity of the target company (including as a result of change of indirect control over the target company) or the right to perform the functions of its executive bodies where the financial thresholds specified in p. 3) above are met;

5) acquisition of the right of ownership or the right to use the main production (fixed) assets located in Russia or intangible assets of a Russian or foreign entity (subject to certain exceptions provided in the Competition Law), if the acquired assets account for more than 20% of the aggregate book value of the main production (fixed) assets and intangible assets of the selling entity where the financial thresholds specified in p. 3) above are met;

6) acquisition of more than 50% of the voting shares of, or any right of control over, a legal entity incorporated outside Russia, or the right to perform the functions of its executive bodies where:
   - such foreign legal entity controls a Russian subsidiary, or such foreign legal entity supplied goods to the Russian Federation worth more than RUB 1 billion during the year preceding the transaction; and
   - the financial thresholds specified in p. 3) above are met;

7) entering into an agreement on joint activities by entities – competitors within the territory of the Russian Federation the aggregate asset value of such entities and their group of persons exceeds RUB 7 billion or the aggregate revenue earned by the entities and their group of persons from the sale of goods during the past calendar year exceeds RUB 10 billion.

The abovementioned transactions with shares and assets of a financial organisation shall be subject to the preliminary approval of FAS if the assets value of the financial organisation according to the latest balance sheet exceeds:

- for a leasing organisation – RUB 3 billion;
- for a credit organisation – RUB 29 billion;
- for microfinance organisation - RUB 3 billion;
- for private pension funds - RUB 2 billion;
- for mutual insurance societies and credit consumer cooperative – RUB 500 million;
- for insurance (except for medical) organisations, professional participants of securities markets, management companies of investment funds, specialized depositories - RUB 200 million;
- for a medical insurance organisation - RUB 100 million.
FAS considers an application for a preliminary approval of transactions or other actions subject to such approval within 30 days from the date of the receipt of the application and other required documents and, if it is necessary, this term may be extended for 2 months. Upon consideration of the application FAS may take a decision:

- to satisfy the application; or
- to satisfy the application and to give to the applicants and/or the persons of its group and/or an entity the shares (participatory interests) or assets of which are acquired and/or an entity being established the prescription for performance of actions aimed at providing for competition; or
- refuse to satisfy the application if the transaction or another action may lead to restriction of competition.

A preliminary approval for a transaction or another action issued by FAS is effective within one year.

In the event a transaction is entered into without FAS preliminary approval it may be rendered invalid upon a court’s decision, a legal entity established – liquidated upon a court’s decision and an administrative fine may be imposed on the responsible parties in the amount of up to RUB 500,000 on legal entities and up to RUB 20,000 on their officers for a failure to file an application for a preliminary approval with FAS or provision of false data in such application or a breach of the term for filing an application.

B. Approval by the Government Commission for Control Over Foreign Investments

In the event a target Russian company is engaged in activities in the sectors which are deemed strategic under the Federal Law No. 57-FZ dated 29 April 2008 "On Procedures for Foreign Investments in Companies of Strategic Significance for National Defence and Security of the Russian Federation" (the "Strategic Companies Law") the transactions involving establishment of control by a non-Russian investor over such company are subject to the preliminary approval of the Government Commission for Control Over Foreign Investments.

A company is deemed a "company of strategic significance for national defence and security of the Russian Federation" (a "Strategic Company"), in particular, if it is engaged in:

- works having an active impact on geophysical processes;
- works related to hydro-meteorological processes and events;
- activities in connection with geological research of subsoil and/or mineral exploration and extraction of federal subsoil;
- activities in the nuclear industry and the storage of nuclear and radioactive materials;
- activities in connection aviation equipment and security;
- space activities;
- activities in connection with the production, trade, repair and utilization of weapons and military equipment, and their spare parts and ammunition (excluding bladed weapons, civil and service weapons) and explosive materials for industrial purposes;
- activities in connection with television or radio broadcasting on a territory, where half or more of the population of a constituent entity of Russia resides;
- services provided by a company included in the register of natural monopolies (excluding natural monopolies in the public telephone and wireless communication and postal communications fields, and services for the supply of heat energy and electrical energy through the distribution grid);
- activities in connection with encryption and licensed encryption techniques (excluding distribution and maintenance of encryption techniques and related services performed by Russian banks that are not directly owned by the Russian Federation);
- activities in connection with confidential obtaining of information in premises and equipment used for these purposes (excluding activities performed for the purposes of the security of legal entities);
– printing performed by a profit-making entity if it is capable of printing not less than 200 million pages a month; and
– performance of editorial office activities and/or activities of a periodical publisher, publishing publications with individual circulations of not less than 1 million.

The following transactions are subject to the preliminary approval of the Government Commission for Control Over Foreign Investments:

1) acquisition by a foreign investor or a group of persons:
   a) directly or indirectly more than 50% of the voting shares in a Strategic Company which does not conduct geological surveys on the subsoil and/or explore and extract minerals on federal subsoil plots (i.e. not “operating on federal subsoil plots”);
   b) the right to appoint (a) the chief executive officer, and/or more than 50 % of the members of the board of directors or another collective executive body of the Strategic Company not operating on federal subsoil plots;

2) acquisition by a foreign investor or a group of persons of:
   a) directly or indirectly not less than 25% and no more than 75% of the voting shares of a Strategic Company operating on federal subsoil plots (except for transactions as the result of which the share of such investor or such group of persons in the charter capital of such Strategic Company is not increased if such transactions are entered into in the course of increase of the charter capital of such company or entered into by persons being under control of the person controlling the Strategic Company);
   b) the right to appoint the chief executive officer, and/or 25 or more percent of the members of board of directors or another collective executive body of a Strategic Company operating on federal subsoil plots;

3) agreements on exercising by a foreign investor or a profit-making entity or individual entrepreneur of its group of persons of the functions of a management body of a Strategic Company;

4) transactions aimed at the acquisition by a foreign state, international organization or organization controlled by them, of the right to dispose directly or indirectly of more than:
   a) 5 % of the total number of votes at shareholder level – for Strategic Companies operating on federal subsoil plots; or
   b) more than 25 % of the total number of votes at shareholder level – for Strategic Companies engaged in strategic activities other than operating on federal subsoil plots;

5) acquisition into property, ownership or use of fixed production assets of a Strategic Company the price of which amounts to 25 and more percent of the balance sheet assets of such company as of the latest reporting date;

6) other transactions or actions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the management bodies of a Strategic Company, including the rights to determine its business activities.

The application for a preliminary approval for any of the abovementioned transactions and other required documents should be submitted with FAS. The standard term for obtaining of is three months from the date of submission of the application which may be extended for three months. If a preliminary approval is obtained, the transaction should be entered into within the term provided for in the respective approval.

Furthermore, in the event of acquisition of 5 % or more of the shares (whether voting or not) in a Strategic Company the acquirer should file a notification on such transaction with the FAS within 45 days following its closing.

The following transactions do not require a preliminary approval or subsequent notification:
   - intergroup transactions between foreign investors that under control of one and the same person;
transactions between foreign investors that possess more than 75% and more in the charter capital of a Strategic Company operating on federal subsoil plots;
- transactions between companies being controlled by a constituent entity of the Russian Federation.

It is expressly prohibited to a foreign state, international organization or organization controlled by them to acquire control, as defined by the Strategic Companies Law, over Strategic Companies.

Transactions entered into in a breach of the Strategic Companies Law are deemed void and the persons who sustained the respective breaches may be brought to administrative liability.

C. Approval by the Bank of Russia

Under the Federal Law No. 395-1 dated 2 December 1990 “On Banks and Banking Activities” (the “Law on Banks”) any acquisition of more than 1% of shares (stakes) in a credit organization by a legal entity or an individual as a result of one or several transactions (except for the case when shares (stakes) in a credit organization are acquired by its founders at establishment) and (or) their receipt to trust management shall require notification of the Central Bank of the Russian Federation (the Bank of Russia) and the latter’s prior approval in the event of acquisition of:

1) more than 10% of shares of a credit organization but no more than 25% of shares;
2) more than 10% of stakes in a credit organization but no more than 1/3 of stakes;
3) more than 25% of shares of a credit organization but no more than 50% of shares;
4) more than 1/3 of stakes in a credit organization but no more than 50% of stakes;
5) more than 50% of shares of a credit organization but no more than 75% of shares;
6) more than 50% of stakes in a credit organization but no more than 2/3 of stakes;
7) more than 75% of shares of a credit organization;
8) more than 2/3 of stakes in a credit organization.

The Bank of Russia’s prior approval is also required when a legal entity or an individual as a result of one or several transactions establishes direct or indirect (via third parties) control over shareholders (members) of a credit organization owing more than 10% of shares (stakes) in this credit organization (the establishment of control over shareholders (members) of a credit organization).

A notification of the acquisition of more than 1% of shares (stakes) in a credit organization shall be sent to the Bank of Russia no later than 30 days following the acquisition.

Not later than 30 days after the receipt of an application for Bank of Russia’s approval to acquire more than 10% of shares (stakes) in a credit organization and (or) approval to establish control over the shareholders (members) of a credit organization, the Bank of Russia shall notify the applicant in writing of its approval or refusal. If the Bank of Russia fails to take a decision within this term, the respective transaction (transactions) shall be deemed approved.

The Bank of Russia may refuse to grant its approval of the transaction (transactions) aimed at acquiring more than 10% of shares (stakes) in a credit organization and (or) establishing control over the shareholders (members) of the credit organization, in particular, in the following cases:

a) if the transaction (transactions) is (are) subject to control according to anti-monopoly legislation and a preliminary approval of the transaction by FAS is not obtained;

b) if the transaction (transactions) is (are) subject to control in accordance with the Strategic Companies Law and a preliminary approval of the transaction by the Government Commission for Control Over Foreign Investments is not obtained;

c) unsatisfactory financial position of a person entering into the transaction (transactions) is established the Bank of Russia;
d) unsatisfactory business reputation of a person entering into transaction (transactions) according to the criteria established by the Law on Banks;

e) a person entering into the transaction (transactions) is found guilty by a court of inflicting losses to a credit organization when performing his/her duties as a member of the board of directors (supervisory board) of the credit organization, the sole executive body, his deputy, and (or) a member of the collegial executive body (management board, directorate).

II. What are the principal advantages and disadvantages of shares and assets acquisition?

Shares acquisition advantages:

1. The purchaser will acquire the company as a going concern with all its assets, property rights and contracts simultaneously. The procedure for execution of the transaction is relatively simple and prompt (although signing and closing may be split within time, if necessary):
   - if a company is a joint stock company (JSC): execution of a sale and purchase agreement (a single document signed by the parties) and submission of the transfer order to the registrar that maintains the shareholders’ register for the registration of the transfer of the title to the shares;
   - if a company is a limited liability company (LLC): execution of a sale and purchase agreement (a single document signed by the parties and certified by a Russian notary) and submission of the application certified by the notary to the Unified state register of legal entities (USRLE) for the registration of the transfer of the title to the shares.

2. The sale and purchase of shares is not subject to VAT (pp.12 p. 2 of Article 149 of the Tax Code of the Russian Federation (the "Tax Code").

3. If the shares were acquired by the seller after 1 January 2011 and the seller has owned them for more than 5 years the companies’ profits tax for the seller will be calculated at the rate 0% (p. 4.1 of Article 284, Article 284.2 of the Tax Code).

Shares acquisition disadvantages:

1. The purchaser acquires a shareholding in the existing company with all its historic liabilities (including tax) and, as the case may be, violations in the course of establishment (e.g. payment of the charter capital not in due term and/or not in the full) and conducting business activities (e.g. licensing, hazardous activities, employment safety requirements) that may be impossible to amend or mitigate and that potentially may result in liquidation of the company upon claims of creditors or state authorities or large administrative fines and/or suspension of the company’s activities.

2. It may be difficult for the purchaser to ensure that the seller does not dispose of the material assets and property rights before closing of the shares sale and purchase transactions.

3. The transaction shall be subject to the preliminary approval by FAS if the thresholds established by the Competition Law are met (the aggregate assets of the purchaser and its group of persons according to the latest balance and the company and its group of persons exceeds RUB 7 billion or the aggregate revenue earned by the purchaser together with its group of persons and the company together with its group of persons from the sale of goods over the past calendar year exceeds RUB 10 billion and the balance sheet value of the total assets of the company and its group exceeds RUB 250 million) which may take up to 2 months to obtain.

Assets acquisition advantages:

1. The purchaser may pick and purchase only the assets the title of the seller to which is valid and effective and which are not pledged or otherwise encumbered with the rights of third parties.
2. The liabilities and risks of liquidation of the company are not generally transferred to the purchaser.

**Assets acquisition disadvantages:**

1. If the company has the signs of bankruptcy according to the Federal Law on Insolvency and Bankruptcy and after execution of the transactions aimed at disposal of the assets and property rights of the company bankruptcy proceedings are instituted with respect to the company such transaction may be contested in a court by an insolvency receiver or the concerned creditors of the company.

2. The sale and purchase of the movable and immovable assets and assignment of the property rights will be generally subject to VAT (Article 146 of the Tax Code) which may involve an increase of the price of the respective assets and property rights.

3. The income of the seller from the sale and purchase of the movable and immovable assets and assignment of the property rights will be generally subject to the companies’ profit tax (Articles 248 and 249 of the Tax Code) or personal income tax (p.1 of Article 208 of the Tax Code).

4. The acquisition of the right of ownership to the main production (fixed) assets located in Russia or intangible assets of a Russian or foreign entity (subject to certain exceptions provided by the Competition Law) shall be subject to the preliminary approval by FAS if the acquired assets account for more than 20% of the aggregate book value of the main production (fixed) assets and intangible assets of the seller and the financial thresholds established by Article 28 of this Law are met.

5. The transactions for the sale and purchase of movable and immovable assets, intellectual property (IP) and assignment of the contracts with customers and lease rights will need to be executed separately.

6. Prior approval of the customers, lessors and other counterparties to assignment of the contracts/lease rights may be required.

7. The purchaser will need to re-register the title to the immovable assets, vehicles and registrable IP (trademarks, service marks, patents, etc.) which shall increase the timing of the completion of the transaction and the costs (legal fees, applicable state duties, etc.).

**III. What terms and conditions may be included in the shares sale and purchase agreement under Russian law?**

In the event the shares in the charter capital of a Russian LLC are acquired, according to Article 21 p. 11 of the Federal Law on Limited Liability Companies (the "LLC Law") the transaction may be formalized by two agreements:

a. the agreement providing for the obligation of the seller and the purchaser to enter into the shares sale and purchase agreement subject to occurrence of certain circumstances or performance by the other party of its corresponding obligations (hereinafter – the "master agreement"), for instance:
   - obtaining the preliminary approval of the transaction by FAS (if applicable);
   - taking the required measures to amend/mitigate the risks revealed in the course of the due diligence of the company and its assets and liabilities;
   - amending the charter of the LLC;
   - other conditions precedent, if applicable (i.e. restructuring the LLC’s group of persons).

Unlike the sale and purchase agreement with respect to shares in the charter capital of an LLC, a master agreement is not subject to certification by a Russian notary and is not deemed a preliminary agreement. However, if upon performance of the conditions precedent provided for by such
agreement the seller refuses to execute the shares sale and purchase agreement, the purchaser may file a claim with a Russian court for a transfer of the share thereto;

b. the shares sale and purchase agreement (SPA) to be notarized by a Russian notary subject to performance by the parties of the obligations and the conditions precedent under the master agreement. The SPA with respect to a share in the charter capital of an LLC shall enter into force upon the registration of the title of the purchaser to the share in the USRLE (according to the rules effective from 15 January 2016).

If shares of a Russian JSC are acquired, a single SPA may entered into by the parties and the title to the shares shall be vested with the purchaser from the moment of making the respective entry in the shareholders’ register of the JSC.

The master agreement and/or SPA governed by Russian law may include (according to the rules of the Civil Code of the Russian Federation effective from 1 June 2015):

a. contingent obligations (Article 327.1 of the Civil Code): the parties may agree that performance of their obligations (in particular, to transfer the shares on the part by the seller and to pay the purchase price by the purchaser) as well as exercise, modification and termination of certain rights or obligations is conditional upon:
   – performance or non-performance by one of the parties of certain actions, or
   – occurrence of other events provided for by the agreement, including those being within exclusive control of one of the parties.

The period for performance of an obligation may be calculated from the date of performance by the other party or from the occurrence of other events provided by law or agreement (Article 314 of the Civil Code);

b. the representations on certain facts pertaining to the target company, its business, the title of the seller to the shares and the legal capacity of the seller, in the event of the falsehood of which the purchaser shall be entitled to demand compensation of damages or a penalty, and, if the representations are of material importance, to rescind the SPA (Article 431.2. of the Civil Code);

c. the obligation of a party to the SPA to compensate to another party the losses sustained due to occurrence of certain circumstances not connected with a breach of the obligations on the part of the former (Article 406.1. of the Civil Code), for example, imposing on the target company tax or administrative liability due to certain breaches sustained in the course of its activity prior to entering into the SPA (which is similar to indemnity under English law).

IV. What terms and conditions may be included in the shareholders’ agreement under Russian law?

A corporate agreement may be entered by some or all the shareholders of the company, that is, entities or persons holding title to the shares, and may provide for, in particular, for their undertakings (Article 67.2 of the Civil Code):

– to vote in a certain way at the general meeting of participants;
– to perform in an agreed manner other activities related to the management of the company;
– to acquire or dispose of shares at a pre-determined price and/or upon occurrence of a certain event; or
– to abstain from the disposing of shares until the occurrence of a certain event.
A corporate agreement, however, may not: (a) bind the participants to vote in accordance with the instructions of the company's management bodies and (b) determine the structure of the company's bodies and their competence – the respective terms and conditions will in such a case be deemed null and void.

At the same time, participants/shareholders of non-public companies (including LLCs and JSCs, whose shares and securities convertible into shares are not placed by public subscription) enjoy considerable freedom in terms of the contractual regulation of their relations.

A corporate agreement of a non-public company may provide for the obligations of the parties thereto to vote at the general meeting of participants that provisions altering the structure of the company's bodies and their competence be included in the company’s charter to the extent that changes in the structure of the company's bodies and their competence are permitted under the Civil Code, the LLC or JSC Laws, respectively.

Based on the Civil Code, JSC Law and LLC Law, the charter of a company must define, inter alia are:

a. the composition and authority of the management bodies of the company and the procedure for the adoption of resolutions by them (including issues regarding decisions that should be taken unanimously or by a qualified majority); this means that a corporate agreement cannot provide for a new management body and/or vest management bodies with additional powers compared to the powers vested under the articles of association;

b. the terms for conducting an ordinary general meeting of an LLC’s participants, where results of the annual performance of the company are approved /the terms for conducting of the annual general meeting of shareholders;

c. the term of authority of the chief executive officer of an LLC;

d. the term of authority and number of members of the collective executive body of an LLC;

e. the procedure for election and quorum to hold a meeting of the board of directors (supervisory board) of a JSC;

f. the procedure for exercising a pre-emptive right to purchase a participatory interest that a participant intends to sell to a third party and a period for the exercising of such a right by other participants;

g. the number and nominal value of shares acquired by the shareholders (outstanding shares) and the rights granted by such shares; the number, nominal value and categories (types) of shares that the company may place in addition to the outstanding shares, and the rights granted by such shares;

h. the amount of a dividend and (or) amount paid in liquidation of the company (liquidation value) on the preferred shares of each type.

Accordingly, a corporate agreement may not regulate the issues specified above but may supplement the charter on the issues provided for by dispositive rules of law.

Furthermore, if a corporate agreement is entered into by and between all the participants/shareholders of a non-public company, such an agreement may include provisions apart from those that must be included mandatorily in the charter under the law.

A corporate agreement of a non-public company may establish, inter alia:

- the procedures for convening, preparing and holding general meetings by participants of an LLC (in the part which is not regulated by the charter and provided that the participants are not deprived of the right to participate in the general meeting and to receive information thereon);
- the procedural requirements for convening meetings by the collective management body or collective executive body of either an LLC or JSC;
- a maximum amount of the participatory interest of a participant in the LLC’s charter capital;
- restrictions regarding the number, total nominal value of shares or maximum number of shares owned by a shareholder of a non-public JSC.

In non-public companies (LLCs and JSCs) shareholders may stipulate as well in the charter and a corporate agreement the scope of the rights of the participants not in proportion to the amounts of their interests in the charter capital. The rights that may be distributed disproportionally include the right to vote at general meetings, the pre-emptive right to purchase shares/interest sold by other shareholders of the company at the price offered to a third party, as well as the distribution of profits between the participants. Information on such corporate agreement and the scope of rights provided thereby should be entered into the USRLE.

V. Is it possible to defer payment of the purchase price by means of an escrow account in Russia?

Starting from 1 July 2014 an escrow account may be opened by a Russian bank as a special banking account for the purposes of accounting and blocking a monetary amount deposited by the owner of the account (the depositor) and transferring it to another person (beneficiary) subject to the conditions provided for in the agreement between the bank, the depositor and the beneficiary (the “escrow agreement”).

The obligations of parties in connection with opening an escrow account may be provided, in addition to the escrow agreement, in another agreement, in particular, SPA (Article 860.7. of the Civil Code).

Unless otherwise is provided for by the escrow agreement:
- neither the depositor nor the beneficiary is not entitled to dispose of money deposited on the escrow account;
- the escrow account may not be credited with any amount other than the amount under the escrow agreement.

Subject to the conditions stipulated in the escrow agreement the bank shall transfer to the beneficiary’s account or hand in to the beneficiary the amount deposited on the escrow account in the term provided for by the escrow agreement, or within 10 business days by default.

VI. Is it possible to structure put and call options and drag-along and tag-along under Russian law?

Starting from 1 June 2015 the Civil Code of the Russian Federation provides for two principal legal mechanisms to structure options.

A. Option to enter an agreement

An option to enter an agreement (Article 429.2 of the Civil Code) is an executory agreement under which:
- one party by an irrevocable offer grants to the other party the right to enter one or more agreements (e.g. shares sale and purchase) under the conditions specified by the option; and
- the other party may enter into the respective agreements by accepting such an offer according to the procedure, under the terms and conditions set forth by the option.
Unless otherwise is provided for by the agreement on granting the option, consideration should be paid by the party to whom the option is granted and the term for acceptance of an irrevocable offer is one year from the date of execution of such agreement.

Consideration to be paid under the option to enter an agreement shall not generally be offset against payments under the agreement based on an irrevocable offer, and is non-refundable in case of non-acceptance.

In other respects, the option to enter an agreement is similar to a preliminary agreement:

- the option must provide for the conditions that allow to define the subject and other material terms of the agreement to be concluded; and
- the option is executed in the form prescribed by the law for the agreement to be concluded (that is, if such agreement requires notarial certification an option should be notarized as well).

Under the new rules of Article 21 of the LLC Law starting from 15 January 2016 a sale and purchase transaction with respect to an LLC shares being entered into in performance of an option may be executed in two stages: first, a notary certifies an irrevocable offer (i.e. by means of certification of an agreement on granting an option to enter into a sale and purchase agreement) and afterwards a notary certifies an acceptance of the offer as well.

An irrevocable offer may provide for a condition precedent or a condition subsequent for acceptance thereof. In this case in order to have the acceptance notarized the acceptant should provide to a notary the evidence that the respective condition has been complied with.

Upon certification by a notary of the acceptance the offer is deemed accepted and the sale and purchase agreement executed, respectively.

**B. Option Agreement**

As opposed to the option to enter an agreement, under an option agreement (Article 429.3 of the Civil Code) one party is granted with the right to demand the other party under the terms and conditions specified by the option agreement to perform actions specified by this agreement, in particular, to pay consideration, to transfer or receive shares.

An option agreement terminates if an entitled party does not demand performance from the other party within the specified period.

An option agreement may be gratuitous or entering into an option agreement may be made conditional upon another obligation or lawful interests that arise from the relationships of the parties.

**C. Tag-along and drag-along**

Tag-along and drag-along undertakings typical for shareholders’ agreements governed by English law, starting from 1 June 2015 may be structured under Russian law by means of contingent obligations where the performance of one party’s obligations or exercise of the rights is conditional upon performance or non-performance by one of the parties of certain actions or occurrence of other events provided for by the agreement, including those being within sole control of one of the parties (Article 327.1 of the Civil Code).

In particular, drag-along undertakings may be included in a corporate agreement by providing that:

a. in the event a shareholder - party to a corporate agreement (the seller) accepts the offer of a third party (the purchaser) to sell thereto the shares of the seller, the latter becomes entitled to demand that the other party (parties) to the corporate agreement sells its (their) shares (or a part thereof) to the purchaser as well at the price and on the other terms stipulated by the offer; and

b. the other shareholder(s) have a correlative obligation to sell their shares to the purchaser upon demand of the seller and subject to receipt of the respective offer(s) from the purchaser.
The Civil Code in general allows for performance of the obligation to a third party authorized by the creditor on condition that a debtor may demand the third party to provide the evidence of such authority (Article 312 p.1).

In the case of tag-along undertakings, a corporate agreement may provide that:

a. in the event a shareholder - party to a corporate agreement (the seller) accepts the offer of a third party (the purchaser) to sell thereto the shares of the seller, the other party (parties) to the corporate agreement becomes entitled to demand that the purchaser purchases its (their) shares; and

b. the seller becomes obliged to procure for sending by the purchaser of an irrevocable offer(s) to such shareholder(s) to purchase their shares at the price and on the other terms stipulated by the offer and shall abstain from entering into sale and purchase transaction with the purchaser until such offer(s) is (are) received by the other shareholder(s).

It should be noted, however, that a corporate agreement may not be binding upon persons that are not parties thereto (Article 67.2. p. 5 of the Civil Code). Therefore, in order to ensure that tag-along and drag-along undertakings are enforceable the corporate agreement needs to provide for the obligation of a shareholder that intends to sell its shares to a third party purchaser to include in the respective sale and purchase instruments the undertaking of the purchaser to purchase the shares of other shareholders upon demand, and such obligation should be secured by either penalties or pledge of the shares.

VII. Can the parties choose non-Russian law as the law governing shares sale and purchase or other transactions?

In general the parties to a contract are free to choose at their discretion the law governing their rights and obligations under the respective contract and applicable either to the contract on the whole or separate parts thereof (p. 1 and p. 4 of Article 1210 of the Civil Code). Such agreement on the choice of law should be explicit or should definitely follow from the conditions of the contracts or the totality of the circumstances of the case (Article 1210 p. 2 of the Civil Code).

The law governing the contract chosen by the parties shall be applicable to the following aspects (Article 1215 p. 1 of the Civil Code):

1) the construction of the contract;
2) the rights and duties of the parties to the contract;
3) performance under the contract;
4) the consequences of a default on performance or improper performance under the contract;
5) the termination of the contract;
6) the consequences of invalidity of the contract.

Notwithstanding the choice of applicable law, certain matters will be subject to the imperative rules of Russian law, in particular:

– incorporation, reorganization and liquidation of the company, including legal succession matters;
– the company's legal capacity;
– procedure for the acquisition by the company of rights and undertaking of obligations;
– liability of founders (shareholders) of the company for their obligations;
– internal relations, including relations between the company and shareholders thereof.

Irrespective of the choice of law by the parties to the contract in the event at the moment of choice of law all the circumstances relating to the substance of the parties’ relations are connected with one country only, the imperative rules of the law of the respective country shall apply (p. 5 of p. 2 of Article 1210 of
the Civil Code). Such situation occurs, in particular, if the shares or assets of a Russian company are acquired and the seller and the buyer are Russian entities or citizens.

Furthermore, even if the court considering a dispute deems that not all the circumstances relating to the substance of the parties’ relations are connected with Russia only, the court shall apply those imperative rules of Russian law that regulate the respective relations of the parties due to express indication in such imperative rules or due to their special significance, in particular, for the purposes of protecting the rights and lawful interests of the parties (the rules of direct application) (Article 1192 p. 1 of the Civil Code). Such rules, in particular, are deemed the rules of the Strategic Companies Law (p. 16 of the Information Letter of the Presidium of the Highest Arbitration Court dated 09.07.2013 No. 158).

Finally, the rules of a non-Russian law chosen by the parties shall not be applicable in exceptional cases when the consequences of their application would have obviously been in conflict with the fundamentals of law and order (public order) of the Russian Federation and in such a case a relevant rule of Russian law shall be applied if necessary (Article 1193 of the Civil Code). In particular, such fundamentals of law are deemed the chief principles of the civil legislation provided for by Article 1 of the Civil Code, including the equality of participants in the relationships regulated by it, the inviolability of property, the freedom of agreement, the inadmissibility of anybody's arbitrary interference into private affairs, the necessity to freely exercise civil rights, the guarantee of reinstatement of civil rights in case of their violation, and their protection in a court.

It should be noted as well that even if a non-Russian law is chosen by the parties and a dispute arising from the contract is successfully resolved by a non-Russian court or an arbitration, when the respective decision is being enforced in Russia a court may refuse in such enforcement in particular, if the enforcement of the decision would contradict to the public order of the Russian Federation (Article 244 of the Arbitration Procedural Code of the Russian Federation).

VIII. Can the parties submit their disputes under a shareholders’ agreement to an arbitration?

Pursuant to Article 225.1 of the Arbitration Procedural Code of the Russian Federation (the "Arbitration Code"), a Russian arbitration court at the location of a legal entity considers corporate disputes (disputes related to the incorporation of a legal entity, governance or participation in the legal entity), including those related to:

- title to shares, establishment of encumbrances thereon and the exercising of rights granted by the shares (except for disputes arising from the activities of depositaries in connection with the accounting of rights to the shares and other securities and disputes arising regarding the distribution of inherited property or common property of spouses);

- appointment or election, termination or suspension of powers and liabilities of members of the management bodies and supervisory bodies of the legal entity;

- contesting decisions of the management bodies of a legal entity.

Based on the above provisions, Russian arbitration courts in their decisions on the case No. А40-35844/11-69-311 came to the conclusion that, since the disputable agreement regulated the issues of corporate governance and the issuing of additional shares, those issues were corporate issues referred to by Article 225.1 of the Arbitration Code to the special jurisdiction of arbitration courts, and therefore could not be submitted for consideration to arbitration "due to the nature and specific character of relationships that give rise to such disputes". The Federal Arbitration Court of the Moscow District, in its judgement dated 26 September 2011, also noted the non-arbitrable nature of public law in the dispute

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2 Arbitration courts in the Russian Federation are state courts that consider commercial disputes and disputes in connection with profit-making and other economic activity.
regarding the transfer of the title to shares as a result of the performance of all conditions of the agreement on corporate governance.

However, the abovementioned position may not be deemed an ultimate position of Russian courts on the issue of the arbitrability of disputes under corporate (shareholders’) agreements since the Supreme Court of the Russian Federation has not yet provided complete clarifications to this effect. In the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 25 dated 23 June 2015 it only stated that disputes in connection with establishment and participation in corporations (both state and private) are subject to consideration by Russian arbitration courts in accordance with Article 33 pp. 4.1. and Article 225.1 of the Arbitration Code.

For the time being there is little doubt that subject to an arbitration clause/arbitration agreement between the parties, such disputes under corporate (shareholders’) agreements as those in connection with the recovery of penalties for the violation of obligations to vote in a certain manner at the general meeting, as well as obligations that are not directly related to the exercise of the rights granted by shares (i.e., obligations concerning the company’s financing and development of its business), may be submitted to arbitration (or international commercial arbitration if one of the parties is a foreign person).

Furthermore, according to the Federal Law dated 29.12.2015 No. 382-FZ "On Arbitrage (Arbitration Proceedings) in the Russian Federation" that will come into force on 01.09.2016 disputes in connection with establishment, management of and participation in a legal entity may be considered by an arbitrage administered by a permanent arbitration institution in accordance with the arbitration rules for corporate disputes, duly approved and deposited; disputes in connection with title to shares and encumbrances on shares may be considered in the absence of such rules. However, under the Federal Law dated 29.12.2015 N 409-FZ arbitration agreements on submission to consideration of arbitrages of corporate disputes may be entered into not earlier than 1 February 2017.

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The information above is prepared for the general information for interested persons on the basis of the laws and regulatory acts of the Russian Federation as of February 2016. This information should not be acted upon in any specific situation without appropriate legal advice.

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