

THE ACQUISITION
AND LEVERAGED
FINANCE
REVIEW

FOURTH EDITION

Editor
Christopher Kandel

THE LAWREVIEWS

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For further information please email
Nick.Barette@thelawreviews.co.uk

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Editor
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THE LAWREVIEWS

PUBLISHER
Gideon Robertson

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
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CONTENTS

PREFACE.....	v
<i>Christopher Kandel</i>	
Chapter 1 INTRODUCTION	1
<i>Melissa Alwang and Christopher Kandel</i>	
Chapter 2 ARGENTINA.....	11
<i>Tomas Allende and Francisco Lombardi</i>	
Chapter 3 AUSTRALIA.....	20
<i>John Schembri and David Kirkland</i>	
Chapter 4 AUSTRIA.....	32
<i>Jasna Zwitter-Tehovnik</i>	
Chapter 5 BELGIUM	44
<i>Jacques Richelle and Eric-Gérald Lang</i>	
Chapter 6 BRAZIL.....	54
<i>Fernando R de Almeida Prado and Fernando M Del Nero Gomes</i>	
Chapter 7 DENMARK.....	71
<i>Nikolaj Jubl Hansen, Soren Theilgaard and Jesper Kragh-Skriver</i>	
Chapter 8 ENGLAND & WALES.....	83
<i>Christopher Kandel and Karl Mah</i>	
Chapter 9 FRANCE.....	96
<i>Etienne Gentil, Hervé Diogo Amengual, Thomas Margenet-Baudry and Olivia Rauch-Ravisé</i>	
Chapter 10 GERMANY.....	112
<i>Andreas Diem and Christian Jahn</i>	

Contents

Chapter 11	HUNGARY.....	125
	<i>Melinda Pelikán, Zsófia Polyák and János Pásztor</i>	
Chapter 12	INDIA.....	136
	<i>Justin Bharucha</i>	
Chapter 13	ITALY.....	146
	<i>Andrea Novarese and Marcello Bragliani</i>	
Chapter 14	LUXEMBOURG.....	157
	<i>Laurence Jacques and Thomas Bedos</i>	
Chapter 15	POLAND.....	169
	<i>Tomasz Kański and Borys Sawicki</i>	
Chapter 16	PORTUGAL.....	180
	<i>Gonçalo Veiga de Macedo and Edgar Monteiro</i>	
Chapter 17	RUSSIA.....	188
	<i>Mikhail Turetsky, Ragnar Johannesen and Ksenia Koroleva</i>	
Chapter 18	SPAIN.....	200
	<i>Fernando Colomina and Iván Rabanillo</i>	
Chapter 19	SWEDEN.....	218
	<i>Paula Röttorp and Carolina Wahlby</i>	
Chapter 20	SWITZERLAND.....	228
	<i>Lukas Wyss and Maurus Winzap</i>	
Chapter 21	TURKEY.....	241
	<i>Umut Kolcuoğlu, Bihter Bozbay and Ayşe Aydın</i>	
Chapter 22	UNITED STATES.....	251
	<i>Melissa Alwang, Alan Avery, Mark Broude, Jiyeon Lee-Lim and Lawrence Safran</i>	
Appendix 1	ABOUT THE AUTHORS.....	263
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	277

RUSSIA

*Mikhail Turetsky, Ragnar Johannesen and Ksenia Koroleva*¹

I OVERVIEW

Although acquisition and leveraged finance is not a new concept for the Russian market, sophisticated Western-style financing transactions involving multiple layers of debt and a bond component remain unusual. Although a number of such transactions have been attempted over the years, the number of completed transactions remains relatively low. This is partly due to the limitations inherent in Russian law which historically has lacked many of the features required to structure complex secured financings, including inter-creditor arrangements.

However, in recent years, a number of significant amendments have been introduced into the Civil Code,² and certain related laws (together, ‘amendments’). The amendments represent a significant step forward for sophisticated financing transactions in Russia as they expand the arsenal of instruments and options available to lenders, borrowers and issuers of debt securities. There have been several series of amendments relating to contractual obligations, security, corporate governance matters and insolvency.³ Importantly, the amendments give creditors and pledge holders the right to agree certain subordination and priority arrangements among themselves. This new feature paves the way for further developments, including multi-layered debt in the context of leveraged finance transactions.

Since March 2014 the Russian market has been affected by the events that have been unfolding in Ukraine and the associated sanctions introduced by the US, the EU and others. Although it is unclear how the current situation will develop or what the long-term effect may be, it can certainly be seen that it has had an impact on market sentiment. Although trade and investment with Russia are not restricted generally, certain Russian persons (including

1 Mikhail Turetsky and Ragnar Johannesen are partners and Ksenia Koroleva is an associate at Latham & Watkins.

2 Part 1 of the Civil Code of the Russian Federation No. 51-FZ dated 30 November 1994, as amended, Part 2 of the Civil Code of the Russian Federation No. 14-FZ dated 26 January 1996, as amended, Part 3 of the Civil Code of the Russian Federation No. 146-FZ dated 26 November 2001, as amended, and Part 4 of the Civil Code of the Russian Federation No. 230-FZ dated 18 December 2006, as amended.

3 Federal Law No. 367-FZ ‘Amending Part I of the Civil Code of the Russian Federation and Providing for Expiry of Certain Legal Acts (Provisions of Legal Acts) of the Russian Federation’ dated 21 December 2013; Federal Law No. 99-FZ ‘Amending Chapter 4 Part I of the Civil Code of the Russian Federation and Cancellation of Certain Provisions of Legal Acts of the Russian Federation’ dated 5 May 2014; Federal Law No. 42-FZ ‘Amending of Part I of the Civil Code of the Russian Federation’ dated 8 March 2015; Federal Law No. 432-FZ ‘Amending and Providing for Expiry of Certain Legal Acts (Provisions of Legal Acts)’ dated 22 December 2014; and Federal Law No. 210-FZ ‘Amending and Providing for Expiry of Certain Legal Acts (Provisions of Legal Acts)’ dated 29 June 2015.

major banks and oil companies) have become the subject of sanctions, and cannot therefore access long-term finance. That said, the current sanctions are perceived as being relatively limited in scope. The deterioration in the price of oil (Russia's key export) has also affected the number of transactions that are coming to the market. Although deal volumes are down, transactions are still being completed successfully. Recent examples include the consortium comprising Glencore and Qatari Investment Authority, which obtained a US\$5.2 billion acquisition finance facility from Intesa Sanpaolo and Banca IMI SpA for the purposes of the partial privatisation of Rosneft, one of the world's biggest listed oil companies.

II REGULATORY AND TAX MATTERS

i Licensing

The Russian banking sector is regulated by the Banking Law.⁴ Pursuant to the Banking Law, every Russian bank shall at all times hold a valid licence from the Central Bank of Russia (CBR). As of 1 June 2017,⁵ the licences can either be universal or basic. Banks with basic licences will not be able to conduct banking operations with, or issue guarantees to secure the obligations of, foreign persons. Foreign banks cannot obtain CBR licences, so most operate in Russia through Russian subsidiaries or representative offices that have obtained such licences. The CBR has the right to refuse the registration and licensing of a bank with non-Russian shareholders if, as a result of such registration and licensing, the aggregate percentage of foreign investment into the share capital of banks in Russia would exceed 50 per cent.

If an entity only acts as a lender or an agent in connection with financing transactions, but does not otherwise engage in banking activities that are regulated by the Banking Law (such as accepting deposits from or providing loans to consumers), then, subject to compliance with certain conditions set out in the Banking Law, such entity does not need a banking licence.

Accordingly, in practice, it is possible for foreign banks to participate as lenders or agents (including security agents) in connection with acquisition and leveraged finance transactions in Russia without a licence. Likewise, intra-group loans and on-loans (whether of acquisition finance proceeds or otherwise) among members of the obligor group can also be provided without a licence.

ii Anti-money laundering and anti-corruption rules

After becoming a member of the Financial Action Task Force on Money Laundering, Russia enacted the AML Law,⁶ which implements anti-money laundering and 'know your client' (KYC) principles. Pursuant to the AML Law, Russian banks and foreign entities conducting monetary transfers in Russia are required to obtain certain information relating to their counterparties and their beneficiaries and to report (and refrain from participating in) 'suspicious' transactions. An entity conducting the transfer is required to conduct KYC checks in respect of all parties (including the seller under an acquisition financing, irrespective of whether the seller is a party to the finance documents).

4 Federal Law No. 395-1 'On Banks and Banking Activity' dated 2 December 1990, as amended.

5 Federal Law No. 92-FZ dated 1 May 2017.

6 Federal Law No. 115-FZ 'On Countering Money Laundering and the Financing of Terrorism' dated 7 August 2001, as amended.

The Anti-Corruption Law,⁷ which contains a broad definition of what constitutes corruption, and includes both state and commercial bribery, will, as of 28 June 2017, have an express set of rules on avoiding any conflict of interest. For the purposes of the Criminal Code,⁸ bribery is a crime and, over the past 10 years or so, Russian legislators have repeatedly increased the penalties associated with bribery in an attempt to combat corruption.

iii Tax issues

The provisions of the Tax Code⁹ are frequently subject to significant revisions. Unanticipated tax matters have the potential to seriously affect the profitability of a business, and any bankability analysis conducted by lenders for the purposes of a Russian acquisition and leveraged finance transaction should take this risk into account.

The most significant tax-related event in recent years is probably the de-offshorisation initiative of the Russian authorities signed into law in November 2014 and subsequently amended. The purpose of the de-offshorisation legislation is to incentivise Russian enterprises and Russian businessmen to retain all legal entities in their group structures onshore by increasing the tax burden on group structures that feature foreign holding companies.

The implications of these rules have resulted in a number of group reorganisations. Some borrowers chose to depart from the classical Russian opco, Cypriot holdco and BVI topco structures for the purposes of Russian financing transactions, while others are trying to create 'substance' offshore.

In Russia, the implementation of debt pushdown structures (that is, the establishment of a Russian special purpose vehicle to purchase a business with a subsequent merger or tax consolidation) is complicated. The main issue is that a Russian company cannot be merged with a foreign company. In addition, Russian thin capitalisation rules need to be considered in connection with such structures (see below). In a recent case,¹⁰ a Russian appellate court challenged interest expenses by a Russian company that merged with its Russian buyer on the basis that there was no economic justification for the transactions preceding the merger.

In addition, in 2016 Russia signed up to the Common Reporting Standard (CRS) established under the relevant multilateral competent authority agreement, signed in accordance with Article 6 of the 1988 Convention on Mutual Administrative Assistance in Tax Matters (as amended).¹¹ The CRS will, as of 2018, enable automatic exchange of certain information between the Russian authorities and the authorities of a number of jurisdictions (including those considered 'tax havens'). The purpose of these measures is to ensure tax transparency at a global level.

iv Withholding tax on interest income

Russian withholding tax on interest income is currently 20 per cent. This statutory rate may be reduced in accordance with applicable double tax treaties (DTTs), provided that the lenders from the relevant DTT jurisdictions offer the borrower (acting as tax agent for

7 Federal Law No. 273-FZ 'On Anti-Corruption Enforcement' dated 25 December 2008, as amended.

8 Criminal Code of the Russian Federation No. 63-FZ dated 13 June 1996, as amended.

9 Part I of the Tax Code of the Russian Federation No. 146-FZ dated 31 July 1998, as amended, and Part 2 of the Tax Code of the Russian Federation No. 117-FZ dated 5 August 2000, as amended.

10 Case No. A50-17405/2016. This case is still subject to cassation.

11 Government Decree No. 834-p dated 30 April 2016 'On Signing of the Multilateral Competent Authority Agreement'.

the purposes of the Tax Code) their respective tax-residency certificates. Favourable DTT jurisdictions that are most frequently used in a Russian context remain Cyprus, Luxembourg and Netherlands.

v Interest expense deductibility

Subject to certain limitations (including the arm's-length and thin capitalisation rules – see below), a Russian borrower generally has the right to deduct interest expenses on loans from operating income for the purposes of profit tax, irrespective of the purpose of the loan.

Pursuant to the recently amended arm's-length rule, the amount of interest expense deducted by a Russian borrower may not be more than the amount of interest expense calculated in accordance with the Tax Code on the basis of certain floating rates, including the CBR rates, Libor, Euribor or Shibor.

If a Russian borrower has outstanding indebtedness that qualifies as 'controlled indebtedness' for the purposes of Russian law and its ratio of debt-to-equity exceeds 3:1, then the thin capitalisation rules apply. Controlled indebtedness arises in circumstances where a Russian borrower obtains financial indebtedness from:

- a* its 25 per cent plus foreign shareholder and certain other group members;
- b* its foreign affiliate; or
- c* an independent lender, if the persons mentioned in (a) or (b) provide security or guarantees in respect of such loan.

In practice, (c) poses a particular problem where the lenders obtain security and guarantees from members of the target or purchaser groups.

However, as of 1 January 2017, indebtedness from independent banks (including foreign banks) mentioned in aforementioned bullet point (c) is excluded from the notion of controlled indebtedness in certain cases, such as where a foreign affiliate has not repaid or pre-paid the relevant loan (in full or in part).

In light of the devaluation of the rouble, the rouble amount of 'controlled indebtedness' in foreign currencies can now be calculated on the basis of specific rates published by the CBR. By fixing an artificial rate, the idea is to help Russian borrowers obtain interest deductions with respect to related-party hard currency loans that otherwise would come within the thin cap restrictions due to the considerable devaluation of the rouble.

If a financing transaction falls foul of the thin capitalisation rules, the relevant interest is not tax-deductible and is also treated as a dividend for tax purposes.

III SECURITY AND GUARANTEES

i Security

A range of forms of credit support is available under Russian law. Taking effective security under Russian law has, however, been problematic historically. Reasons include the unavailability of security over certain classes of assets, and the inadequacies of the security public record and the enforcement regime. However, the changes to the security enforcement regime (as well as the amendments) have considerably improved the position and, in particular, the protection of secured creditors.

The primary security interest recognised by the Civil Code is the pledge. Under Russian law, a pledge only exists if (and for as long as) it secures a valid obligation. A pledge does not transfer legal title, even if the security asset is itself physically transferred into the possession

of the pledgee. However, a pledge provides the pledgee with certain priority rights over the pledged asset and, as a result of the amendments, a pledge of shares (or participatory interests) may also confer on the pledgee the right to vote or receive dividends, or both.

Russian law distinguishes between pledges of moveable and immovable assets (the latter type is often termed a 'mortgage' and is subject to specific rules set out in the Mortgage Law).¹²

Unlike loans secured by real estate, which have benefitted from a public registration system in Russia for over two decades, security over equipment or inventory was sub-optimal prior to the introduction of the amendments. In an enforcement scenario, creditors were often unable to locate their collateral or discovered that it had also been pledged in favour of other creditors.

To address this issue, the amendments introduced a system of notification of moveable property pledges into the Civil Code, a register of such notifications and an associated voluntary registration regime. Russian notaries are the new system's gatekeepers. The pledgor or pledgee (or, in certain cases, other persons) has the right to submit a notification of pledge (either in a hard or electronic copy) to a notary for inclusion in the pledge register. This pledge register does not apply to pledges that are subject to other registration procedures, such as pledges over immovable property or shares.

The amendments set out a new regime pursuant to which pledges may be held by multiple pledgees (either on a *pari passu* basis or at different levels of seniority). For pledges ranked at different levels, the amendments introduce a concept of 'pledge seniority'. By default, seniority is linked to the time when the relevant pledge is created (that is, when the relevant pledge agreement is entered into). However, there are important exceptions to this general rule, including that seniority may be altered by agreement among the various pledge holders. As mentioned above, these new features are likely to pave the way for further intercreditor-related developments.

Account security

Previously, only direct debit rights (which are contractual, revocable and do not create a security interest) were available to creditors; however, the amendments permit taking security over rights to bank accounts. Security can be taken over a specific type of bank account that is opened by the pledgor with the bank acting as pledgee or a third-party account bank. In the latter case, the account bank and the pledgor may not terminate or amend the bank account agreement without the consent of the pledgee. This is a major step forward in the context of receivables financings, but is also helpful in connection with acquisition and leveraged finance transactions.

Guarantees

Russian law distinguishes between 'suretyships' and 'independent guarantees'.

Under Russian law, a guarantee provided by corporate entity is referred to as a suretyship. Generally, a Russian company may provide upstream and cross-stream suretyships. Like a Russian law pledge, a suretyship only exists if (and for as long as) it secures a valid obligation. The suretyship is a quasi-security instrument, since it does not create a proprietary interest but merely gives a creditor a contractual right of recourse against the relevant entity.

12 Federal Law No. 102-FZ dated 16 July 1998 'On mortgage (pledge of immovable)', as amended.

An independent guarantee is another quasi-security instrument and, in essence, is similar to a suretyship. The difference between an independent guarantee and a suretyship under Russian law is that an independent guarantee creates an independent obligation of the guarantor to pay the amount stipulated in the guarantee, whereas a suretyship creates an accessory payment obligation. Prior to the amendments, independent guarantees were referred to as 'bank guarantees' and could only be provided by credit and insurance organisations.

Russian law suretyships and guarantees are both subject to certain specific rules, although, some of the more stringent rules have been significantly relaxed by the amendments, which now allow description of the relevant secured obligations by way of simple reference to the underlying loan.

Limitations on guarantees and security and corporate benefit

There is no well-developed concept of corporate benefit under Russian law. There are rules relating to the consent to and approval of major transactions (transactions amounting to 25 per cent or more of the balance sheet) and interested-party transactions (transactions with certain related persons). With effect from 1 January 2017,¹³ consent to interested party transactions is generally not required; however, in the absence of such consent, a transaction can easily be challenged.

In addition to these rules, in practice, the charters of Russian companies often contain specific mechanisms for approving transactions pursuant to which security is created.

Members of the management bodies of Russian companies are generally required to act in the best interests of the company and may be held personally liable for any breach of statutory duty.

Security agents

Unlike common law legal systems, Russian law does not recognise the concept of a security agent that acts as a trustee for the lenders from time to time. Accordingly, in the context of secured financing transactions with a broad and potentially changing composition of secured creditors, a key issue is always how best to structure security in an efficient manner. Clearly, having each secured party from time to time sign a pledge agreement or register its security interest is sub-optimal for such transactions. To address this issue, various practical solutions have been developed in the market, including, most notably, a structure that includes a security agent acting as a joint and several creditor with each of the individual creditors. While these structures are likely to remain viable, they have so far not been properly tested in the Russian courts.

The amendments introduced a new structure that has the advantage of being clearly spelled out in the legislation and that is therefore likely to be welcomed by market participants, especially perhaps in the context of Russian law-governed syndicated loans.

This structure enables the appointment by the creditors of a 'pledge manager', who conceptually is not dissimilar to a common law security agent.

Although not expressly mentioned in the amendments, it appears that a pledge manager could potentially be appointed in respect of more than one rank of secured creditors. The

13 Federal Law No. 343-FZ dated 3 July 2016.

amendments are not clear as to how a pledge manager would simultaneously owe a duty of care to junior and senior pledgees, but nothing appears to prevent pledgees from different classes agreeing how enforcement proceeds should be distributed.

ii Insolvency issues

In cases of insolvency or insolvency proceedings against a borrower, a pledgor or a guarantor (relevant person), the following transactions entered into by such relevant person within a certain period of time prior to the commencement of the insolvency proceedings may be challenged:

- a* suspicious transactions: transactions without mutual consideration and on disadvantageous terms, or transactions wilfully aimed at causing harm to creditors generally; and
- b* preferential transactions: transactions that lead, or may lead, to preferential treatment of a particular creditor, including transactions aimed at changing the order of priority of claims.

Pursuant to the recent amendments to the Civil Code, the arbitration manager may submit an application for invalidation on its own initiative or at the request of the creditors' meeting or committee. The amendments also allow a creditor to challenge a transaction without involving the arbitration manager if such creditor's exposure exceeds 10 per cent of the total indebtedness of all creditors featured in the ranking list. This development has the effect of simplifying the procedure for challenging antecedent transactions as interim procedures (such as creditors' meetings) are no longer necessary.

IV PRIORITY OF CLAIMS

i Priority of claims in insolvency

In cases of insolvency, the Bankruptcy Law¹⁴ requires that each creditor assert its claims so that these are included in the ranking list, which determines the amount due by the debtor to such creditor. Most claims that arise after the commencement of insolvency proceedings have super-priority in relation to any unsecured claims and need not be included in the ranking list.

All claims that became due before the commencement of the insolvency proceedings and have been included in such ranking list are generally discharged as follows:

- a* first-priority claims include those arising from the debtor's liabilities to individuals for harm to life or health;
- b* second-priority claims arise out of the debtor's obligation to pay wages, salary or other amounts payable under employment agreements in the ordinary course of business, or to pay fees or royalties to authors of intellectual property (these claims are sub-divided into categories depending on the amount payable); and
- c* other claims included into the ranking list constitute third-priority claims. Claims secured by collateral over the debtor's assets are generally settled out of the proceeds from the sale of such collateral ahead of all other claims with certain exceptions. The

¹⁴ Federal Law of the Russian Federation No. 127-FZ 'On Insolvency (Bankruptcy)' dated 26 October 2002, as amended.

Bankruptcy Law basically allows for allocation of 70 to 80 per cent of such proceeds to the relevant secured lenders, with the remaining 20 to 30 per cent being divided between creditors in respect of first and second priority and current claims.

Claims of creditors that are not included in the ranking list or that qualify as preferential or suspicious transactions (as described above) are generally the last creditor claims to be satisfied, and may be considered claims of fourth priority.

The Bankruptcy Law also sets out additional rules for priority of claims in the cases of bankruptcy of certain types of entities, including credit organisations (including banks) and insurance companies, allowing for super-priority of claims of individual bank account holders and customer deposit account holders. Prior to the amendments, there was a separate law devoted to bankruptcy of credit organisations, but the relevant rules are now set out in the Bankruptcy Law.

ii Intercreditor arrangements

Prior to the amendments, the Russian legislation was silent on the ability of creditors of a non-bank debtor to enter into subordination or other ranking arrangements.

The amendments implemented the concept of ‘intercreditor agreements’ which aims to facilitate syndicated loans and debt restructurings in Russia. Under these new rules (substantially based on common law concept of ‘intercreditor arrangements’), creditors of one borrower may conclude an intercreditor agreement so as to restrict the ability of some or all creditors (parties to such intercreditor agreement) to enforce claims or security on an individual basis set out rules on priority and subordination of claims or provide for non-proportional allocation of proceeds (or both). However, it is argued that such intercreditor arrangements do not apply to debtors undergoing bankruptcy proceedings. In such case, it is the Bankruptcy Law and not the intercreditor arrangements that will govern the procedure of satisfying creditors from these assets and determine the enforceability of the contractual ranking of claims.

Russian courts and bankruptcy administrators were previously reluctant to take into account the contractual ranking when allowing claims against the debtor’s assets or when distributing proceeds to creditors. Their key argument was that the subordination is only a matter of contract between the parties to the relevant intercreditor arrangements, and that thus it does not affect the statutory rules of liquidation of the borrower’s assets, which also concern third-party creditors. It is likely that such approach would continue to be taken by the practitioners despite the fact that intercreditor arrangements are now generally allowed by the Civil Code.

Therefore, it is likely that only the statutory subordination and ranking of claims will be taken into account, with the effect that the liquidation proceeds will be distributed in the order set out above. However, the intercreditor arrangements may arguably be taken into account to the extent that they relate to indebtedness owed to creditors of the same rank.

V JURISDICTION

In Russia the parties to a contract may choose foreign law as the governing law of the contract provided that the contract has a ‘foreign element’ (a foreign party, a foreign asset or similar). English law is most commonly chosen as the governing law of the facility agreement.

Generally, the parties are free to choose litigation or arbitration. Russian law, however, requires that certain disputes are exclusively resolved by Russian state arbitrazh (commercial) courts.¹⁵

In December 2015, the legislation regulating domestic and foreign arbitration was amended.¹⁶ The majority of these amendments (the ‘new arbitration rules’) came into force on 1 September 2016. The new arbitration rules, *inter alia*, relate to regulation of arbitrability of certain types of disputes, overhaul the Russian arbitration court system, and limit the use of *ad hoc* proceedings. Pursuant to the new arbitration rules, most disputes relating to state registration, insolvency, privatisation and public procurement are expressly considered non-arbitrable. Corporate disputes (relating to establishment and operations of legal entities and their managing bodies, and listed in the Arbitration Procedure Code)¹⁷ may, in certain cases, be arbitrable subject to certain pre-conditions, such as institutional (and not *ad hoc*) arbitration having its seat of arbitration in Russia.

Russian courts have challenged the enforceability of dispute resolution clauses (typically found in English law finance documents) pursuant to which one party only may choose arbitration or litigation on the basis that such provisions violate the principle that each party must have equal access to justice. As a result, the parties tend to include a single dispute resolution option – usually arbitration in an internationally recognised arbitration forum such as the London Court of International Arbitration.

Foreign arbitral awards are generally recognised and enforced pursuant to the New York Convention,¹⁸ which Russia is a party to. The judgments of foreign courts are recognised and enforced in Russia only if there is an international treaty between Russia and the country in which the judgment was issued; or a Russian federal law providing for the recognition and enforcement of court judgments from such country. However, taking into account the new arbitration rules, the parties should be careful when choosing a foreign arbitration institution with respect to certain corporate and other types of disputes.

No law or treaty currently exists that recognises and enforces judgments of the courts of England and Wales. Accordingly, arbitration is generally perceived as the only available option in respect of contracts governed by English law.

VI ACQUISITIONS OF PUBLIC COMPANIES

i Overview

Following the changes to the Civil Code and further amendments to the JSC Law¹⁹ and LLC Law,²⁰ public companies in Russia are called ‘public’ joint stock companies (JSCs) (and not ‘open’ JSCs).²¹

15 Such disputes include insolvency disputes and certain specific ‘corporate disputes’ (e.g., relating to title to shares in a Russian company or encumbrances over such shares).

16 Federal Law No. 382-FZ dated 29 December 2015 ‘On arbitration proceedings in the Russian Federation’ and Federal Law No. 409-FZ dated 29 December 2015 ‘Amending certain Federal Laws’.

17 Federal Law No. 95-FZ ‘Arbitration Procedure Code’, as amended.

18 The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

19 Federal Law No. 208-FZ dated 26 December 1995 ‘On Joint Stock Companies’, as amended.

20 Federal Law No. 14-FZ dated 8 February 1998 ‘On Limited Liability Companies’, as amended.

21 Please note that a reference to a ‘public’ JSC includes a JSC whose securities are publicly traded on a stock exchange and a JSC that may offer its shares to an unlimited number of persons.

ii Mandatory tender offers and minority squeeze-outs

Under the rules relating to mandatory tender offers (MTOs), any pledge holder who as a result of an enforcement acquires more than 30 per cent (50 per cent, 75 per cent together with its affiliates) of the voting shares in a public JSC must make an MTO to the other shareholders.

If a pledge holder (individually or together with its affiliates) becomes the owner of more than 95 per cent of the shares in a public JSC, it must buy out the remaining shares at the request of the shareholders (MTO); or shall have the right to require that the shareholders sell their shares to it, provided that it has reached 95 per cent as a result of acquiring more than 10 per cent on the basis of a tender offer (minority squeeze-out).

In an enforcement scenario, banks tend to find third-party purchasers to bear the related MTO obligations. However, if the pledge holder itself acquires the shares and consequently reaches the 30, 50 and 75 per cent thresholds, it may make an attempt to avoid the MTO obligation if it sells such number of shares as is required to go below the relevant threshold no later than 35 days after such acquisition.

A bank or a third-party purchaser making a tender offer should first confirm such tender offer with the CBR (which is now the main regulation in Russian securities market). Pursuant to the recent amendments to the JSC Law, the rules on MTO and minority squeeze-out extend to non-public companies that used to be open JSCs as of 1 September 2014. Such companies may only be exempted from these rules by way of charter amendments to that effect. On 1 July 2016, certain technical amendments to the MTO entered into force. In particular, shareholders that receive an MTO should submit their request for the sale of shares to the register (depository) rather than to the address specified in the MTO; such shares offered for sale will then be blocked upon submission of the request for sale thereof and it will become possible to effect payment for the shares acquired in the course of an MTO to the bank account of the depository (rather than the shareholders) if the relevant shareholders are not registered in the register of shareholders.

The lower chamber of the Russian parliament has adopted a draft law amending the rules pertaining to MTOs. This law aims to introduce significant changes to the Russian rules and remove certain legal loopholes. For instance, if a pledge holder acquiring more than 30, 50 or 70 per cent of the votes together with certain persons in a public JSC refuses to make an MTO to other shareholders, such shareholders will have a right to compel the pledgeholder to make the MTO.

iii Certain funds requirement

Russian legislation does not contain a certain funds requirement with regard to an acquisition of shares in a public JSC; however, the person making a tender offer must accompany it with a bank guarantee securing its obligations to pay. Such bank guarantee is irrevocable and valid for at least six months after the termination of the payment period.

iv Minority shareholders challenge

A sale or pledge of shares in a public JSC is not generally restricted under Russian law; however, if a public JSC issues new shares to an unlimited number of persons, the existing shareholders of the public JSC have a right of first refusal. If this right is disregarded, the shareholders may challenge the sale.

In addition, if a person is under an obligation to make a tender offer (including as a result of share enforcement), this may require the approval of the shareholders, in the absence of which the minority shareholders may be entitled to challenge any transactions triggered by such enforcement.

v Other permitted conditionality

The acquisition of shares in a public JSC may also trigger the requirement to obtain regulatory approvals in accordance with the Competition Law²² or the Strategic Law.²³ From a practical point of view, a bank may not agree to provide its financing before the relevant regulatory approvals are obtained by the purchaser given that, in the absence of these approvals, the transaction may be unwound. Similar regulatory approvals may also be required in a share pledge enforcement scenario.

vi Disclosure requirements

As a matter of Russian law, a public JSC is subject to mandatory disclosure requirements. The acquisition finance is usually structured such that a purchaser is the borrower under the finance documents; and pledges shares in the public JSC upon completion of the acquisition.

Given that the public JSC is itself usually not a party to the finance documents, the terms of the financing would not typically be disclosed.

However, if the purchaser acquires control over the public JSC (on the basis of the shareholding or by way of a corporate agreement) or enters into a share pledge agreement that qualifies as a major transaction for the Russian purchaser, who controls the public JSC, then such public JSC will need to disclose the terms of the pledge. When the purchaser acquires more than 5 per cent of shares in the public JSC, the latter must disclose the identity of the purchaser. If as a result of such acquisition the purchaser makes a tender offer, the terms of the tender offer will also need to be disclosed by such public JSC.

vii Confidentiality requirements

There are no specific statutory confidentiality requirements applicable to the acquisition of shares in a public JSC.

Russia has adopted the Insider Law,²⁴ which prohibits insider trading of information relating to a public JSC. The banks participating in acquisition finance transactions may be in possession of certain insider information relating to the acquisition and must, therefore, also comply with the Insider Law.

There is also a draft law (not yet submitted to the lower chamber of the Russian parliament) that aims to provide additional information access rights to minority shareholders to allow certain insider information, including information about purported acquisition financings, to be provided to them.

22 Federal Law No. 135-FZ dated 26 July 2006 'On Protection of Competition', as amended.

23 Federal Law No. 57-FZ dated 29 April 2008 'On the Procedure of Foreign Investment in Commercial Entities of Strategic Importance for the Country's Defense and State Security', as amended.

24 Federal Law dated 27 July 2010 No. 224-FZ 'On Counteraction Against Illegal Use of Inside Information and Manipulation of the Market, and On Introduction of amendments to Certain Legislative Acts of the Russian Federation', as amended.

VII SANCTIONS

As a result of the sanctions that have been implemented by the US and the EU in the wake of the ongoing situation in Ukraine (and the heightened vigilance of US and EU banks in this respect), foreign lenders, in addition to conducting KYC, also insist on sanctions-related provisions in the finance documents. These are frequently the subject of heavy negotiation, however, the language of these provisions has become fairly standardised.

VIII OUTLOOK

2016 and the first half of 2017 have proven to be a difficult period for the Russian market. However, provided that the current geopolitical tensions ease, in the long term there is plenty to suggest that the market is generally maturing and deepening, including positive and progressive legal developments, confident local banks, established and new international participants and the emergence of more and more ambitious deal structures.

ABOUT THE AUTHORS

MIKHAIL TURETSKY

Latham & Watkins LLP

Mikhail Turetsky is a partner, and the Moscow office managing partner, in Latham & Watkins' Moscow office. His practice focuses on finance and capital markets, and he has extensive experience advising banks and corporate clients on all aspects of transactions in Russia and the CIS. Mr Turetsky is qualified to practice law in Russia and also holds a UK LLM degree. His primary areas of expertise include debt and equity capital markets as well as a broad range of finance transactions, including project finance, structured finance and financial restructuring.

RAGNAR JOHANNESSEN

Latham & Watkins LLP

Ragnar Johannesen is an English law-qualified solicitor based in Latham & Watkins' Moscow office specialising in banking and corporate finance, with a particular focus on event-driven transactions, restructurings, and structured and limited recourse financings (including structured trade and export financings). He has experience in transactions involving multilateral financial institutions, development banks and export credit agencies. Mr Johannesen has been identified as a 'leading individual' in the Russian market by *Chambers Global* since 2012.

KSENIA KOROLEVA

Latham & Watkins

Ksenia Koroleva is a Russian-law qualified associate in Latham & Watkins' Moscow office.

LATHAM & WATKINS

Ul Gasheka 6, Ducat III

Office 510

Moscow 125047

Russia

Tel: +7 495 644 1910 / 1931 / 1943

Fax: +7 495 785 1235

mikhail.turetsky@lw.com

ragnar.johannesen@lw.com

ksenia.koroleva@lw.com

www.lw.com



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