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## Current M&A transaction models



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Against the backdrop of changing global political conditions, the Russian M&A market has transformed. Below is an overview of key trends for 2022 and 2023. In particular, the following issues are considered:

- Features of exit-related transactions of foreigners from Russian assets;
- Features of transactions between Russians in respect of foreigners assets;
- Features of transactions on the domestic market between Russian parties (redomiciliation to the Russian Federation and friendly jurisdictions);
- dispute resolution.

### FEATURES OF EXIT-RELATED TRANSACTIONS OF FOREIGNERS FROM RUSSIAN ASSETS

A notable feature of M&A transactions involving foreign owners has become the predominance of

regulatory issues and issues of settlements over the commercial issues.

**The settlement mechanisms turned out to be the main problem. Given the new sanctions from unfriendly states and Russia's counter-measures, possible settlement options have been significantly reduced. If a transaction requires approval of the Government Commission for the Implementation of Foreign Investments (hereinafter referred to as the Government Commission), buyers have very few tools for settling with counterparties from unfriendly countries.<sup>1</sup>:**

- payment in rubles to the seller's account in Russian bank without transferring funds outside the Russian Federation;

<sup>1</sup> Extract from the decision of the subcommittee of the Government Commission for Monitoring the Implementation foreign investment in the Russian Federation dated 07.07.2023 No. 171/5, clause 1, subclause 9.

- payment to a type "C" account, funds from which may only be used for certain purposes (for example, paying taxes or bank fees<sup>2</sup>);
- payment to the seller's foreign account when payment installments are provided for.

It is obvious that the presented options do not satisfy the interests of foreign sellers. In turn, the Russian buyer is faced with the impossibility of directly paying for the asset to the seller and fulfilling his obligations under the transaction. In this regard, the parties are forced to seek and use alternative payment instruments, which leads either to a complication of the payment structure and, as a consequence, of the transaction itself, or to an increase in the time between signing the transaction and making settlements.

Since such restrictions deprive the parties of the certainty of receiving payment, the parties seek to receive money quickly, which is why mechanisms for withholding the purchase price or adjusting it are used less frequently. In particular, the conditions allowing the buyer to adjust the transaction amount based on the future performance of the acquired company (earn out) are excluded. It is not uncommon for owners from unfriendly countries to sell assets at par value.

### The second significant aspect, influencing on transactions related to the exit of foreign

**investors, — the need to obtain consent for their implementation. This is associated with a number of requirements:**

- 1 Special procedure for determining and paying the purchase price:
  - conducting an independent assessment of the market value of assets by an appraiser recommended by the Government Commission, with confirmation by an expert opinion;
  - sale of assets with a discount comprising at least paying for 50% of the market value of assets, determined according to an independent assessment;
  - allocation to the federal budget of at least 15% of the market value of assets;
  - if there is a call option: repurchase of an asset at its market value on the date of exercise of such an option; maximum term of the call option — no more than two years.
- 2 Establishment of key performance indicators (KPIs) for buyers or the acquired company. For example, maintaining technological potential, working places, the main type of economic activity<sup>4</sup>. The implementation of KPIs is monitored by the relevant ministry.
- 3 Compliance with requirements for transactions (operations) related to public joint-stock companies (PJSC) (if applicable):

- 2 Decision of the Board of Directors of the Bank of Russia dated 21.11.2022 "On the establishment of the type "C" account regime for settlements and the implementation (execution) of transactions (operations) to which the procedure for fulfilling obligations provided for by Decree of the President of the Russian Federation dated March 5, 2022 No. 95 "On the temporary procedure for fulfilling obligations to certain foreign creditors" applies, clause 1.1.
- 3 Extract from the decision of the subcommittee of the Government Commission for Control over the Implementation of Foreign Investments in the Russian Federation No. 171/5 dated 07.07.2023, paragraph 1.
- 4 At the moment, the most well-known case of introducing KPIs is related to the permission granted to Best Price LLC, a Russian subsidiary of the Fix Price holding, to pay dividends: [https://ir.fix-price.com/upload/iblock/3e6/fp2xnucafa2r19p3l1p27ru0xor84857/Press%20Release\\_Gov.%20permission\\_10Jan2024\\_rus.pdf](https://ir.fix-price.com/upload/iblock/3e6/fp2xnucafa2r19p3l1p27ru0xor84857/Press%20Release_Gov.%20permission_10Jan2024_rus.pdf). However, the parameters of the key indicators were not disclosed.

- if as a result of a transaction (operation) with shares PJSC retains its status:
  - the public offering at an exchange of up to 20% of the acquired share package;
  - The public offering start - no later than a year from the date of the transaction (operation), and the period for its implementation is no more than three years from the date of commencement of such placement;
- during the reorganization of a business entity in the form of merger with PJSC:
  - The public offering at an exchange of shares of the PJSC to which the merger took place, in an amount equivalent to up to 20% of the shares of the merged company, taking into account the conversion rate of shares of such companies upon merger;
  - implementation of such public offering within three years from the date of the transaction (operation);
- in case of termination of public status of PJSC or liquidation of such company as a result of the implementation (execution) of a transaction (operation):
  - the public offering at an exchange of up to 20% of shares of a public joint-stock company (newly created or as a result of the acquisition of public status by a joint-stock company);
  - acquisition of public status by a joint stock company and the implementation of such Public Offering- no more than three years from the date of the transaction (operation).

The described conditions are aimed at preserving foreign capital in the country, making the process of exiting Russian assets economically unprofitable by creating non-competitive transaction conditions. due to this measures, the number and volume of transactions in 2023 decreased significantly compared to the previous year - the total volume of transactions amounted to \$ 11.14 billion against \$ 16.31 billion in 2022.

Due to the special procedure for the sale of Russian assets by foreign investors from unfriendly countries, assets often began to be acquired on an "as is" basis, that is, in the

condition in which they are at the time of the transaction, and the buyer accepts all defects. This model provides for the waiver of a wide range of representations about the circumstances and warranties, as well as a waiver from the indemnity obligations. Previously, such transactions were accompanied with a thorough due diligence, but in the current situation, when an asset is acquired under non-standard conditions, the significance of the results of the due diligence is reduced, and they often do not affect the price or terms of the transaction. In this regard, due diligence is not carried out at all or is carried out in a limited format. The focus is on the title and only material issues for the business.

**Another popular trend is the buyout of company shares by its management (Management buyout or MBO). As a rule, this method is used in the market when the person controlling the company:**

- wants to sell the asset quickly but can't find a buyer willing to pay a fair price;
- refuses to finance it due to with the economic weakness of the company, including due to limited access to foreign resources;
- is a foreign business owner and plans to return to the market later. In such cases, the MBO mechanism allows to temporarily save the asset.

When selling Russian assets, certain owners face increased demand due to significant underpricing. In some cases, this has led to parallel negotiations on the deal or the organization of auctions among potential buyers, which also reflects the extraordinary and non-market nature of the situation regarding foreign investments frozen in Russian assets.

## FEATURES OF TRANSACTIONS BETWEEN RUSSIANS IN RESPECT OF FOREIGNERS ASSETS

Sanction risks inevitably affect transactions by Russian citizens with foreign assets. The main problem is potential sanctions from unfriendly countries, as a result of which assets may be frozen. For this reason, Russian investors are increasingly choosing jurisdictions of friendly countries for doing business and investing. Despite the fact that the UAE is currently the most popular jurisdiction, the market situation can change significantly in a matter of months, so some entrepreneurs are looking at other, more exotic jurisdictions.

However, even acquiring companies in friendly jurisdictions does not guarantee complete safety from sanctions risks. For example, in the case of indirect investment in a company operating in an unfriendly country, it may also be subject to sanctions. This is possible when an investor from the Russian Federation was previously subject to personal EU sanctions, and he acquired 50% of shares in a company that, although located in a friendly jurisdiction, conducts business that is closely connected with the EU. Such a company automatically falls under EU sanctions, which can make it unprofitable and hinder further development. This leads to the need for additional structuring of asset ownership.

As in the case of foreign investments in the Russian Federation, Russian citizens investing in foreign assets also face the issue of complicated settlements, which is slightly different. Thus, Russian buyers face difficulties when opening accounts in foreign banks and when performing payment transactions. In addition, the accounts of Russians are often closed under one

or another pretext. As a result, the parties use payment gateways, agents and alternative payment methods (offset, accord and satisfaction, etc.), which can increase costs and complicate the transaction procedure.

## FEATURES OF TRANSACTIONS IN THE DOMESTIC MARKET BETWEEN RUSSIAN PARTIES

Another feature of M&A transactions in the current reality is that holding companies that own Russian assets are often registered in jurisdictions unfriendly to Russia. To carry out a transaction, it is necessary to exclude the foreign link from the ownership chain. For this, one of the following methods can be used.

1

### **Redomiciliation to the Russian Federation** (examples: VK, TCS Group)

#### **Pros:**

- it is possible to hide information about beneficiaries in the Russian registry, which will reduce the risk of sanctions being imposed on the client, as well as indirect US sanctions on the company;
- tax preference.

#### **Cons:**

- will take from six months to one year;
- It is necessary to make investments in the amount of not less than 50,000,000 rubles, in addition, it is necessary to transfer property worth 800,000,000 rubles to the created company;
- legislation of the country of registration of the company may not provide for the possibility of redomiciliation.

2

### Redomiciliation to a friendly jurisdiction (the most suitable jurisdiction is Kazakhstan) (examples: Polymetal, "Dodo Pizza")

#### Pros:

- no minimum investment required on the territory of the Astana International Financial Center;
- no minimum requirements the amount of the authorized capital for private companies;
- flexible accounting of rights to company shares (possibility to independently to maintain a register of shareholders of private companies;
- a small registration fee for redomiciliation - \$300;
- lack of strict regulation of transaction approval, which allows the company to consider these issues independently (reflection of the conditions in the charter).

#### Cons:

- The registrar has the right to refuse redomiciliation based on expediency (if it deems necessary), which creates risks of uncertainty;
- the need to further structure the most important business processes with the holding's Russian subsidiaries, taking into account the requirements of Kazakhstan's legislation.

3

### Procedures for taking direct ownership of shares within the framework of the Law on Economically Significant Organizations<sup>5</sup>(examples: X5 Retail Group, Alfa-Bank, Azbuka Vkusa)

- 5 Federal Law of 04.08.2023 No. 470-FZ "On the specifics of regulating corporate relations in business entities that are economically significant organizations."

#### Pros:

- Russian persons who own economically significant organizations through foreign holding companies (FHCs) can exclude FHCs from the chain of ownership by filing an application with the Moscow Region Arbitration Court. The claim can also be filed by the federal executive authority (as in the case of X5 Retail Group), which reduces the risks for shareholders;
- the speed of the procedure, since the decision on the case is issued no later than one month from the date of acceptance of the claim, without holding a preliminary hearing and immediately comes into force;
- the absence of mandatory requirements, which which apply to a company in the event of such forced redomiciliation;
- no need to obtain approval of the Federal Antimonopoly Service of Russia (FAS), the Bank of Russia and the Government Commission.

#### Cons:

- Suitable only for companies that are recognized to be economically significant organizations.

4

### Purchase of shares of Russian companies from a holding company

#### Pros:

- absence of mandatory requirements, which apply to a company upon redomiciliation (whether voluntary or forced).

#### Cons:

- lack of tax preference received by a company in case of voluntary redomiciliation;

- possible need to obtain consent to the deal by a foreign regulator, as well as the Russian Government Commission, the Bank of Russia, and the FAS.

**It is also worth noting the closed-end unit investment fund (ZPIF) as a way of structuring ownership, which has proven its practical significance (in particular, Yandex's business is now structured through ZPIF) to protect the buyer or business from sanctions after the transaction.** The peculiarity of these funds is that all transactions within the fund are exempt from taxation. This allows the fund's capital to grow faster, since the profit earned during the fund's existence can be fully reinvested. The management company of the ZPIF withholds income tax when redeeming or selling shares, as well as when paying interim income to the investor. The ZPIF also provides a significant level of confidentiality, which makes it a tool for protecting Russian assets from international sanctions.

## DISPUTE RESOLUTION

**Due to significant changes in the domestic and international business environment, entrepreneurs' preferences in choosing arbitration centers for dispute resolution have changed. Currently, when concluding transactions with a foreign element, parties often prefer arbitration centers of friendly (neutral) jurisdictions, among which the Hong Kong International Arbitration Centre (HKIAC) is the most popular,** whereas previously the choice more frequently

fell on the London Court of International Arbitration (LCIA), the International Court of Arbitration of the International Chamber of Commerce (ICC) or the Singapore International Arbitration Centre (SIAC).

**This choice is justified by the fact that in connection with the adoption of the so-called "Lugovoy Act"<sup>6</sup> For foreigners working with Russian individuals, there is a significant risk of non-enforcement of decisions of international arbitration courts and foreign courts.** The Innovations have given Russian entrepreneurs the right to apply to a Russian arbitration court to issue a foreign counterparty an anti-suit injunction preventing it from initiating or continuing arbitration or judicial proceedings in a country that has imposed sanctions against Russian individuals. This makes it impossible for foreign counterparties to enforce decisions to recover assets from Russian individuals in the Russian Federation, which is why foreign individuals have begun to conduct a careful risk assessment when including dispute resolution clauses in contracts with Russian individuals.

The compromise was to refer potential disputes to friendly (neutral) jurisdictions with respect to Russia and the corresponding arbitration institutions, such as the previously mentioned HKIAC, SIAC and others. It is worth considering the risk that a neutral jurisdiction may lose such status for the Russian Federation. Thus, in the well-known decision of the St. Petersburg court in the Ruskhimaliyans case, the court refused to enforce the HKIAC decision due to the fact that the arbitration institution is located in Hong Kong, which, in turn, is under the influence of Great Britain, which introduced restrictive measures against the Russian Federation and is unfriendly.

6 Federal Law of 08.06.2020 No. 171-FZ "On Amendments to the Arbitration Procedure Code of the Russian Federation in Order to Protect the Rights of Individuals and Legal Entities in Connection with Restrictive Measures Introduced by a Foreign State, State Association and (or) Union and (or) State (Interstate) Institution of a Foreign State or State Association and (or) Union."

This case is exceptional, since Hong Kong did not impose sanctions, but is merely under the influence of the UK. It is unlikely that other courts will follow this approach. HKIAC and Hong Kong in general are friendly jurisdictions, and HKIAC is one of the priority and most favorable arbitration centers for Russian entrepreneurs, despite the decision of the St. Petersburg court. However, individual decisions of Russian courts show that the practice of application may change in an unfavorable direction.

## CONCLUSION

To sum up, we note significant changes in the circumstances and conditions for M&A transactions under the influence of sanctions and regulatory pressure, as well as changes in market conditions.

**First of all** regulatory risks have become one of the main circumstances in transactions with foreign sellers, which the parties have to take into account as imposed non-market conditions, and this directly affects the conditions of the

transactions and the procedure for conducting them. It is also worth considering the actual unenforceability of decisions of arbitration courts of unfriendly jurisdictions and foreign courts.

**Secondly**, internal transactions in Russian market are also carried out in extraordinary conditions, which is expressed in significant sanctions risks in terms of import substitution of foreign software and technologies, as well as in terms of corporate governance, which was previously often structured using IHCs registered in unfriendly jurisdictions. When conducting transactions to acquire Russian assets, the parties were faced with the need to exclude the foreign link from the ownership chain.

**Sanction risks also create significant difficulties for Russian individuals investing in foreign assets.** These negative measures entail both the impossibility of direct settlements with counterparties and the risk of blocking the assets of Russian individuals abroad, which forces them to transfer foreign investments to friendly or neutral jurisdictions, or to abandon them altogether.

