ANALYSIS OF CURRENT ISSUES IN THE REGULATION OF MERGER AND ACQUISITION DEALS BY THE RUSSIAN LEGISLATION

Abstract. There is a lapse in the Russian corporate law governing merger and acquisition deals. This is striking as most processes of management streamlining and corporate efficiency boost are in a way related to these deals. Even the existing draft legislation on the issue has been designed to hinder reorganization processes and not facilitate them. It is unclear and controversial to an extent that any reorganization is highly likely to be considered unlawful.

It is clear that realities and related legal challenges require improvements in the regulation of merger and acquisition deals. Incompleteness and lack of detail in the Russian legislative provisions on regulation of M&A deals create a major obstacle for their execution in this country. A law on mergers and acquisitions should address two major issues: ensuring transparency and low cost of the processes involved and balancing the interests of owners and the state.

Incompleteness and lack of detail in the Russian legislative provisions on regulation of M&A deals create a major obstacle for their execution in this country: the absence of relevant regulatory acts and laws puts at risk the rights of companies taking part in merger and acquisition processes. That is why Russian owners conclude the majority of such deals within foreign jurisdictions.

The amendment of the Russian corporate legislation in line with modern standards and requirements should be moving on gradually but consistently, as it is necessary for today’s economic growth in Russia and the build-up of the Russian economics as an independent and sovereign entity in the global economic system.

аннотация. Российское законодательство, регулирующее сделки по слиянию и поглощению, содержит ряд пробелов. Это особенно ярко заметно на фоне того, что большинство процессов улучшения качества корпоративного управления и повышения эффективности работы в той или иной степени связаны с этими сделками. Даже те проекты законодательных актов, которые осуждаются сегодня, по сути своей будут затруднять, а не облегчать процессы реорганизации. Законодательство по данной теме настолько непрозрачно и противоречиво, что существуют значительный риск того, что незаконной можно признать любую сделку по слиянию и поглощению.

Очевидно, что реальности развития российской экономики требуют улучшения правового регулирования сделок по слиянию и поглощению. Неполнота и не проработанность законодательства на данную тему является препятствием для его применения. Закон о сделках по слиянию и поглощению должен обеспечивать решение 2 вопросов: обеспечение их правовой прозрачности и низкого уровня издержек на их осуществление вкупе с поддержанием баланса интересов владельцев бизнеса и государства.

Неполнота и недостаточная детализированность положений российского законодательства, регулирующего сделки по слиянию и поглощению создает основное препятствие для их осуществления в российской юрисдикции – отсутствие востребованных правовых норм и законов подвергает серьезному
risks to the company, participating in such transactions. This is why the main part of such transactions is the division of the asset and the acquisition of the company.

However, most processes of management optimization and improvement of efficiency in industries are somehow related to merger and acquisition deals, there is definitely a gap in the Russian legislation regarding the civil regulation of corporate mergers and acquisitions.

It is clear that practical realities and related legal challenges require improvements in the regulation of M&A deals.

This ‘improvement of regulation’ is aimed at optimizing civil law transactions in the area under consideration and at clarifying its conceptual framework that, in the current context, does not provide proper understanding of legal acts being part of M&A processes in Russia.

With regard to the matter under consideration, it is noteworthy that according to the legal definition established in the judicial practice, firstly, a reorganization may not be considered a deal, but is a way of the establishment or termination of companies (legal entities) specified by the Russian law². At the same time, it is recognized that any reorganization implies a complex set of facts³; and, secondly, that the Civil Code of the Russian Federation does not require drawing up any contracts when reorganizing a legal entity⁴.

Indeed, the stated legal definition is based on Article 57 of the Russian Civil Code, which, in particular, directly specifies that consolidation, joining, split-up, spin-off, and transformation are forms of reorganization of a legal entity, but a reorganization may involve two or more legal entities⁵.

At the same time, while considering the consolidation issues, we should take into account Federal Law No. 14-FZ On Limited Liability Companies dated February 8, 1998, article 52 of which states as follows: ‘3. Companies involved into a consolidation shall enter into a contract on consolidation which shall specify the procedure and terms of consolidation, the procedure for exchange of the shares in the authorized capital of each company for the shares in the authorized capital of the new company⁶. A similar provision is included in Federal Law No. 208-FZ On Joint-Stock Companies dated December 26, 1995 (article 16)⁷.

Thus, it seems possible to admit the contractual nature of consolidation of legal entities, which implies a complex set of facts due to preliminary activities (decisions taken by meetings of (members) shareholders) [4].

Mergers and acquisitions never fully meet the interests of the parties involved. They are rarely mutually consensual, they do not commonly involve market players with absolutely equal opportunities, as they are ‘directional’ deals involving a stronger company and a weaker one, the initiating party and another party being actually the ‘target’ of the deal.

That is why there is a set phrase ‘mergers and acquisitions’, in which only the first term (‘mergers’) is specified in the Russian legislation, but the second one – ‘acquisitions’ is not actually a part of the Russian

legal vocabulary with the term ‘joining’ being more preferred, but it does not seem to reflect the true nature of the processes almost always involving stronger and weaker companies [1,2].

The strong party and the weak party to the contract inevitably enter into micro- and macro-level conflicts that shall be regulated by law.

So, when carrying out a merger or an acquisition, the company shall establish the procedures, controls and standards for using this measure to balance all the interests.

The phrase ‘mergers and acquisitions’ is often used as a whole and corporate restruc turings are just called M&A deals lately. It is important to realize that ‘merger’ and ‘acquisition’ are radically different notions and imply different approaches to closing the respective deals and fulfilling all the conditions.

In case of a merger, two separate companies unite their efforts to create a new ‘joint’ legal entity that will have a new structure of ownership, management, which means that ‘senior management positions’ will be distributed among the ‘representatives’ of each joining legal entity in a certain proportion.

Acquisition does not imply mandatory establishment of a new legal entity, the most important is that one legal entity gains full direct or indirect control over the other entity.

Both processes have a great impact on the structure of assets and the management processes within the company.

Acquisitions usually have more negative consequences, while the legally recognized term to describe the procedures involved in this type of reorganization in Russia is ‘joining’. It gives a superficial understanding of the grounds, nature and aims of the economic processes behind these procedures.

Mergers may be classified into vertical and horizontal ones [3]. They are a certain alternative to internal investments helping to reduce the expenses. So, when a horizontal merger takes place, the two joining companies manufacture similar goods and (or) use the same markets. Such consolidations help companies increase their market share and diversify the range of products offered, which leads to the revenue growth.

In case of a vertical merger as compared to a horizontal one, companies do not aim at increasing their revenues. It is more important for them to enhance the efficiency and reduce the expenses, and that, consequently, will lead to an increase in profits. For instance, a merger of an end product manufacturing company with a company supplying the components and raw materials can be called a vertical merger. Such deals can really raise the competitiveness and efficiency by means of production and workflow synchronization.

But, in our opinion, there are ‘gaps’ in the regulation of these deals by the Russian law.

Firstly, the process of acquisitions should be given a clear definition and should be differentiated from the term ‘merger’ in the legislation as a failure to do that makes it impossible to define specific cases of organizational and economic integration as a merger or an acquisition, and to figure out whether it is friendly or hostile, as is case with illegal seizure. In the law enforcement practice, there have been cases when law enforcement bodies made different conclusions with respect to the ‘maliciousness’ of the parties’ conduct.

Mergers and acquisitions may influence rights and legally protected interests of the third parties, so the legislation shall provide for the prevention of unfair competition, market monopolization and social conflicts that may result from the use of M&A deals.

We can give some noteworthy examples from international practice showing the consequences that may arise from the lack of attention to these issues even in the countries where there is a much higher level of legislative coverage of M&A deals.

Thus, in mid-August 2011, HP completed the purchase of Autonomy, a British company dealing in software development for corporate customers and offering cloud computing services. Many experts noted that Autonomy was ‘highly overvalued’, the total price of the deal was a bit less than 10 billion US dollars.

However, in 2012, HP wrote down 8.8 billion US dollars stating that Autonomy’s management ‘used accounting improprieties, misrepresentations and disclosure failures’ to inflate the company’s value. HP also referred the matter to the US Securities and Exchange Commission’s enforcement division, and that entailed both a criminal and a civil investigation.

According to the court ruling, HP’s management was aware of Autonomy’s accounting practices before starting the consolidation process.

Here is another example. In 2013, Microsoft’s CEO Steve Ballmer saw new opportunities in purchasing Nokia, a Finnish mobile telephone company.

The deal was closed in 2014, but the purchase soon proved to be impractical. Microsoft spent 8 billion US dollars in vain on its experiment with Nokia. To make up for the losses, among other measures taken, it had to dismiss about 15,000 employees.

‘Terminology issues’ in regulating mergers and acquisitions have not been reflected and addressed in the Russian law up to now, which does not contribute to proper development and operation of corporate relations. In particular, due to the lack of legal framework covering these issues among other reasons,

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the Magna-Sberbank consortium failed to purchase 55% of Opel’s shares in 2009.

To solve these issues, it is certainly necessary to pay special attention to the experience of foreign countries in the legal regulation of M&A deals, especially to the practices applied by countries with the Anglo-Saxon legal system, as, to this date, they have established the most advanced and developed regulation of ensuing corporate relations.

Nowadays, the Russian legislation on reorganization of legal entities is primarily a part of the Russian Civil Code, a general codified regulatory act, then it has been included in the special legislation – federal laws, etc.

In general, the Russian legislation focuses more on the legal status of legal entities and procedures of their reorganization, rather than on protection of the interested parties’ rights.

Besides, in Russia, there is now no unified concept of legislation on consolidations and acquisitions, which causes a lot of social conflicts in practice. So, there has appeared a clear need to review the existing primary legislation on reorganization of legal entities.

The ideology of the existing draft legislation implies that the current legislation not only hinders reorganization processes, but leads (due to its imperfection, unclear and controversial nature) to a high risk of any reorganization now being considered unlawful.

At present, in the absence of the respective law, acquisitions and consolidations are regulated by the Competition Law through identifying, firstly, the impact of the deal on the competitive environment, and, secondly, the need for the Federal Antimonopoly Service’s involvement in the process. The Competition Law provides for identifying the revenue, the financial condition, the size of business and other figures related to the deal.

Foreign legal systems have a radically different approach to the matter. This can be explained by Russia’s small experience in regulation of mergers and acquisitions. In other countries, public bodies interfere with merger and acquisition processes using a wealth of best practices and a more elaborate theoretical background.

As a result, the current situation for the parties of corporate relations is that the same economic integration phenomenon may be interpreted in different ways depending on the level of interest of the parties in the deal which cannot be tolerated, as the rules of the market ‘game’ should be set in advance and should be clear, equal and unambiguous. Besides, absence of the clear legislative regulation certainly raises the corruption intensity of such deals.

Incompleteness and lack of detail in the Russian legislative provisions on regulation of M&A deals create a major obstacle for their execution in this country: the absence of relevant regulatory acts and laws puts at risk the rights of companies taking part in merger and acquisition processes. That is why Russian owners conclude the majority of such deals within foreign jurisdictions.

Given the above, we believe that a law on mergers and acquisitions should be adopted in order to address two major issues: ensuring transparency and low cost of the processes involved and balancing the interests of owners and the state. The amendment of the Russian corporate legislation in line with modern standards and requirements is moving on gradually but consistently, as it is necessary for today’s economic growth in Russia and the build-up of the Russian economics as an independent and sovereign entity in the global economic system.

References

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