OECD Russia Corporate Governance Roundtable

LEGAL ISSUES WITH ACQUISITION OF MAJOR STAKES IN RUSSIAN COMPANIES

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The purpose of this report is to present background information to participants of the OECD Russia Corporate Governance Roundtable organized for 25 and 26 October 2012 in Moscow, Russian Federation. The report addresses general background, the forms and methods of acquiring a controlling interest in companies. After a brief description of takeovers regulation in the OECD Corporate Governance Principles, legal frameworks in the European Union and USA, the report analyzes particular features of the regulations and current enforcement problems in the corresponding sector in Russia. It looks in some detail at the institution of the mandatory bid, the grounds for creating and dropping an obligation to issue a mandatory bid, the rights of minority shareholders, and ways to protect minority shareholders. A separate section of the report is devoted to the notion of squeezing out minority shareholders and to the problems which have arisen in Russia in relation to this institution. An analysis of the TGK-2 case provides a highly controversial example of acquisition regulations in force in Russia. The report also covers more general pressing issues specific to corporate governance in Russia, such as: specific matters associated with the interpretation and application of corporate law by courts, the powers of the financial market regulator, and their implementation. It offers various options to improve the institutions for major shareholding acquisition in Russia, and discusses ways to further develop enforcement practices and increase protection with regard to the rights of those involved in corporate relations.

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I. OVERVIEW OF ACQUIRING A CONTROLLING INTEREST IN COMPANIES

1.1. General background, forms, methods and advantages of acquiring a controlling interest in a company

1. Acquiring a controlling interest is usually understood to mean acquiring the possibility to govern the actions and decisions of a company. A controlling interest can be acquired in numerous ways, both directly and indirectly. The most widespread form of acquiring a direct controlling interest is by purchasing, on the basis of agreements with holders of securities, enough company shares with voting rights to make it possible to determine the actions or decisions of that company[1].

2. A person can acquire this number of voting shares in various ways: in particular, by acquiring shares on the basis of agreements with individual shareholders; acquiring shares on organised securities markets (at a stock exchange) or by issuing a public offering to acquire shares belonging to the remaining shareholders of the company in question.

3. Depending on whether the change in control is supported by the company's management or not, such acquisitions can be divided into friendly and hostile takeovers[2]. The management's opposition to the takeover is often reflected in actions undertaken by the management to prevent a change in control at the company ("poison pills" etc.). However, the actual distinction of the takeover in terms of a friendly or hostile takeover only has any practical significance in those countries with a dispersed shareholder equity structure, where, due to the extremely small size of the shareholding held by shareholders, it is in fact the management which exercises control over the company. But in those countries with a concentrated shareholder equity structure, including Russia, this distinction is of no practical significance, for actual control over the company is exercised by the controlling shareholder, while the management (constituted by the controlling shareholder) is in fact accountable to the controlling shareholder and essentially undertakes no independent actions.

4. A change in control at a company offers a range of benefits. Traditionally, they are summarised as follows:[3]

- A change in control at a company allows an ineffective leadership to be replaced. In this regard, the controlling shareholder is more able to change the company's management than other shareholders. Effective corporate management brings with it increased share value.

- The controlling shareholder is not only able to replace the company's management, but there is in fact an incentive to do so. A new controlling shareholder will receive a larger share of the company's profits, the value of which is largely dependent on the quality of the company's management.

- A change in control is advantageous to current shareholders. For example, the share acquisition price on the basis of a public offering often includes a premium in comparison with the market value of the company's shares. Accordingly, in the event of a change in control, shareholders have the opportunity to leave the company under more profitable conditions than if the change in control did not occur.

- The potential for a change in control serves as a stimulus for the current management to raise the quality of corporate governance. Thus, the management can prevent a change in control (and, correspondingly, losing their jobs) by maintaining high company share prices through competent and effective company management.

1.2. OECD corporate governance principles

5. OECD corporate governance principles establish fundamental rules which form a basis for establishing regulations to govern dealings related to the acquisition controlling interests. Firstly, legislation regulating the acquisition of controlling interests must be clearly worded and publicly available, so that investors understand their rights and the protection available to them. Secondly, deals must be concluded on equitable terms, which must protect the rights of all shareholders. Thirdly, the mechanisms to prevent company takeovers must not be used to protect the management from liability.

1.3. Regulating the acquisition of controlling interests in the European Union

6. Acquisitions of controlling interests in companies based in the European Union are regulated by Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids) (hereinafter referred to as the "Directive") and by the laws of those EU member-states which have implemented this Directive.

7. The Directive regulates the acquisition of controlling interests in companies whose securities are traded by a securities market operator (art. 1(1) of the Directive).

8. Generally speaking, the aims of this Directive are as follows[4]:

- protecting minority shareholders when a person acquires a controlling interest in the company by imposing an obligation on this person to issue a public offering to acquire shares;

- ensuring that minority shareholders are able to adopt an informed decision regarding the sale of shares owned by them to the offeror;

- ensuring that shareholders can decide of their own free will whether to sell shares owned by them without any form of coercion from the person acquiring the controlling interest;

- protecting those minority shareholders which have not accepted a public offering or have not disposed of shares owned by them when a person acquires a near-100% shareholding with voting rights.

9. The following sections describe how these objectives put forward by the Directive are achieved.

1.3.1. Protecting minority shareholders during the acquisition of a controlling interest

10. The Directive stipulates that any person who has independently or through actions in concert with other persons acquired a certain number of voting rights, taking into account the shares belonging to that person and those persons with whom concerted actions have been undertaken, is obliged to

make a public offering to the other holders of securities to acquire the shares belonging to them (art. 5 (1) of the Directive).

11. The amount (percentage) of voting rights which must be reached in order to give rise to the obligation to issue a public offering is determined by the national legislation of EU member states (art. 5 (3) of the Directive).

1.3.2. Ensuring that minority shareholders are able to adopt an informed decision regarding the sale of shares owned by them to the offeror

12. The Directive contains an array of provisions which seek to ensure that the person acquiring the controlling interest has provided complete and reliable information about the conditions of the proposal, so that each shareholder can adopt an informed decision regarding the sale of their shares.

13. The reason for this is, on the one hand, that the public offering is made to a large number of shareholders, for whom it is difficult, based on the information available to them, to make a reasoned conclusion regarding the validity or invalidity of the proposal. On the other hand, the offeror may provide incomplete or unreliable information about the conditions of the proposal.

14. In essence, these provisions state that:

- the person acquiring the controlling interest is obliged to issue a public offering to all the holders of the securities for which the public offering is being made (art. 6 (2), 5 (1) of the Directive);

- the public offering must provide any information required for the shareholders to adopt a reasoned decision regarding the sale of their shares. Article 6 (3) of the Directive provides a list of information which must be indicated in the public offer, which includes the intentions of the person acquiring the controlling interest with regard to the company and its employees;

- the company's board of directors is obliged to draw up and disclose its written opinion with regard to the conditions of this mandatory bid, including an assessment of the intentions of the person acquiring the controlling interest with regard to the company and its employees (art. 9 (5) of the Directive).

1.3.3. Ensuring that shareholders can decide of their own free will whether to sell shares owned by them

15. The Directive stipulates a range of guarantees aimed at ensuring that shareholders can decide of their own free will whether to sell shares owned by them without any form of coercion from the offeror.

16. These provisions boil down to (a) establishing deadlines for accepting a mandatory bid which would make it possible to adopt a reasoned decision regarding the sale of the shares, free from any coercion, and (b) establishing requirements which require uniform share acquisition conditions to be created for all shareholders, both within the context of a public offering and in other contexts. Otherwise the offeror would be able to influence shareholders by offering higher prices to those who agree to sell their shares by a certain time, i.e. faster than others.

17. According to the Directive, the deadline to accept a public offering is set by member states and must be between 2 weeks and 10 weeks after the issue date of the public offering (art. 7 (1)).

18. The proposal must be made under equitable share acquisition pricing terms (art. 5 (1)). In this regard, an equitable share acquisition price is understood to mean the highest price paid for the same securities by the offeror or by persons acting in concert with him/her, over a period, to be determined by member states, of between 6 months and 12 months before the proposal issue date (art. 5 (4)). If, after the proposal has been issued, the offeror or person acting in concert with him/her acquires securities at a higher price than the offer price, the offeror is obliged to increase his/her price so that it is not less than the highest price paid for the securities acquired (ibid.).

1.3.4. Protecting those minority shareholders which have not accepted the public offering or have not disposed of shares owned by them when a person acquires a near-100% shareholding with voting rights

19. The Directive states that a person acquiring a controlling interest is entitled to require the remaining securities holders to sell him/her their securities at an equitable price, if:

- the offeror holds securities representing at least 90% of the voting rights, or
- if, following acceptance of the bid, he/she has acquired or undertaken to acquire securities representing at least 90% of the voting rights.

20. In the first instance, member states may set a higher threshold, which must, however, be less than 95% of the voting rights (art. 15 (2)). Under the same conditions, a holder of securities is entitled to require the person acquiring the controlling interest to acquire their securities at an equitable price (art. 16 (2)).

1.4. Current problems associated with regulating the acquisition of controlling interests

21. Recent trends and problems which have arisen in regulating the process of acquiring major shareholdings can be taken from the example of the EU countries which have implemented the Directive on takeovers in their national legislation, as, firstly, the European mergers and acquisitions market is one of the largest in the world in terms of size and activity, and, secondly, it is in the EU that regulation of the controlling interest acquisition and transfer process is renowned for being developed in full.

22. Generally speaking, it is possible to discern two tendencies in the regulation of the controlling interest acquisition process in Europe. On the one hand, the development of regulations is, in the majority of instances, conducted through supplementing appropriate general provisions of the Directive, which is directly provided for by Article 3.2 (b). At the same time, European governments have been establishing special regulations which are not rooted in the Directive, but whose adoption is conditioned by the economic realities and problems of recent years, in particular, the global financial crisis. As we will see subsequently, many of the problems faced by European countries in this field are also applicable to Russia.

1.4.1. Establishing additional ownership thresholds for voting shares, which, when exceeded, give rise to an obligation to issue a public offering

23. Some governments have established certain legislative ownership thresholds for voting shares, which, when exceeded, give rise to an obligation to issue a public offering (for example, 30% and 50% of voting shares in Finland). Some other governments have stipulated in their domestic legislation that the obligation to issue a public offering arises once a certain number of, not just voting shares, but all company shares have been acquired (i.e. once a person has acquired a certain proportion of the company's share capital, including non-voting shares) (*France*).

1.4.2. Establishing additional guarantees to protect the rights of shareholders and ensure that they are able to adopt an informed decision regarding the sale of shares owned by them

24. The legislation of some states includes provisions aimed at establishing additional guarantees to protect the rights of minority shareholders during a change in control at a company.

25. In this respect, certain governments have made it obligatory for the directors of a company undergoing a change in control, alongside issuing recommendations regarding the public offering, to request an independent opinion (for example, from an investment bank) of the conditions of the proposal (*Great Britain*), even though the Directive does not directly stipulate such a requirement for boards of directors.

26. Furthermore, numerous governments have adopted provisions aimed at eliminating the uncertainty surrounding hearsay about a possible change in control at a company. According to such provisions, information about the *intention* to issue a public offering to acquire company securities must be disclosed, among other things (*France, Great Britain*).

27. Thus, in *France* information about the intention to issue a public offering is disclosed on the basis of an order from the securities market regulator (*AMF*), which must, if there are sufficient grounds to suggest that a person is preparing to issue an offering, order that person to disclose such information in a press release. If this person refutes the intention to issue a public offering, he/she will be unable to issue an offering for the next 6 months. In *Great Britain* any company undergoing a change in control is obliged to disclose information about the fact that it has entered into negotiations with a potential offeror. This information can be disclosed by the potential offeror him/herself. The company is then no longer obliged to disclose this fact itself.

1.4.3. Establishing additional criteria to determine an equitable share acquisition price under a public offering

28. Many EU member states have passed legislation establishing additional criteria to determine an equitable share acquisition price under a public offering.

29. Thus, certain governments have adopted provisions whereby the share acquisition price under a public offering must be more than the average price of such shares on the stock market for a particular period (*Germany, Austria, Italy and others*). Other countries have stipulated that in the event of any conflict of interests, the fairness of the share acquisition price must be corroborated by a report written by an appraisor appointed by the company undergoing the change in control (*France*).

1.4.4. Establishing additional guarantees for employees of companies undergoing a change in control

30. This policy to enhance regulation with regard to acquiring controlling interests is particularly topical, for, as stated in the Report on adoption of the Directive, 3/4 of surveyed workers at companies governed by the Directive believe that the Directive does not sufficiently protect their interests. In this regard, the legislation of some governments has incorporated provisions on the right to a works council, to consult with representatives of the offeror. During this consultation process, the offeror's representative is obliged to provide the works council with information about the offeror's intentions for the company and its employees. In turn, members of the works council are able to comment on this and ask questions. If the offeror does not fulfil his/her duty to participate in consultations with the works council then any shares belonging to the offeror will be stripped of their voting rights (*France, Belgium*).

31. It is important to note that the matter of establishing additional guarantees for employees is all the more topical for countries with advanced controlling interest acquisition regulations. At the same time, this problem is not so pressing for Russia, where so far the main problem itself – protecting the rights of company minority shareholders – has not even been resolved.

1.4.5. Allowing domestic companies to adopt measures to resist a change in control

32. Some governments are adopting measures to establish barriers to prevent foreign companies from acquiring a controlling interest in key domestic companies whose share prices have dropped considerably during the current economic crisis.

33. Such measures include, for example, increasing the number of votes needed to pass a decision to change the composition of a board of directors (*Hungary*), giving companies the right to postpone their annual general shareholders' meetings (*Italy*), etc.

34. In Russia, with a view to preventing foreign companies from acquiring controlling interests in strategic enterprises, the government has passed the Federal Law dated 29.04.2008 No. 57-F3 "On foreign investment in domestic companies of strategic importance to the security of the country and the protection of the state". This law states that any transactions bringing about certain effects must have been approved in advance by the appropriate state body. The application of this law to mandatory bids is discussed further below.

1.5. Peculiarities of regulating acquisitions of controlling interests in the USA

35. Acquisitions of controlling interests in the USA are governed by the Securities Exchange Act 1934, which has been supplemented by regulations on acquiring controlling interests, the Williams Act 1968, as well as state laws.

36. Federal legislation and the legislation of the overwhelming majority of states do not require a person acquiring a certain number if shares to issue a mandatory bid with regard to the acquisition of shares belonging to other shareholders. Such legislation also does not establish rights for that person to require other shareholders to sell their securities in the event of that person acquiring near-100% of the voting rights. There are also no provisions requiring this person to buy out all the shares belonging to shareholders at their request.

37. The key feature of regulating acquisitions of controlling interests in the USA lies in the fact that a person is entitled to make a voluntary bid, as a result of which the person can acquire a controlling interest over more than 5% of a certain type of securities, on the condition, however, that information is made available about the offeror him/herself, about the terms of the securities' acquisition and his/her plans for the company.

38. At the same time, legislation establishes certain guarantees regarding uniform conditions for the acquisition of shares from all shareholders.

1.5.1. Disclosing information about acquiring a controlling interest

39. If, as a result of a voluntary bid, a person acquires more than 5% of a certain type of securities, that person must issue an information disclosure statement (*Schedule TO disclosure statement*) to the Securities and Exchange Commission (SEC) and simultaneously send a copy of this statement to the company whose shares are being acquired by the person, as well as to the stock market where the shares are being traded (17 CFR para. 240.14d-3).

40. Then the offeror must make the bid known to the company's shareholders. This made be done by publicising the full text of the offer in a national newspaper, publishing the main substance of the offer and delivering the complete text of the document to those shareholders who have requested that a copy of the bid be sent to them, or delivering the complete text of the document to all shareholders (17 CFR para 240.14d-4).

41. The bid must state, in particular, information about the offer, including accounting for the last 5 years, and financial statements for the last 2 years; the purpose of the transaction, including plans to affiliate the company whose shares are being acquired, plans to sell its shares, change the dividend policy or composition of the board of directors, as well as plans to delist the company's shares (17 CFR para 240.14d-6(d), 17 CFR para 240.14d-100).

42. The deadline for accepting an offer is 20 working days from publication of the bid or delivery of the bid to the securities holders (17 CFR para 240.14e-1).

1.5.2. Uniform conditions for the acquisition of shares from all shareholders

43. Federal legislation in the USA requires uniform conditions to be established for all shareholders with regard to the acquisition of securities:

- the securities acquisition bid must be open to all holders of the class of securities subject to the acquisition offer (17 CFR para 240.14d-10(a)(1)).

- the share price paid to each shareholder disposing of shares in relation to the offer must be equal to the highest share acquisition price paid to any other shareholder disposing of shares in relation to the offer (17 CFR para 240.14d-10(a)(2)).

- if the shareholders have expressed their desire to sell a larger number of shares than the offeror wishes to purchase, the offeror must acquire shares from all the shareholders who have expressed their desire to sell them, proportionately to the number of shares each shareholder has declared that they wish to sell (17 CFR para 240.14d-8).

- no securities for which a bid has been made outside the scope of the offer may be acquired (17 CFR para 240.14e-5).

II. REGULATING THE ACQUISITION OF CONTROLLING INTERESTS IN RUSSIA

44. All dealings associated with the acquisition of major shareholdings are governed by a set of special regulations laid down in corporate legislation. These norms are set forth in Chapter XI.I of the Federal Law "On joint stock companies" ("The acquisition of more than 30 per cent of shares in an open joint stock company"), which was incorporated into this Law in 2006, more than 10 years after its adoption.

45. The scope of Chapter XI.I of the Federal Law "On joint stock companies" is limited to the acquisition of controlling interests in open joint stock companies. Nonetheless, the provisions of this law apply equally to those companies whose shares are traded on the stock exchange, and to those companies whose shares are not traded on the stock exchange.

46. A key authority in the regulation of corporate relations, including transactions involving the acquisition of controlling interests in joint stock companies, is the Supreme Arbitrazh Court of the Russian Federation (which specialises in commercial disputes), which has the power to adopt Plenary Resolutions and Informational Letters of the Presidium of the Supreme Arbitrazh Court of the Russian Federation on questions of judicial practice. These instruments explain, in particular, the procedure for administering the Federal Law "On joint stock companies" by standardising judicial practice for litigation in this field. At the present time the Supreme Arbitrazh Court of the Russian Federation has been preparing a draft Informational Letter of the Russian Supreme Arbitrazh Court Presidium which explains specific issues associated with the application of Chapter XI.I of the Federal Law "On joint stock companies" (hereinafter referred to as the draft Informational Letter of the Russian Supreme Arbitrazh Court). There are plans for this draft Informational Letter of the Russian Supreme Arbitrazh Court to form a basis for a Plenary Resolution of the Russian Supreme Arbitrazh Court on questions of this nature. At the time of writing, this Resolution has not yet been adopted.

47. There are also attempts currently to make amendments to Chapter XI.I of the Federal Law "On joint stock companies" itself. In this regard, the Russian Federal Financial Markets Service (hereinafter referred to as FFMS Russia) has prepared a draft bill which aims to refine and clarify the provisions of the Federal Law "On joint stock companies" with regard to acquiring controlling interests, having on several occasions proposed more precise wordings, and having also resolved numerous issues which were not covered in the current version of the law or in judicial practice (hereinafter referred to as the FFMS Draft Bill).

2.1 Main provisions of the Federal Law "On joint stock companies", in particular with regard to regulating the acquisition of major shareholdings

48. The regulation of controlling interest acquisition in the Federal Law "On joint stock companies" has, generally speaking, the same aims as controlling interest regulation in the European Union.

49. Thus, just like the Directive, the section of the Federal Law "On joint stock companies" on regulating controlling interest acquisitions seeks to protect minority shareholders by establishing an obligation to issue a mandatory bid; it seeks to ensure that minority shareholders are able to adopt a reasoned decision with regard to the sale of their shares; it ensures that shareholders are able to choose of their own free will whether to sell their shares; and it also protects minority shareholders who have not accepted a mandatory bid from a offeror acquiring a near-100% majority shareholding.

2.1.1. Protecting minority shareholders during the acquisition of a controlling interest

50. The central provision of chapter XI.1 of the Federal Law "On joint stock companies" is the obligation to issue company shareholders with a mandatory bid to acquire their securities in the event that the offeror surpasses a certain threshold for ownership of voting shares in a company.

51. This obligation is similar to the provision set forth in art. 5 (1) of the Directive. This obligation arises when a person acquires more than 30, 50 or 75 per cent of the total number of ordinary and preferred shares with voting rights in an open joint stock company (point 1, art. 84.1, point 1, 7, art. 84.2 of the Federal Law "On joint stock companies"). For this, when deciding whether the stipulated threshold has been surpassed or not, not only those shares which belong to the offeror him/herself are taken into account, but also those of his/her affiliates are also considered.

52. The Law lays down the consequences of a person failing to comply with this obligation to issue a mandatory bid. Thus, as soon as more than 30, 50 or 75% of the total number of shares is acquired and up to the actual date on which the mandatory bid is issued to the company in accordance with the law, the offeror and his/her affiliates are only entitled to vote on the basis of those shares corresponding, as appropriate, to 30, 50 or 75% of the total number of shares. In this respect, all remaining voting shares belonging to this person and his/her affiliates are not considered and are not taken into account for the quorum (point 6, art. 84.2 of the Federal Law "On joint stock companies").

2.1.2. Ensuring that minority shareholders are able to adopt an informed decision with regard to the sale of their shares to the person acquiring a controlling interest

53. The Federal Law "On joint stock companies" contains numerous guarantees aimed at ensuring that shareholders receive complete and reliable information about the conditions of a bid, so that each shareholder can make an informed decision with regard to the sale of their shares.

- The mandatory bid must be issued to all shareholders – to holders of any remaining shares of the relevant category (type) and to holders of equity securities converted into such shares. Consequently, the offeror is obliged to submit a mandatory bid to the company (point 1, art. 84.2, point 1, art. 84.3 of the Federal Law "On joint stock companies"), which, in turn, within 15 days from receipt of the mandatory bid, is obliged to forward it to all securities holders affected by the bid (point 2, art. 84.3 of the Federal Law "On joint stock companies").

- The law sets requirements for the information which must be provided in the mandatory bid. In this respect, the mandatory bid must indicate the name of the offeror, the number, category and type of shares which belong to the person and to his/her affiliates, the acquisition price of the shares, as well as information about the transfer procedure for the securities and payment. At the same time, it would seem that the guarantees provided for by the Federal Law "On joint stock companies" are weaker than those stipulated by the Directive. In this respect, it is not obligatory to state in the mandatory offer the intentions of the person acquiring the controlling interest with regard to the company and its employees, in contrast with the regulations stipulated in the Directive, and it is in fact left to the offeror's discretion whether to provide this information.

- An important guarantee for shareholders is that if the market value of the securities is assessed by an independent appraisor (see below), a copy of the independent appraisor's report on the market value of the securities being purchased must be attached to the mandatory bid sent to the company. In this instance the company is obliged to provide shareholders receiving the mandatory bid with a copy of the substantive provisions of this report, and at the same time grant securities holders access to the complete report text in accordance with legislative provisions on providing shareholders with corporate documentation (point 2, art. 84.2 of the Federal Law "On joint stock companies").

- The company's board of directors is obliged to make recommendations in relation to the received bid, which must include an assessment of the proposed acquisition price of the securities and any potential change in their market value after the acquisition, and an appraisal of the intentions of the offeror with regard to the company and its employees. These recommendations must be sent to company shareholders together with the mandatory bid itself, i.e. within 15 days of the company receiving the bid (see above) (points 1, 2, art. 84.3 of the Federal Law "On joint stock companies").

54. It is worth noting that current legislation does not require a board of directors to request an opinion from an independent person (for example, an investment bank) with regard to the conditions of the offer when drawing up the recommendations concerning the mandatory bid.

2.1.3. Ensuring that shareholders are able to choose of their own free will whether to sell their shares

55. The Federal Law "On joint stock companies" establishes a range of guarantees aimed to ensuring that shareholders are able to choose of their own free will whether to sell their shares, without any form of coercion from the offeror.

56. These provisions, just as in the Directive, boil down to (1) establishing deadlines for accepting the mandatory bid which would make it possible to adopt an informed decision with regard to the sale of shares and (2) establishing a requirement to create uniform conditions for the acquisition of shares across all shareholders, both within the context of a mandatory bid and outside the scope of such a bid.

57. According to the Federal Law "On joint stock companies" the deadline for accepting a mandatory bid is set by the bid itself and must be between 70 and 80 days from the time that the company receives the mandatory bid (point 2, art. 84.2 of the Federal Law "On joint stock companies").

58. A mandatory bid must establish uniform share acquisition conditions for all shareholders.

59. Moreover, the share acquisition conditions must be identical within the context of the mandatory bid and outside the scope of a bid. Legislation does not establish any form on ban on the acquisition of shares outside the scope of a mandatory bid. However, the offeror cannot, prior to the mandatory bid acceptance deadline, acquire shares subject to a mandatory bid under conditions which are different to those set forth in the bid itself (point 1, art. 84.2 of the Federal Law "On joint stock companies").

60. The Federal Law "On joint stock companies" sets a requirement to determine the share acquisition price on the basis of a mandatory bid. This procedure is dependent on whether the shares being acquired are being traded on the stock exchange.

61. In this respect, if the shares are being traded on the stock exchange, then their acquisition price must be more than their weighted average price determined on the basis of the trading results of the securities market operator over the six months prior to the date on which the mandatory bid was submitted to the federal executive body (point 4, art. 84.2 of the Federal Law "On joint stock companies"). If the shares are not being traded on the stock exchange, then their acquisition price cannot be lower than their market value as determined by an independent appraisor (ibid.). As noted above, the independent appraisor's report must be attached to the mandatory bid sent to the company.

62. The acquisition price of securities on the basis of a mandatory bid must be more than the highest price paid by the offeror or his/her affiliates for the same securities as part of a transaction concluded within the 6 months prior to the date on which the mandatory bid was sent to the company (point 4, art. 84.2 of the Federal Law "On joint stock companies").

63. The shares must be paid for with money or other securities. The right to choose the payment method lies solely with the seller of the shares (point 5, art. 84.2 of the Federal Law "On joint stock companies").

64. The offeror's obligation to pay for the shares is secured against a banker's guarantee, which must be attached to the mandatory bid (point 3, art. 84.2 of the Federal Law "On joint stock companies"). This guarantee must stipulate the obligation of the guarantor to pay the former holders of the securities the price of the sold securities in the event that the offeror fails to comply with his/her obligation to pay for the acquired securities on time. This banker's guarantee must be irrevocable, and the validity period must run for at least 6 months after the deadline to pay for the acquired securities, as stated on the mandatory bid.

2.1.4. Protecting minority shareholders who have not accepted a mandatory bid or have not disposed of their shares when a person acquires a near-100% major shareholding

65. The Federal Law "On joint stock companies" states that any person who, as a result of a voluntary bid to acquire all the voting shares of a company or a mandatory bid, has come to hold more than 95% of the total number of voting shares at a company, taking into account the shares belonging to that person and to his/her affiliates, is obliged to buy out the voting shares belonging to any other shareholders at their request (point 1, art. 84.7 of the Federal Law "On joint stock companies").

66. For this, the person acquiring the controlling interest is obliged to send a notice to any holders of securities who have the right to request a buy-out of their securities to inform them of this right.

67. The buy-out price must meet the same requirements as the securities acquisition price on the basis of a mandatory bid. However, for the buy-out price of shares when the person is acquiring more than 95% of a company's voting shares, there are additional requirements, in particular, that the buy-out price must not be lower than the price at which such securities had been purchased on the basis of a voluntary or mandatory bid resulting in the offeror coming to hold more than 95 per cent of the voting rights, or the price at which the securities were acquired after the deadline to accept this voluntary or mandatory bid (point 6, art. 84.7 of the Federal Law "On joint stock companies").

2.1.5. Squeeze-outs of minority shareholders by a person who has acquired in excess of 95% of voting shares

68. The acquisition by any person of more than 95% of the voting shares in a company also results in the offeror having the right to buy-out the remaining voting shares held by other shareholders (art. 84.8 of the Federal Law "On joint stock companies"). The buy-out price is determined according to the same regulations as the price to acquire shares from remaining shareholders at their request.

69. In order to ensure that the person intending to establish complete control over a company cannot increase the size of his/her shareholding covertly or in instalments, the law has laid down a requirement that squeeze-outs can only be carried out by a person who has reached the 95 per cent threshold on the basis of a voluntary bid to acquire all the company's shares or as a result of a mandatory bid.

70. A person is entitled to send a request to buy-out securities belonging to other shareholders if, as a result of the acceptance of a corresponding voluntary or mandatory bid, that person has acquired at least 10 per cent of the total number of voting shares at the company in question.

2.2. Main provisions of the draft Informational Letter of the Russian Supreme Arbitrazh Court Presidium on mandatory bids

71. The provisions of the draft Informational Letter of the Russian Supreme Arbitrazh Court Presidium will be examined in further detail below in the context of specific problems arising during the acquisition of major shareholdings. Without going into details, the amendments put forward by the Russian Supreme Arbitrazh Court to the acting regulations boil down to the following:

- making it a specific obligation to issue a mandatory bid when acquiring an indirect controlling interest over a company;

- significantly broadening the ways to protect the rights of holders of disposable securities in the event that the person acquiring the controlling interest violates the provisions set forth in Chapter XI.I of the Federal Law "On joint stock companies";

- giving the offeror and shareholders the opportunity to conclude shareholder agreements;

- clarifying the procedure for courts in terms of applying certain exclusions from the obligation to issue a mandatory bid;

- examining specific disputes which arise when enforcing regulations on mandatory bids;

- clarifying provisions on the process for a person who has acquired in excess of 95 per cent of the voting shares at a company to squeeze out minority shareholders from that company;

- introducing provisions aimed at suppressing instances of abuse which have occurred through application of the current version of the Federal Law "On joint stock companies" (in particular, instances of abuse associated with the failure to comply with the obligation to issue a mandatory bid, underestimating share acquisition prices etc.).

2.3. Main provisions of the FFMS Draft Bill to make amendments to chapter XI.I of the Federal Law "On joint stock companies"

72. Due to the fact that the provisions of the FFMS Draft Bill will not receive special coverage, in contrast with the draft Informational Letter, the adoption of which, in one form or another, is expected to take place before the end of the year, we will now try to highlight the changes proposed by the Draft Bill.

2.3.1. Measures are to be adopted to broaden the scope of circumstances where there is an obligation to make a mandatory bid

73. The Draft Bill links the rise of an obligation to issue a mandatory bid with **the acquisition of the right** to independently, or in concert with affiliated persons, dispose of a certain number of voting shares beyond the defined threshold (point 1, art. 84.2 of the Draft Bill), and not with **the acquisition of the shares**, as stipulated by the legislation in its current form. This means that it is possible to transfer the obligation to issue a mandatory bid, including when acquiring a controlling interest by indirect means, without directly acquiring the shares (for example, by acquiring depositary receipts).

74. To solve this issue surrounding the creation of the obligation to make a mandatory bid, the Draft Bill proposes assessing the number (percentage) of voting shares held by the person acquiring the controlling interest together, not with his/her affiliates, but with his/her associates. This proposal for amendments to the law has come about as very few true mutual associates appear on the legally established list of affiliates. This, in turn, means that it is possible to get around the regulations on mandatory bids and therefore avoid having to send them in instances where the controlling interest is held by mutual associates, even though they are not formally affiliated. This concept of associates is used by the Draft Bill and applied to regulating voluntary bids, as well as the right to request a buy-out and forced buy-outs for acquisitions of controlling interests representing more than 95% of the voting rights.

2.3.2. The deadline for issuing a mandatory bid is to be extended

75. The Draft Bill extends the deadline for issuing a mandatory bid up to 50 days from acquisition of the right to dispose of the relevant number of voting shares exceeding the corresponding threshold (current legislation has established the deadline for issuing a mandatory bid at 30 days from the date on which the person is credited with the corresponding number of shares).

2.3.3. New regulations are to be established for failure to comply with the obligation to issue a mandatory bid

76. In this regard, a mechanism to buy-out shares at the initiative of minority shareholders has been established for instances when the majority shareholder has failed to issue a mandatory bid (point 12, art. 84.2 of the Draft Bill). Those securities holders which should have been subject to a mandatory bid are entitled to request that the majority shareholder buy-out the securities held by minority shareholders. This request must be submitted within one year from when the securities holder became aware of his/her right to request a buy-out of his/her securities (point 2 of the Draft Bill).

77. The Draft Bill establishes **a procedure for determining the price** of securities being acquired in the event of the mandatory bid being sent to the federal executive body for securities markets after the mandatory bid deadline (point 8, art. 84.2 of the Federal Law "On joint stock companies"). In this instance, the price of the securities being acquired is to be the higher of the two following amounts: the weighted average price determined on the basis of trading results from the securities market operator for the 6 months prior to the date on which the mandatory bid was submitted to the federal executive body for securities markets, or the weighted average price determined on the basis of the trading results of the securities market operator for the 6 months prior to the deadline stipulated in point 1 of the article mentioned above. Currently, before the Draft Bill is adopted, there is no procedure in place to determine the price in such an instance.

78. The remainder of the Draft Bill is devoted, in essence, to refining and clarifying the current version of the Federal Law "On joint stock companies".

79. In this regard, the current law is supplemented by requirements in terms of the content of mandatory bids (they must provide information about the authorised body's decision regarding preliminary approval for the acquisition of a controlling interest etc.), and there are more detailed requirements in terms of the content of applications to sell securities, requirements to buy-out securities etc.

III. MANDATORY BID (LAW ENFORCEMENT ISSUES)

3.1. The acquisition of depositary receipts as a trigger for the obligation to issue a mandatory bid. Other means of "indirect" share acquisition.

80. According to the wordings of point 1, art. 84.1 and point 1, art. 84.2 of the current version of the Federal Law "On joint stock companies", the obligation to issue a mandatory bid is bound only to the outright acquisition by a person of voting shares in an open joint stock company. At the same time, besides the direct acquisition of shares, control over votes can be established other ways which are not covered by the existing wording of the law.

3.1.1. The acquisition of depositary receipts

81. The most striking example of the described situation is the acquisition of securities from a foreign issuer, released in accordance with foreign laws and certifying rights over the shares of a Russian company ("a depositary receipt"). It is clear that ownership of depositary receipts makes it possible for a person to effectively exercise the same control over the particular number voting shares as if he owned the same shares in the open joint stock company directly.

82. In this regard, one notes that the lack of a requirement at the present time in terms of issuing a mandatory bid for a person who has acquired the ability to dispose of more than 30, 50 or 75 per cent of voting shares in a joint stock company through the acquisition of depositary receipts is an obvious way to circumvent those provisions relating to the institution of the mandatory bid which are directed, primarily, at a person acquiring a certain level of control over a company, and not at the actual means by which this is achieved.

83. The significance of the problem noted above is intensified by the fact that in the near future, regulations are due to come into force which abolish the quantitative limit on the number of depositary receipts released by a specific issuer, in relation to which, these depositary receipts will potentially become a way to certify the ownership rights of their holders over 100 per cent of the shares in an open joint stock company.

84. This existing gap in current legislation can be remedied in two ways. Firstly, amendments can be made to point 1, art. 84.1 of the Federal Law "On joint stock companies", replacing the wording of this point *"acquire more than 30 per cent of the total number of ordinary shares and preferred shares of an open joint stock company"* with the wording *"obtain the right to directly or indirectly dispose of more than 30 per cent of the total number of votes attached to the ordinary and preferred shares of an open joint stock company"*, which in all likelihood will make it possible to cover all instances where indirect control is established over a company. The second approach allows us, without making any changes to the existing rule of law, to adjust its enforcement by Arbitrazh Courts. Thus, in point 14 of the draft Informational Letter of the Russian Supreme Arbitrazh Court, there are proposals to settle cases directly where indirect control has been established, including through the acquisition of depositary shares, entailing the obligation to issue a mandatory bid.

3.1.2. Acquiring the ability to determine the members of the supreme management bodies of a company

85. This situation of establishing an indirect controlling interest is also mentioned in the draft Informational Letter as one which gives rise to issuing a public offering. In spite of the fact that it is certainly important to consider the person's decisions with regard to the composition of a company's managerial bodies, as a means for this person to govern the decisions of the company, it still seems that the reference to this circumstance as giving rise to the obligation to send a mandatory bid is irrelevant, insofar as this option does not arise by itself, but rather from the actual direct or indirect controlling interest over a specified number of votes in the company.

86. Moreover, it must be noted that the terms used by the Russian Supreme Arbitrazh Court, *"appointment of a person to a management body of a company"*, firstly, is in itself inaccurate, and, in any case, should be replaced with the term *"election"*, and secondly, the wording used by the Russian Supreme Arbitrazh Court covers a situation where just one person is elected to a collective body, which, evidently, has nothing to do with control as a means to determine the actions and decisions of a

company. It should also be noted that the majority of foreign legal systems do not legislate for such a basis.

3.1.3. Acquiring a direct or indirect controlling interest over a company which owns shares in an open joint stock company

87. In this instance, the controlling interest over a company is acquired not directly, by acquiring its shares, but by establishing control over a company which has a major shareholding in the company in question.

88. Given that the current version of the Federal Law "On joint stock companies" does not stipulate any other means of establishing a controlling interest over votes, besides acquiring the shares of the target company, this situation continues to be an effective means to circumvent the obligation to issue a mandatory bid. There are plans to eliminate this flaw in the draft Informational Letter of the Russian Supreme Arbitrazh Court.

3.1.4. Acquiring a controlling interest as a result of actions in concert

89. Faced with the existence in current Russian legislation of very narrow criteria for affiliation and the inclination of the courts to interpret these criteria relatively formally, the matter of bad faith persons evading their obligation to issue a mandatory bid continues to be a question of their ingenuity without there being any chance of combating this type of abuse.

90. In this respect, the provisions of chapter XI.I of the Federal Law "On joint stock companies", even taking into account the aforementioned draft explanations of the Russian Supreme Arbitrazh Court with regard to its application, do not cover the breaking up of a unified controlling shareholding between formally unassociated persons who, on the basis of certain arrangements or by virtue of some form of control over them, actually own the shareholding on behalf of another specific person. Similarly, it is possible that a few independent shareholders could collude with one another and, acting in concert, increase the size of their shareholding with a view to gaining corporate control at the company.

91. The way forward is either a radical reform of the provisions governing affiliation and control in current Russian legislation, which would make it possible to immediately address the entire range of problems across numerous institutions in corporate governance, or, with regard to the situation under discussion, a direct provision stating that the obligation to issue a mandatory bid arises for any person whose actions in concert are suggestive of a joint controlling interest over more than 30, 50 or 75 per cent of the voting shares in the relevant company. By way of an example of such a regulation, there is the concept of "parties acting in concert" as set forth in the EC Directive discussed above.

3.2. The fate of the mandatory bid obligation in the event of a reduction in size of a person's shareholding to below the statutory threshold of 30, 50 or 75 per cent of shares in a company

92. Chapter XI.1 of the Federal Law "On joint stock companies" does not lay down any consequences for disposal, by a person obliged to issue a mandatory bid, of shares resulting in that person's share falling below the statutory threshold of 30, 50 or 75 per cent of the shares, as appropriate.

93. In practice, there have been many cases where this gap in current regulation has allowed numerous majority shareholders who have acquired a controlling shareholding in a particular company

to subsequently distribute this shareholding between factually subordinate, but not formally associated persons, as a result of which the share of each of the group's members has not exceeded the 30, 50 or 75 per cent threshold, thereby meaning that the majority shareholder him/herself has evaded his/her obligation to issue a mandatory bid by making reference to the subsequent sale of the shares and the resulting termination of his/her obligation.

94. The mechanism described above is abusive, as it is clear that the subsequent sale of a shareholding is often associated, not with the replacement of its actual owner, but with the change in the ownership structure within one group. In view of the fact that, as described above, the Russian courts profess a highly formal approach to the concept of affiliation and groups of persons, recognising the presence of a link between the subjects only in the event of a mutual interest in each other's share capital or the coincidence of a certain number of people in management bodies, proving abuse on the part of the person acquiring the major shareholding and obligating that person to issue a mandatory bid for the holding in the situation described above has been simply impossible.

95. This problem has been touched on in the draft Informational Letter of the Russian Supreme Arbitrazh Court (point 1), which has put forward for discussion 3 alternative consequences for a person reducing his/her shareholding below the statutory threshold:

- termination of the obligation to issue a mandatory bid;
- termination of the obligation to issue a mandatory bid if the reduction of the person's shareholding occurred prior to the 35-day deadline during which the person is obliged to deliver the mandatory bid to the open joint stock company;
- the obligation to issue a mandatory bid retains.

96. In view of the foregoing, in the current realities of the Russian system the third approach seems to be the most reasonable solution[5]. It is also linked to the following.

97. Firstly, parties to civil law transactions, acting with due diligence and in good faith, control the size and composition of the shares that they own. In relation to this, the "chance" acquisition by one person (several affiliated persons) of more than 30% of the shares in an open joint stock company is unlikely and should not remain unnoticed for such a person (such persons). Therefore, this person (the several affiliated persons) should become aware of the consequences of their actions, as a result of which he/she (they) have obtained the right to control a major shareholding, and bear the risks that these shares bring. In this regard, these persons are not deprived of their ability to set up a corporate governance system for their group to simplify checks on transactions concluded by the group's participants, and to rule out the possibility of a chance build-up, under the group's control, of more than 30% of the shares in a particular company.

98. Secondly, reinforcement of the principle whereby the obligation to issue a mandatory bid passes to another person when a major shareholding is disposed of cannot possibly satisfy the interests of the remaining company shareholders. Given that the price at which the major shareholding was sold to its subsequent buyer may be lower than the price at which those shares were acquired in the first place, in order to issue a mandatory bid, it will be this later, lower price which will be taken into account.

99. Thirdly, regardless of the amount of time the person (several affiliated persons) have owned the major shareholding, that person has been able to exercise his/her rights ensuing from this ownership, as well as to influence the actions and decisions of the company's management bodies.

3.3. The ability of minority shareholders to force the person acquiring a major shareholding to issue a mandatory bid

3.3.1. The problem of the right to bring action

100. Besides the indication that failure to comply with the obligation to issue a mandatory bid entails limits on the voting rights associated with those shares above the defined threshold and the imposition of an administrative fine, legislation does not contain any provisions whatsoever regarding accessible means for minority shareholders to force a person to fulfil his/her entrusted obligation to buy-out shares.

101. Until very recently, Arbitrazh Courts, headed by the Russian Supreme Arbitrazh Court, have stuck to the formal approach, denying securities holders the opportunity to institute legal action to force a person to issue a mandatory bid, on the grounds that besides that which is stated above, *"no other consequences for failure to comply with the obligation laid down in point 1 of Article 84.2 of the Law, including the possibility of shareholders presenting a demand for the issuing of a mandatory bid, are currently provided for by current legislation"* (see Ruling of the Russian Supreme Arbitrazh Court dated 25.08.2009 No. VAS-9041/09 in respect of case No. A41-10327/08, Ruling of the Russian Supreme Arbitrazh Court dated the 18.09.2009 No. VAS-11766/09 in respect of case No. A08-3197/2008-29)[6].

102. Yet, in May 2012, when examining a case, the Russian Supreme Arbitrazh Court adopted the exact opposite view[7]. It is thought that the approach adopted by the Russian Supreme Arbitrazh Court with regard to the assessment of a similar situation will change after the implementation of point 5 of the draft Informational Letter of the Russian Supreme Arbitrazh Court, which contains a direct instruction that *"in the event that a person who has acquired more than 30, 50 or 75 per cent of the total number of shares in an open joint stock company fails to comply with his/her obligation to issue a mandatory bid, the holders of the securities are entitled to bring a claim in court to petition for said person to be obliged to fulfil his/her obligation as set forth in Article 84.2 of the Law on joint stock companies"*.

3.3.2. The problem of guaranteeing payment for the securities

103. For minority shareholders, the official consolidation of their ability to initiate such legal action is not sufficient in and of itself to guaranteeing an effective procedure to oblige a person who has acquired a major shareholding, and who is avoiding issuing a mandatory bid, to actually pay minority shareholders for their shares. Consequently, the next section raises the question about the mechanism in place to guarantee payment for the purchased shares.

104. As a more general way to guarantee payment for securities put up for sale, the Federal Law "On joint stock companies" advocates the use of a banker's guarantee, which should be attached to the mandatory bid and which makes it possible for shareholders, in the event that the debtor refuses to pay for the shares, to still receive the funds owed to them from a third person – a bank or an insurance company. At the same time, such an approach cannot work in a situation where the person shirking his/her obligations is ordered to issue a mandatory bid by a court ruling.

105. In its draft Informational Letter, the Russian Supreme Arbitrazh Court did not focus on this problem, stating only that the absence of a banker's guarantee does not preclude the settlement of a claim to require the issuing of a mandatory bid. However, the absence of a banker's guarantee, in the situation in question, which, in the event of the debtor shirking his/her obligation to pay, is the only means for the securities holders to receive the funds owed to them, significantly reduces the amount of protection accorded to their rights and the likelihood of achieving their main aim through a mandatory bid – exercising their right to withdraw from the company.

106. One of the ways to resolve this problem is by broadening the scope of the restrictions set forth in the Federal Law "On joint stock companies" with regard to voting rights on those shares exceeding 30, 50 or 75 per cent of shares in an open joint stock company for the period prior to the actual fulfilment of the obligation to pay for all the holders' securities put up for sale (on the basis of a corresponding court ruling) to a person who has acquired 30, 50 or 75 per cent of the total number of shares in an open joint stock company, as well as to his/her affiliates.

107. The mechanism proposed above is in keeping with the literal interpretation of the law, insofar as the person subject to the court ruling has not issued a mandatory bid with an attached banker's guarantee, and with the essence of the mandatory bid, insofar as the right of minority shareholders to withdraw from a company has not, in reality, been guaranteed.

108. Moreover, provisions can be made such that the joint obligation to pay for the acquired securities, based on a mandatory bid ensuing from a court ruling, is to be assumed both by the person stipulated in the point of article 84.2 of the Law on joint stock companies, and by his/her affiliates with whom more than 30, 50 or 75 per cent of the shares in an open joint stock company have been acquired.

3.4. The possibility of recall of the mandatory bid by the person who sent it

109. In accordance with point 2, art. 84.2 of the Federal Law "On joint stock companies", the mandatory bid is considered to have been made to all holders of the corresponding securities with effect from its delivery to the joint stock company. It is from this precise moment that the period starts during which the securities holders are entitled to accept the mandatory bid and put forward their shares for sale.

110. Currently, both in terms of legislation and court practice, there is a lack of understanding of the options available to participants in corporate relations when, after the issuing of a mandatory bid, the number of shares belonging to the person who sent the mandatory bid turns out to be less than the value of the statutory threshold.

111. Such a situation can arise in two instances:

- when the person who sent the mandatory bid disposes of all or part of his/her shareholding;
- when a transaction causing the person's shareholding to fall below the value of the statutory threshold is recognised as invalid.

112. The problem described above is currently being discussed by the Russian Supreme Arbitrazh Court, which has proposed the following approaches to resolve the issue, as set forth in its draft Informational Letter.

113. With regard to situations where the number of shares belonging to the person who sent the mandatory bid falls below the statutory threshold as a result of his/her disposal of such shares, the Russian Supreme Arbitrazh Court has adopted a simple position: this occurrence cannot, in and of itself, be viewed as grounds for exemption from the obligation to buy-out shares from those persons who accepted the mandatory bid.

114. At the same time, in the event that the threshold is crossed in the opposite direction as a result of a transaction to acquire shares being recognised as invalid, the Russian Supreme Arbitrazh Court proposes the following alternatives:

- the fact that a share acquisition transaction is recognised as invalid should not serve as grounds for exemption from the obligation to buy-out shares from those persons who accepted the mandatory bid;

- the person acquires the right to recall the mandatory bid up to the acceptance deadline;

- in the event that the transaction is recognised as invalid under circumstances beyond the control of the person obliged to issue the mandatory bid, the sale and purchase agreement with those persons who accepted the mandatory bid is to be considered unconcluded.

115. Taking into account the circumstances set forth in point 3.2 of this report, the most expedient way out of this situation would appear to be the third conceptual approach with the following change to its content: if, after a mandatory bid has been issued, a transaction giving rise to a person being obliged to issue a mandatory bid has been recognised as invalid (unconcluded) for circumstances beyond the control of this person, and equally beyond the control of his/her affiliates, as well as if the corresponding securities are reclaimed from the corresponding person pursuant to Article 302 of the Civil Code of the Russian Federation (reclamation of property from a *bona fide* purchaser), as a result of which the size of the shareholding belonging to that person has fallen below the statutory threshold, the issued mandatory bid may be recalled up to the acceptance deadline.

116. A similar change to the concept as proposed by the Russian Supreme Arbitrazh Court is based on the following:

- the ability to recall the issued mandatory bid, in comparison with the concept of unconcluded agreements proposed by the Russian Supreme Arbitrazh Court, establishes a fair balance between the interests of the person who issued the mandatory bid, and the interests of those who accepted it, as well as helping to preserve the stability of civil law transactions;

- given that the recognition of an agreement forming the basis for a person acquiring a major shareholding as unconcluded in reality brings about the same effects as the reclamation of shares from a person who issued a mandatory bid, as well as the recognition of an agreement as invalid (in every case the person ceases to be the owner of the shares), it has been proposed that all the aforementioned instances be enumerated in the concept;

- since a transaction to acquire securities may be rendered invalid due to circumstances beyond the control of the person acquiring the securities, or beyond the control of his/her affiliates who have not directly acquired the securities, it has been proposed that the corresponding gap be filled by supplementing the wording.

3.5. Determining the price at which a person who has issued a mandatory bid must buy securities from their holders (the influence of delisting and a dip in quotations on price determination)

117. The procedure for determining the price at which a person who has issued a mandatory bid must buy securities from their holders is set forth in point 4 of art. 84.2 of the Federal Law "On joint stock companies":

- the price of the securities being acquired on the basis of a mandatory bid must be greater than their average-weighted price determined on the basis of trading results on the stock market for the six months prior to the date on which the mandatory bid was delivered to the financial market regulator (FFMS);

- if the securities are not being traded on the stock market or have been traded on the stock market for less than six months, their price is to be determined by an independent appraisor;

- the price at which a person who has issued a mandatory bid must buy securities from their owners must not be lower than the highest price at which the same person or his/her affiliates acquired (undertook to acquire) corresponding securities within the six-month period prior to the date on which the mandatory bid was issued.

118. In this regard, the mandatory bid must be sent within 35 days from the shares being credited to the obligated person or from when the person or his/her affiliates became aware of the corresponding obligation arising.

119. From the quoted provisions it is not clear how the 6-month period applied when determining the acquisition price of shares is calculated if the obligated person sent the mandatory bid late in violation of the 35-day period:

- from the time when the mandatory bid was actually issued;

- from the time when it should have been issued.

120. The literal interpretation of the current rule on calculating the 6-month period, in all instances from the actual date of issuing the mandatory bid, encourages those acquiring major shareholdings to infringe the rights of minority shareholders, as an intentional delay in issuing the mandatory bid will allow the buyer to manipulate the 6-month period and not take into account, when determining the price of the mandatory bid, transactions which would have been considered if the mandatory bid were issued in a timely manner[8]. This problem became all the more apparent during the crisis of 2008-2009, when majority shareholders intentionally delayed the issuing of a mandatory offer for the purposes of not taking into account, when determining its price, transactions which were concluded at higher pre-crisis prices. In this regard, in all instances where, in order to calculate the price, the 6-month period is important, provisions could be made such that, in the event that the statutory period for issuing a mandatory bid is violated, the six-month period should count, not from its actual submission date to the company, or, equally, to the FFMS, but from the last day of the 35-day period during which the mandatory bid should have been issued.

121. In order to determine the average-weighted price of listed shares, provisions could also be made such that due consideration should be given both to quotations over the six month period

preceding the deadline for fulfilment of the obligation to issue a mandatory bid, and to quotations over the six month period preceding the actual issue of the mandatory bid, with the highest of these amounts being used. Establishing such a regulation would encourage buyers of major shareholdings to fulfil their obligation to issue a mandatory bid within as short a period as possible.

122. One notes that the draft Informational Letter of the Russian Supreme Arbitrazh Court has adopted the first of the concepts given above: in this case, if the mandatory bid was issued within the stipulated 35-day deadline, then the 6-month period is calculated from the last date when the mandatory bid should have been issued in accordance with the law, and not from the date on which the mandatory bid was actually issued.

123. Special attention should also be given to the following, which has become prevalent in abusive Russian practices. A person who has acquired a major shareholding in a company, and as a result of which has gained corporate control over the company, delists shares of the company from the stock exchange, which results in the shares' average-weighted quotation not being taken into account when the price of the mandatory bid is determined, thereby allowing the majority shareholder to enlist the services of a technically independent, but in fact partial appraiser[9].

124. To rule out this type of abuse, there are proposals to stipulate that if, after an obligation has arisen to issue a mandatory bid and until that bid is sent to the company, the shares of that company have been delisted, then the end date of the 6-month period should be considered as the last date on which the corresponding securities were traded on the stock market.

3.6. The right of minority shareholders to dispute the price of the mandatory bid

125. Chapter XI.I of the Federal Law "On joint stock companies" does not provide any mechanism for minority shareholders who disagree with the price offered to contest the value of a mandatory bid, but only grants former securities holders the right to claim damages from a person who has sent a mandatory bid which does not comply with the Federal Law "On joint stock companies".

126. With regard to this, Russian courts[10] have adopted a simple position, essentially resulting in any holders of securities who have not accepted the mandatory bid not having the right to challenge the price of the bid, as an unaccepted mandatory bid does not actually violate their rights. Furthermore, the courts have remarked that accepting a mandatory bid is only a right, and not an obligation on the part of the claimant.

127. In point 4 of the draft Informational Letter, the Russian Supreme Arbitrazh Court drew particular attention to this problem and proposed that any person who receives a mandatory bid is entitled, up to its acceptance deadline, to initiate legal action in order to amend the mandatory bid in the form of an increase in the securities' acquisition price, with this amended mandatory bid being enforceable *vis-à-vis* all securities holders who accepted the bid at its former price.

128. That said, even with the planned clarifications, minority shareholders can, in practice, encounter significant difficulties. By way of example, court proceedings can establish that while the price of a mandatory bid has in fact been reduced, the price indicated to a minority shareholder in the petitionary stage of the suit can be higher or lower than the "actual" price, in relation to which, during the trial of the case, a minority shareholder may have their claim rejected on such formal grounds as a discrepancy between stated claims in terms of the price of the mandatory bid and the price established by the court as the appropriate price. Moreover, if, at the appeal stage of the proceedings, it is

established that the price of the securities which should have been indicated in the mandatory bid is higher than the price indicated by the shareholder in the claim, this shareholder will stripped of their ability to increase the amount of their claims, since this is not allowed during the appeal stage of proceedings. In this regard, it would seem advisable to stipulate a rule whereby any securities holder who disagrees with the price contained in the mandatory bid is entitled not only to demand that this price be increased, by indicating a specific amount in their claim, but to initiate legal action to bring the acquired securities' price in line with legislation (a claim for their "actual" price).

129. Owing to the fact that the draft Informational Letter has not stipulated any legal consequences of an amendment to the price of a mandatory bid for those securities holders who have already accepted the bid, it would be advisable to directly highlight their right to bring a suit in court to claim damages, which in the case in point will be in the form of the difference between the price of the securities established by the court and the price of the securities stated in the mandatory bid. Thus, if, when the claim is filed, there has already been a court ruling which has entered into legal force with regard to amending a mandatory bid by increasing the value thereof or establishing an "actual price", such a ruling would be prejudicial to the dispute.

3.7. Problems associated with the mechanism for shareholders who have accepted a mandatory bid to transfer shares to the person who issued the bid, and the mechanism to pay for such shares

130. The Federal Law "On joint stock companies" provides the following mechanism for shareholders to sell their securities on the basis of a mandatory bid:

- Acceptance of the mandatory bid by sending a notice of sale with regard to the securities to the person who issued the mandatory bid. Once the final day of the period stipulated to accept the mandatory bid has passed, all issued acceptances are deemed to have been received, and securities sale and purchase agreements concluded;

- Transferring the securities to the majority shareholder's account, which involves two procedures if the majority shareholder's account has been opened with a depositary (a nominee): (1) the securities holder issuing instructions to have the shares written off his/her account and (2) the majority shareholder issuing instructions to transfer the shares to his/her account, or simply the first procedure if the majority shareholder's account has been opened in register of a securities holders. If the securities will not be transferred to the majority shareholder's account within the validity period of the mandatory bid, the majority shareholder is entitled to unilaterally refuse to fulfil the sale and purchase agreement;

- The majority shareholder pays for the securities transferred to his/her account.

131. This mechanism causes problems, as described below.

3.7.1. The majority shareholder evading acceptance of the securities due to be credited to his/her account, as well as the unjustified return of securities

132. The main problem with the existing mandatory bid implementation mechanism is the highly exposed position the securities holders find themselves in after they have accepted the bid. The requirement that payment for the securities is only possible after they have been transferred to the account of the mandatory bid issuer, and only on the proviso that the securities are kept in this

person's account, creates a risk for shareholders, which can last an indefinite period of time, that they will be both without the shares themselves, and without the money which is owed to them.

133. For example, if the account of the person issuing the mandatory bid has been opened with a depositary, in order to transfer the shares to the said account, you need both an instruction from the seller of the securities to have the shares written off his/her account, and a reciprocal instruction from the depositary account holder to accept the shares. The majority shareholder, refusing to issue a reciprocal transfer instruction, is able to block the transfer of the shares to his/her account, and subsequently to refuse to pay for them on the grounds that they were not transferred to his/her account. A similar situation occurs when shares which have already been transferred without any legal basis are returned by the majority shareholder back to the account of the person who accepted the mandatory bid. In these instances the holders of the securities are placed in a difficult situation: they can either re-accept the shares back into their account, which deprives them of their right to demand payment, or, having refused to accept them, initiate court action, during which time they will, in essence, be deprived of their status as a shareholder and will be unable to participate in the governance of the company.

134. Since current legislation and court practice is unable to combat this type of abuse, it would now seem that there are two ways to resolve the problem. The first involves a fundamental change to the described "shares before money" mechanism and its replacement with a procedure to block securities in the holder's account and to subsequently transfer them to the account of the person who issued the mandatory bid, but only after a registrar (depositary) has received documents regarding payment for the securities. This mechanism appears more balanced, insofar as by guaranteeing that the majority shareholder will receive the securities paid for, the securities holders are not prevented from exercising their corporate rights in the event that a dispute arises.

135. The second option is less radical and boils down to creating an alternative mechanism for securities holders to perform their obligations in the event that a majority shareholder blocks the transfer of the shares. For example, provisions could be established so that if a person who has issued a mandatory bid evades acceptance of the shares due to be transferred to his/her account, shareholders are entitled to transfer the purchased securities to a notary's deposit, which will equate to due performance of their obligations and sufficient grounds for appealing to the guarantor for payment for the securities in the event that the majority shareholder refuses to do so.

136. Further provisions could also be stipulated so that the unilateral and unlawful return by a majority shareholder of shares transferred to him/her account on the basis of a mandatory bid is not permitted and does not exempt that person from buying the securities and discharge them from his/her obligation to pay for them.

3.7.2. A majority shareholder blocking a transfer of securities to his/her account

137. In disputes related to a mandatory bid, the Russian courts have repeatedly adopted interim measures to prevent the registrar (the depositary) from transferring securities to the account of the person who issued the mandatory bid before the merits of the dispute have been examined. The adoption of such measures is not to protect the interests of the offeror, who has not suffered any form of property damage, but results in the sellers of the securities losing the right to accept the mandatory bid and to sell their shares as a result of the acceptance deadline set by the mandatory bid having expired.

138. In this situation, it has been proposed either that the imposition of such interim measures be prohibited, for, in accordance with the stance adopted by the Russian Supreme Arbitrazh Court, interim measures cannot prevent a party from implementing procedures which, if not completed, result in a complete or partial loss of rights, or that a mechanism be laid down in law which allows the period for the shares to be transferred to the account of the person issuing the offer and the validity period of the banker's guarantee to be extended in such a situation. This period should be restarted only after those circumstances preventing the shares from being transferred have lapsed and after a public notice about this has been issued to the shareholders by the person who issued the mandatory bid. In this regard, during the validity period of this prohibition, the unfavourable consequences associated with the failure to issue a mandatory bid should be extended to the majority shareholder (restrictions on voting rights).

3.8. Correlation between the provisions of Chapter XI.I of the Federal Law "On joint stock companies" and anti-monopoly regulations, as well as with the requirements of the Federal Law "On banks and banking activities" and the Federal Law "On foreign investment in companies having strategic importance to the defense of the country and the protection of the state"

139. As we know, the aim of the notion of a mandatory bid is to ensure that minority shareholders are able to sell their shares to a buyer acquiring a major shareholding in the same company. Thus, in accordance with the Federal Law "On the protection of competition", the Federal Law "On foreign investment in companies having strategic importance to the defense of the country and the protection of the state", all transactions involving shares in companies with a special status or engaging in specialist types of activities are to be concluded in a particular manner – with prior consent from the relevant government bodies or with subsequent notice to such bodies about the conclusion of such transactions if the acquired number of shares exceeds the statutory threshold. In the event that this requirement to obtain prior consent for the transaction from the relevant government body is not fulfilled, the transaction is deemed null or can be voided.

140. One notes that current legislation does not provide any means to resolve conflicts between the requirements of Chapter XI.I of the Federal Law "On joint stock companies" and the specialist procedure for concluding certain types of transactions, as established by the aforementioned laws, as a result of which such a clash can lead to an infringement of minority shareholders' interests, being deprived of their ability to sell their shares on the basis of a mandatory bid. Russian economic practice provides numerous examples when the person acquiring a major shareholding, in order to not fulfil their obligations regarding a mandatory bid, avoid seeking prior consent to the share sale and purchase transaction, and then, with reference to the lack of required consent, recognise sale and purchase agreements concluded with holders of the securities as invalid. In this regard, Arbitrazh Courts, acknowledging the invalidity of transactions concluded on the basis of a mandatory bid, do not enforce any sanctions whatsoever on the bad faith person acquiring the major shareholding and fail in every way to protect the interests of minority shareholders. Thus, the majority shareholder is effectively allowed, without obstruction, to increase the size of his/her shareholding in the company without actually (really) complying with the regulations governing mandatory bids[11].

3.8.1. Enforcement of the sanctions set forth in Chapter XI.1 of the Federal Law "On joint stock companies" vis-à-vis a bad faith acquiror of a major shareholding

141. In accordance with point 6 of art. 84.2 of the Federal Law "On joint stock companies", from the time that a person acquires 30, 50 or 75 per cent of the total number of shares in an open joint stock company and until a mandatory bid is issued, that person, as well as his/her affiliates, are subject

to restrictions on their voting rights ensuing from those shares which surpass 30, 50 or 75 per cent of the shares in the open joint stock company.

142. At the present time, this norm is interpreted particularly formal by the Russian courts: the prohibition on a majority shareholder voting using shares acquired by him/her by circumventing the requirements of Chapter XI.I of the Federal Law "On joint stock companies" is limited only to cases where a mandatory bid has not been issued to the remaining shareholders of the company. In this instance, if the mandatory bid has technically been issued, but the shares have not been bought out as a result of bad faith acts on the part of the person acquiring the major shareholding, the restrictions on his/her voting rights do not apply.

143. Ways to prevent such abuse include the following:

- it is essential that the law or the clarifications of the Russian Supreme Arbitrazh Court establish the sense of the regulations on mandatory bids to mean that any shareholder who has become the owner of a major shareholding must not simply issue a mandatory bid to the company, but actually acquire the securities from their owners who have accepted the mandatory bid (these owners must receive payment for the shares transferred to the person who issued the mandatory bid from that person or a corresponding guarantor);

- it is essential that it be stipulated that until the obligation to pay for all the securities owned by holders whose shares have been offered for sale to a person who has acquired 30, 50 or 75 per cent of the total number of shares in an open joint stock company, or to his/her affiliates, on the basis of a mandatory bid, has actually been fulfilled, the restrictions set forth by point 6 of article 84.2 of the Law "On joint stock companies" with regard to voting rights should extend to those shares which surpass 30, 50 or 75 per cent of the open joint stock company's shares.

144. As an alternative, it could be stipulated that, if a securities acquisition agreement concluded on the basis of a mandatory bid requires prior consent from a relevant government body, the mandatory bid must provide information about the decision to be made by this body with regard to the application by the person issuing the mandatory bid. In this instance, the person acquiring the major shareholding will be required to request this prior consent, as otherwise he/she will not be able to issue a mandatory bid and will be disqualified.

3.8.2. The right of the person acquiring a major shareholding to appeal to the invalidity of a transaction arising as a result of his/her bad faith conduct

145. As described above, it is the person acquiring the major shareholding him/herself who must bring a claim to recognise a transaction concluded on the basis of a mandatory bid as invalid, making reference to the lack of required consent from the relevant body to conclude the transaction, despite the fact that it is the person acquiring the major shareholding who intentionally failed to apply to obtain this consent.

146. To eradicate such bad faith conduct, it is essential that the following regulations be implemented:

- when examining disputes brought by buyers of major shareholdings to recognise securities sale and purchase agreements concluded on the basis of a mandatory bid as invalid, it is essential in every case to ascertain the grounds for the invalidity of the disputed agreements. If it is established

that the invalidity of the agreements results from bad faith acts or inaction on the part of the person who issued the mandatory bid or his/her affiliates, the legal action to recognise the agreement as invalid should be dismissed on the grounds of abuse of rights, for the negative consequences arising from bad faith conduct by one of the parties to the agreement cannot be held against the other party;

- only a relevant authority is entitled to bring claims to recognise securities sale and purchase agreements concluded on the basis of a mandatory bid as invalid, on the grounds of a lack of consent from the relevant body to conclude such a transaction, for, in such instances, the other party does not have a legally protected interest in bringing such claims.

147. It is important to note that the second rule provided above has been included in the draft Informational Letter of the Russian Supreme Arbitrazh Court, however only with reference to the failure to obtain consent from an anti-monopoly body. In this regard, the corresponding provision of the Informational Letter needs to be extended so that it covers, together with anti-monopoly laws, legislation on banking activities and legislation on foreign investment.

3.9. The possibility for a security holder to invalidate the transactions concluded on the basis of a mandatory bid

148. The Federal Law "On joint stock companies" mentions nothing about the possibility of contesting a transaction concluded on the basis of a mandatory bid, stating only that in the event of any discrepancy between the mandatory bid or the transaction itself and the provisions of this law, the former holder of the securities is entitled to demand that the person who issued the mandatory bid redress any damages caused by this (point 6, art. 84.2).

149. At the same time, art. 168 of the Civil Code of the Russian Federation established that any transaction which does not comply with legal provisions or any other legal acts is to be deemed null and void if the law does not state that such a transaction can be challenged, or does not state any other consequences for infringement.

150. The matter of non-compliance between two applicable provisions is reflected in the draft Informational Letter of the Russian Supreme Arbitrazh Court, which has proposed two alternative clarifications:

- the recovery of damages is considered to be a special consequence, not linked to the invalidity of the transaction, which brings with it the possibility of recognising the transaction as invalid on the grounds that it does not comply with the law (art. 168 of the Civil Code);

- the statutory right to recover damages does not deprive a former shareholder of his/her right to demand that the corresponding share sale and purchase transaction be recognised as invalid pursuant to art. 168 of the Civil Code of the Russian Federation.

151. It is particularly noteworthy, in this regard, that the option of independently disputing a mandatory bid is not provided for by law.

152. Given that the interest of a securities holder who has accepted a mandatory bid clearly lies not in these shares being returned to him/her, but in receiving equitable monetary compensation, the

most appropriate way to protect his/her rights is to recover all damages caused to him/her from the majority shareholder[12].

153. Meanwhile, under the existing regulations, even taking into account the forthcoming clarifications of the Russian Supreme Arbitrazh Court, if is difficult for a shareholder to recover all outstanding sums of money owed to him/her.

154. The problem lies with the misleading terminology used in point 6 of art. 84.2, which uses the term "damages" with reference to a discrepancy between the purchase price of the securities and the provisions of acting legislation, thereby misleadingly evoking an economic side to the problem, as in this case, the question should not be one of damages, but of the appearance, on the part of the person acquiring the shares, of unjustified enrichment, through payment of only part of the purchase price of the securities. In a situation where legal proceedings on defining an equitable market price for the securities continue for a long time, during which time the person acquiring the securities makes use of spared (unpaid) cash, the minority shareholders should have the right to recover both "damages" (i.e. the actual sums remaining unpaid under the agreement) and receive compensation for the delay in payment by the majority shareholder ("interest on the use of another's money").

155. Under normal circumstances, a party to a contract has the right to demand accrual of interest on any unpaid amount for each day that it is overdue. However, due to the fact that the law refers to the money not received by the shareholder pursuant to an agreement as "damages", they are stripped of their right to demand payment of interest, as, according to the explanations of higher courts and existing case law, the accrual of interest for use of another's money in addition to the damages is not permitted, as interest on damages is offsetting in nature. In this regard, the terminological inaccuracy in the law needs to be removed.

3.10. The acquisition and transfer of shares which do not require the issue of a mandatory bid

156. A list of exclusions from the obligation to issue a mandatory bid are provided in point 8, art. 84.2 of the Federal Law "On joint stock companies". Not long ago, the existing list was supplemented by instances of transferring shares in an open joint stock company under one form of state ownership to another form. The more controversial exceptions in practice are as follows.

3.10.1. The transfer of shares by a person to his/her affiliates or the transfer of shares to a person by his/her affiliates

157. The situation under discussion is very broad in terms of its legal wording and eliminates the obligation to issue an offer when transferring shares between affiliated persons in that the grounds for affiliation differ and do not always pass the "maintaining control" test when shares are being transferred from one person to another.

158. The draft Informational Letter of the Russian Supreme Arbitrazh Court has explained that a person is released from his/her obligation to issue a mandatory bid only when the buyer's circle of affiliates does not include persons who have not been affiliates of the transferor prior to the transfer of the shares. So, for example, point 8 of art. 84.2 of the Law should not cover instances when two unaffiliated natural persons, each of whom owns a 20% share in Company A, establish Company B, in which each person owns 50% of the share capital, and one of the two persons transfers to Company B the shares he/she holds in Company A.

159. At the same time, if affiliate relations have been artificially created to evade the obligation to issue a mandatory bid, a court can uphold the existence of this obligation lying with the buyer. From the point of view that the mandatory bid should not be sent when a formal change in "owner" of the shares does not lead to a change in the person actually dealing with the associated votes, it would be more appropriate to have a rule permitting the offer not to be sent only in the case of a transfer of shares between controlling and controlled persons, as well as between persons controlled by the same persons. In this regard, only control arising from the participation of one person in the share capital of another (in excess of 50% of the voting rights) should be taken into account. This approach would eliminate cases of artificial constructs of affiliation between companies which are actually controlled by different persons.

3.10.2. Redemption of shares by an open joint stock company

160. If, as a result of a company buying back a proportion of its shares, a person surpasses the 30-per-cent ownership/disposal threshold bringing about the obligation to issue a mandatory offer, then that person is exempted from the obligation to issue a mandatory offer.

161. The wording of this rule is weak. In essence, it allows a person exceeding the 30-per-cent threshold following a redemption of a proportion of shares to continue to increase the size of his/her shareholding right up to 50 per cent of the voting rights without being required to issue a mandatory bid. To end this abusive practice, it would be advisable to supplement this rule to the effect that a person is obliged to issue a mandatory bid as soon as he/she acquires the right to make use of even just one vote provided by the company's shares after this threshold has been surpassed. If a person, exempt from the obligation to issue a mandatory bid, as in the process described above, acquires a shareholding and does not exceed a set threshold (for example, after surpassing a threshold as a result of redemption of a portion of shares the number of shares has been decreased, and the subsequent purchase does not result in the threshold once again been surpassed), the person will not be required to issue a mandatory bid.

3.10.3. The acquisition of shares resulting from a shareholder exercising his/her pre-emption right during an additional issue of shares

162. The expediency of keeping this exemption in acting legislation is disputed. A pre-emption right is one of the ways to combat the degradation and reduction in the share size of minority shareholders in a company's share capital and to maintain the status quo at that company. The use of a pre-emption right, rather than to prevent a reduction in the size of a person's shareholding, but to increase the level of his/her corporate control over the company, contradicts the sense of this institution. Special attention should be given to this exemption in that the actual procedure to increase share capital in Russia is a broad stage for abuse by owners of major shareholdings.

3.10.4. A securities holder agreement to refuse to accept a mandatory bid

163. Despite the need for such an instrument being determined by practical requirements, the Federal Law "On joint stock companies" does not directly provide for this possibility.

164. In its Informational Letter, the Russian Supreme Arbitrazh Court proposes this option, planning to provide the following explanations:

- Any person issuing a mandatory bid is entitled to conclude with securities holders an agreement to refrain from accepting a mandatory bid.

- The existence of a shareholder agreement does not affect the right of a shareholder to accept the mandatory bid, however he/she may be held liable for breach of contract.

165. However, these provisions do not appear to be a complete solution, as even if securities holders, acting in good faith, will not accept the offer, then this still does not exempt the person acquiring the major shareholding from obtaining a banker's guarantee for the company's shares. Further problems arise if those securities holders who have concluded a shareholder agreement dispose of their shares to a third party during the validity period of the offer. In this case, the new shareholders will not be bound by the agreement signed by the former holders and will be able to present their securities for sale.

166. It seems that rectifying these problems within the scope of the Russian Supreme Arbitrazh Court's clarifications is not possible. Instead, the law should be supplemented by the following provisions:

- directly prescribe the option of concluding an agreement (between securities holders and the person issuing a mandatory bid) to refuse to accept an offer;

- stipulate that during the validity period of a mandatory bid securities holders are not entitled to conclude deals to sell their securities;

- during the validity period of a mandatory bid, shares in the account of holders who have concluded an agreement to refuse to accept an offer are to be blocked, and no transactions involving these accounts can be carried out.

IV. THE PROCEDURE FOR SQUEEZING OUT MINORITY SHAREHOLDERS

4.1. The artificial creation of grounds for appearance of a right to demand buy-outs

167. Pursuant to point 1 of art. 84.8 of the Federal Law "On joint stock companies", any person who, as a result of a voluntary bid to acquire all the securities of an open joint stock company or a mandatory bid, has come to hold more than 95 per cent of the total number of voting shares, taking into account the shares belonging to that person and to his/her affiliates, has the right demand that the other shareholders sell their shares to him/her.

168. The securities are to be redeemed at a price determined by an independent appraisor, which must not be less than:

- the price at which the securities were acquired on the basis of a voluntary or mandatory bid, resulting in a person coming to hold more than 95 per cent of the company's shares;

- the highest price at which the corresponding person or his/her affiliates acquired or undertook to acquire the same securities after the deadline to accept a voluntary or mandatory bid.

169. Any securities holder who does not agree with the price for the redeemed securities is entitled to refer the matter to an Arbitrazh Court to claim damages caused in relation to the improper definition of the securities' redemption price. The submission of this petition is not grounds for suspending the buy-out of the securities or invalidating it.

170. Due to the inadequate development of this institution in Russian business practices, there are many instances where grounds for appearance of a right to make squeeze out and unfair squeeze-outs have been artificially created. In this regard, the norms given above and their interpretation by Russian courts do not under any circumstances allow securities holders to challenge the actual buy-out procedure itself or the grounds for the buy-out[13]. So a major shareholder can intentionally sell 10 or more per cent of his/her shares to a supposedly independent shareholder (an investment company, bank) which, a short while later, accepts the voluntary or mandatory bid made by the major shareholder, which in essence means that the major shareholder has been able to circumvent the requirements of the law and be in a position to implement a forced buy-out of the shares.

171. A similar situation arises when, for example, the actual acquisition of a certain number of shares by a particular person is a well-known fact, including through numerous press reports, but it is later uncovered that, strictly speaking, from a legal perspective, the person acquired 10% (15, 20%) less shares than actually declared. In such instances, the buyer of the controlling shareholding for the most part agrees with the contracting party that the shares will not be acquired by him/her immediately, but within the context of a subsequently issued mandatory bid, which creates the impression that he/she has reached the 95-per-cent threshold on the basis of a mandatory or voluntary bid.

172. Given that, in such instances, the right to a forced buy-out does not arise, minority shareholders should be given the right, not just to dispute the price of the squeeze out, but also to recognise the squeeze out itself as invalid.

173. Meanwhile, in its Informational Letter, the Russian Supreme Arbitrazh Court has ignored this problem described above, and has proposed further reinforcement of the recovery of damages as a special legal consequence, as per the aforementioned art. 168 of the Civil Code of the Russian Federation, and therefore, an application to recognize a completed buy-out of securities as invalid will not be accepted.

4.2. Disputing the price at which securities have been redeemed (the problem of calculating interest on damages caused by a reduced squeeze out price)

174. In relation to the process of an independent appraisor determining the value of securities due to be squeeze out, in practice the following problems tend to arise.

175. Proving a discrepancy between the market value of redeemed shares and the price at which they were bought is often impossible, as Russian courts do not consider an alternative report, submitted to the case by minority shareholders, assessing the market value of the redeemed shares to

be sufficient evidence, making reference to the fact that the appropriate way to prove this in this instance is by submitting evidence of a discrepancy between the processes of the initial valuation and resulting report and the legal requirements and standards governing valuations. All other evidence of a reduced squeeze out price (own calculations, certificates etc.) is not accepted by the courts[14].

176. It is clear that any changes to legislation would not be able to resolve this problem, and a solution to the current situation is only foreseeable through a fundamental change in the courts' approach to accepting and assessing evidence for this type of dispute.

177. At a time when the vast majority of cases of minority shareholder squeeze-outs are taking place in companies whose shares are not traded on the stock exchange (i.e. where there is no objective information on their market price), and, accordingly, where the system of an "independent" appraisor assessing market value is used, the squeezed-out shareholders are significantly restricted in their use of legal remedies. On the one hand, due to the limitations of current legislation, they do not have access to primary documents which would allow them to independently assess the value of their redeemed shares, and on the other hand, the financial market regulator, whose mandate should include pre-trial checks on the legality of the squeeze-out procedure, is limited restricted to establishing only the formal aspect of the case and does not verify either the final redemption price or the mechanism used to define it. In particular, the Russian FFMS has repeatedly stated that its remit does not extend to investigating valuation reports submitted by minority shareholders, and that its role is simply to ensure that the report exists.

178. Special mention should be given to the way in which appraisors deliberately manipulate results to reduce the market value of redeemed shares. For example, when determining the market value of shares belonging to minority shareholders, appraisors apply a special reduction due to the fact that these shares are not part of the controlling shareholding. The Russian Supreme Arbitrazh Court previously ruled it inadmissible that such a coefficient is applied, within the context of examining a specific case on a squeeze out[15], and now the Russian Supreme Arbitrazh Court has proposed reflecting the same reasoning in the draft Informational Letter with regard to determining the price of shares acquired on the basis of a mandatory bid.

179. Russian courts, on the one hand, uphold the lack of violations in the actions of majority shareholders owing to the fact that the market value of the shares is determined not by the courts, but by an independent appraisor, and on the other hand, adopt the position that an appraisor, whose report has defined the price of redeemed shares, cannot be held liable for damages, as he/she was not the person who implemented the forced buy-out and there is no causal link between his/her actions and the damages incurred.

180. In the draft Informational Letter put forward by the Russian Supreme Arbitrazh Court, there are proposals to correct this contradiction in court practice, making specific reference to the fact that the legal provisions on appraisal activities allow third parties to recover damages from an appraisor which have occurred as a result of the use of unreliable market values stated in his/her report. At the same time, to exclude the possibility of bad faith majority shareholders passing the liability for determining the buy-out price on to the appraisor, it would seem advisable to specifically state that if a claim to recovery damages is filed against the person implementing a forced buy-out, and the price of the securities was defined in an independent appraisor's report, then the respondent cannot cite this fact in court as grounds for being cleared of his/her liability, as the respondent has his/her own obligation to determine an equitable buy-out price which, in itself, entails the obligation to select a qualified appraisor.

V. THE TGC-2 CASE

181. Pursuant to a share sale and purchase agreement concluded with RAO UES of Russia JSC, and after an additional issue of shares, Kores Invest LLC acquired more than 30% of the shares in TGC-2 JSC. In accordance with the provisions of the Federal Law "On joint stock companies", Kores Invest LLC issued a mandatory bid, which was accepted by the majority of shareholders at TGC-2 JSC.

182. After the mandatory bid was accepted, Kores Invest JSC filed a claim with the Arbitrazh Courts calling for the signed sale and purchase agreements to be recognised as invalid, due to an alleged contradiction with acting legislation.

183. Half a year before this, the government implemented the Federal Law "On foreign investment in domestic companies of strategic importance to the security of the country and the protection of the state" (hereinafter referred to as the Law on Strategic Companies), which states that a foreign investor, or group of people including a foreign investor, is entitled to conclude transactions resulting in establishing a controlling interest over a strategic company only with prior consent from the relevant body, otherwise the transactions will be deemed invalid. In this regard, it is directly stated that the listed restrictions also cover cases where shares are acquired on the basis of a mandatory bid.

184. Due to the fact that TGC-2 was given a licence to operate radiation equipment, a that a storage facility for radioactive waste was situated and operated on its land, the courts considered TGC-2 to be a strategic company.

185. The conclusion that consent for Kores Invest LLC's transaction to purchase shares in TGC-2 JSC was reached on the grounds that Kores Invest LLC was part of a group of entities with foreign companies – "Divent Enterprises Limited" and "Rustenburg Co Limited".

186. Since Kores Invest LLC did not seek approval for the transaction and had not received permission from the relevant body on the date on which the transaction was finalised, the courts declared all the sale and purchase agreements invalid.

187. In this regard, the courts turned down the following arguments put forward by the respondents:

- The respondents argued that under the meaning of the Law on Strategic Companies, restrictions are put in place only if a foreign investor directly or indirectly comes to control the company. In this case, Kores Invest LLC cannot be a foreign investor, as it is controlled by a Russian citizen, who is the ultimate beneficiary of the entire group. However, the courts applied the law too formally, indicating that the obligation to obtain prior approval, as stated in the law, for transactions involving not just foreign investors, but also to Russian organisations belonging to a group of entities with foreign companies, irrespective of the connections between them.

- The courts dismissed the reference made by the respondents to point 5 of art. 84.3 of the Federal Law "On joint stock companies" whereby if the number of shares which have been put up for sale exceeds the number of shares which an offeror is permitted to acquire in accordance with the

provisions of the Law on Strategic Companies, the shares are to be acquired from the shareholders proportionately. The claimants asserted that since this provision states specific consequences for a transaction's failure to comply with the law (art. 168 of the Civil Law of the Russian Federation), the transactions could not be recognised as invalid. However, the court indicated that the provision of point 5 of art. 84.3 and the provisions regarding obtaining prior approval for the transaction from the relevant body are differing mandatory requirements and compliance with one is not contingent on compliance with the other.

- The respondents indicated that the underlying process was initiated by Kores Invest LLC in order to avoid the obligation to buy-out shares from minority shareholders, the company knowingly ignored the legal requirement to obtain prior approval for transactions from the relevant body, as a result of which the legal action should be dismissed due to abuse of rights. The courts considered this argument to have no effect on qualifying the disputed transactions as invalid, as under current provisions, the invalid transaction was void with effect from its conclusion, irrespective of whether it is recognised as such by a court.

- The courts did not apply the regulations of the Law on Strategic Investments, whereby it is directly stated that transactions do not require approval if, at the time of their conclusion, the foreign investor already controls a strategic company. When the disputed transactions were finalised, Kores Invest LLC owned a 50% shareholding in TGC-2 JSC, which, with a total number of 300,000 shareholders, reflected Kores Invest LLC's "dispersed" control over TGC-2 JSC.

188. The respondents tried to use the following avenues to protect their rights, all of which were unsuccessful:

- The courts refused the recovery of damages from Kores Invest LLC on the grounds that point 6 of art. 84.3 of the Federal Law "On joint stock companies" permits the recovery of damages only when there has been a discrepancy between the offer or securities acquisition contracts with this law alone, and not any other laws.

- The shareholders failed to obtain restrictions on Kores Invest LLC's voting rights at general shareholders' meetings, as the law prescribes this only for instances where a mandatory bid was not issued, which Kores Invest LLC did indeed issue.

- The courts recognised that Kores Invest LLC's failure to obtain approval for the transaction from the relevant body is an unlawful omission, which did not, however, bring about any negative effects for the company.

- The respondents were unable to have recourse to payment under a banker's guarantee, as its validity was initially blocked by interim measures pursuant to the primary disputes, and after the securities agreements were recognised as invalid, the courts upheld Kores Invest LLC's petition to block payment under the banker's guarantee, in spite of the fact that the law directly states the lack of interdependence between the banker's guarantee and the validity of the claims it secured.

VI. THE POWERS OF THE FINANCIAL MARKET REGULATOR IN THE ACQUISITION OF CONTROLLING INTERESTS (REGULATIONS IN FORCE AND CURRENT PROBLEMS)

189. In the Russian Federation, the financial market regulator is the FFMS (Federal Financial Markets Service) Russia. Its powers in the field of controlling major shareholdings acquisitions are governed by Chapter XI.I of the Federal Law "On joint stock companies", the FFMS Russia Regulations, as approved by Resolution of the Government of the Russian Federation on the 29.08.2011, No. 717, the Code of Administrative Procedure of the Russian Federation and several other instruments. Broadly speaking, the powers of the FFMS boil down to the following:

- Verifying the compliance of a mandatory bid or securities buy-out request with acting legislation before being sent to the company;

- If a discrepancy is uncovered between a mandatory bid or securities buy-out request and acting legislation, the FFMS brings the violator to account under administrative law by levying fines and issues orders to bring the documents in line with the stipulated requirements;

- The FFMS receives a report from the person acquiring the major shareholding with regard to the outcome of the mandatory bid.

190. Meanwhile, six years of experience in terms of the legal effect of Chapter XI.I of the Federal Law "On joint stock companies" has revealed that in some situations, the powers accorded to FFMS Russia are clearly insufficient, and in others, the body is highly inactive in using the powers it does have. The combined result is that FFMS Russia is unable to prevent a series of instances of abuse.

6.1. Placing restrictions on the general meeting voting rights of a person who has violated his/her obligation to issue a mandatory bid

191. In spite of the fact that this consequence of not issuing a mandatory bid is directly stipulated in the Federal Law "On joint stock companies", there is currently some uncertainty surrounding which subjects this sanction applies to. Given that it is not directly listed among the powers available to the FFMS, this duty, in fact, lies with the counting board, which is either the registrar, or the actual company closely linked with the majority shareholder, and is not inclined to levy such sanctions against him/her.

192. In view of this, it is essential that the Russian Supreme Arbitrazh Court clarify the law so that FFMS Russian is entitled to send an order to the counting board or to the open joint stock company itself to limit the voting rights of the person obliged to issue a mandatory bid.

6.2. An order to a person acquiring a major shareholding to issue a mandatory bid

193. In spite of the fact that the Federal Law "On protecting the rights and legal interests of investors on the securities market" adequately defines the powers of the regulator, by allowing the regulator to issue various orders on matters within its remit to cease or prevent violations, appropriate

law enforcement has not been taking place, and FFMS officials often have doubts as to whether they have the right to issue an order to submit a mandatory bid.

6.3. The general problem of the ineffectiveness of FFMS orders as a means to prevent violations

194. Even in those instances when FFMS Russian takes an active role in a corporate dispute, its rulings and orders often do not have any significant effect on its development. This situation has come about, firstly, due to the law establishing weak sanctions for failure to comply with the regulator's rulings (small administrative fines in the absence of an actual criminal offence), and also, due to the very limited scope of these sanctions.

195. For example, in a current corporate dispute associated with the forced buy-out of minority shareholders in Sedmoi Kontinent JSC, FFMS Russia has taken an active role by banning the shares from being written off, as, according to the FFMS, the person has no legal basis for the buy-out. Meanwhile, the shares were written off the accounts of their holders, circumventing the order, as its effect only extended to a certain legal entity – the holder of the shareholders register. The majority shareholder simply transferred maintenance of the register to another person who was not covered by the order, and proceeded with the buy-out.

VII. CONCLUSIONS AND RECOMMENDATIONS

196. In spite of the fact that standards on mandatory bids are being consolidated in Russian law, practical application of these norms brings us to the conclusion that this institution does not work in its current form. Thus, during the process of a change in control in 2007-2008 in 18 generating companies under the RAO UES structure, a mandatory bid was issued in only 10 of these cases[16]. The legal mechanisms described in the sections above which allow buyers of major shareholdings to get around buying out shares from minority shareholders range from forming a highly controversial (from a legal and economic perspective) structure for transactions to acquire a controlling interest, to playing off the shortcomings and contradictions of the existing regulations through the Russian courts' inability to ensure the actual functioning of these institutions.

197. In summary, we can list the following key problems which are hindering the normal functioning of the concepts of mandatory bids and forced buy-outs in Russia.

198. The insufficiently developed and fragmentary nature of the Federal Law "On joint stock companies" in the corresponding sections; the contradiction of certain provisions with other federal laws.

199. These include, in particular, the problems described above which arise when the size of an obligated person's shareholding has fallen below the set threshold, the rules on determining the price

of a mandatory bid, the recovery of damages by minority shareholders, the correlation between mandatory bid norms and legislation on foreign investments, etc. These existing problems can be resolved both by adopting the clarifications issued by higher courts on court practices, and by making changes to current legislation.

200. The lack in Russian corporate law of a truly functional mechanism to establish the existence of affiliation and groups of entities.

201. The concept of "affiliates" or "affiliated persons" and "group of entities" or "group of persons", as often used in Russian corporate law, is found in anti-monopoly legislation and does not meet the requirements of modern civil transactions. What is more, these institutions assume the existence of affiliation or groupings only where there is a formal link between subjects in the case of a joint contribution to the share capital of one another or a certain number of shared personnel in managerial bodies. These institutions have existed for a long time and stakeholders have developed numerous ways to build a corporate structure which allows them to effectively control the business, but without it being possible to ascertain the actual existence of this control in a specific legal dispute. In particular, the existing regulations do not concern instances of indirect control, the possibility of there being several entities under common control, control (affiliation) being established as a result of concerted actions. This shortcoming in the modern Russian rule of law is evident, for example, in cases where indirect control is established over votes in a joint stock company, a certain number of shares are transferred to a technically un-affiliated person, shareholdings are transferred within a group to obtain buy-out rights, etc. So it must be noted that, though some problems pertaining to the institution of the mandatory bid can be eliminated at the level of court practices, the solution to this problem ultimately lies with a radical reform of the institutions of affiliation and groups of entities.

202. The formal approach of the Russian courts towards enforcement of legislation, the inability in problem situations to be guided by the aims of a particular institution and the inability to apply general legal and industry-wide principles to resolve any contradictions which may arise[17].

203. In relation to this topic, below are some notable examples:

- the refusal by the Russian courts, in cases brought by minority shareholders against bad faith buyers of major shareholdings, to apply art. 10 ("Abuse of a right") of the Civil Code of the Russian Federation;

- the refusal to be guided by the principle that a mandatory bid should not only have been formally issued, but also strictly fulfilled and, as a result, the failure to enforce the sanctions set forth in law against persons who have issued a mandatory bid, but have failed to fulfil it through their own fault;

- the refusal to be guided by the principle that the obligation to issue an offer arises if a person or several associated persons establish control over a certain number of votes, irrespective of the manner in which this control is established, remarking the creation of this obligation to issue an offer only when a certain number of shares in a company have been acquired.

204. It seems that these problems do not lie with the existing regulations, but with the traditions of the rule of law and the legal mentality of the Russian courts, often unwilling to depart from the wording of a specific legal prescription, meaning that these difficulties can be overcome only through

the active involvement of higher courts in terms of clarifying the procedure for applying existing legislation and increasing the training given to serving judges[18].

205. The passive position of the financial market regulator in corporate disputes involving the acquisition of major shareholdings, the inadequacy of the regulator's powers in certain situations.

206. Obviously, pre-trial proceedings and preventing violations of the law play an important role in the stability of civil transactions. By way of analogy with the European and American financial markets, it can be argued that the activities of the regulator and their decisions have, in many ways, a determining influence on the resolution of corporate conflicts. Meanwhile, such effective mechanisms are not evident in Russia at the present time.

207. Firstly, as described above, FFMS Russia is largely passive in applying the mechanisms available to it in combating the unfair conduct of those acquiring major shareholdings. In this regard, more pro-active work needs to be done within the regulator itself by holding various coordination meetings with regional bodies, issuing (in a similar way to higher courts) internal informational clarifications on questions of interpreting the powers available to the service and on uniform application of such powers. Meanwhile, taking into account the fact that any decision passed by the regulator is final and can be challenged in court, there needs to be active support for such initiatives from the court system, in particular, by establishing court practices which are beneficial to the FFMS in terms of more active application of the existing powers available to the service.

208. Secondly, the FFMS clearly needs wider and more discretional powers in certain areas than those which it has at the present time. A detailed discussion is needed with regard to the possibility of granting the FFMS powers such as carrying out pre-trial investigations into the activities of financial market participants with a view to determining if there is any affiliation or concerted actions between participants, as well as establishing whether a market participant has certain rights or obligations or not (for example, whether a person is obliged to issue a public offering, whether he/she has the right to demand a buy-out etc.).

209. Thirdly, at the present time the FFMS clearly needs effective mechanisms to enforce and implement any decisions it adopts. As mentioned above, even in instances where the FFMS takes an active role in a corporate dispute and issues specific directives to parties after examining a particular case, these directives are often simply ignored by one of the parties to the conflict, or they simply try to make it appear officially as though they are complying with the instructions. The root of the problem, it seems, is that compliance with decisions passed by the financial regulator are backed up by extremely weak sanctions[19], which, if the "stakes" of a dispute involve very large sums, are not likely to offer an offender any incentive to comply. It seems that the growing importance of the regulator's actions and decisions in major shareholding acquisitions should be accompanied by a significant intensification of sanctions for failure to comply with the regulator's decisions, both for the buyer itself, and for his/her officials. However, this range of measures will inevitably require some change to existing legislation.

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NOTES

[1] For more detail, see S. V. Gomtsyan, *Pravila pogloshcheniya aktsionernykh obshchestv: sravnitel'no-pravovoi analiz: monografiya* [Joint-stock company acquisition regulations: a comparative-legal analysis: monograph], M. Wolters Kluwer, 2010 (§ 1 ch. 1)

[2] Ibid.

[3] A. Cahn, D. C. Donald, *Comparative Company Law. Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA*, chapter 24

[4] The aims of the legislation to regulate the acquisition of controlling interests are explained in: A. Cahn, D. C. Donald, *Comparative Company Law. Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA*, chapter 24

[5] A. A. Kuznetsov, *Obyazatel'noe predlozhenie: voprosy zashchity prav aktsionerov* [The mandatory bid: questions of protecting shareholders' rights] (Russian Supreme Arbitrazh Court Bulletin, No. 12, December 2010), pp. 34-35

[6] A. A. Kuznetsov, *Obyazatel'noe predlozhenie: voprosy zashchity prav aktsionerov* [The mandatory bid: questions of protecting shareholders' rights] (Russian Supreme Arbitrazh Court Bulletin, No. 12, December 2010), p. 33

[7] Decision of the Russian Supreme Arbitrazh Court dated the 24 May 2012, No. VAS-3878/12

[8] A. A. Kuznetsov, *Obyazatel'noe predlozhenie: voprosy zashchity prav aktsionerov* [The mandatory bid: questions of protecting shareholders' rights] (Russian Supreme Arbitrazh Court Bulletin, No. 12, December 2010), p. 35

[9] National Corporate Governance Report, 1 May 2008, p. 98-99.

[10] Ruling of the Federal Arbitrazh Court of the Volgo-Vyatka District dated the 31.03.2009 in respect of case No. A79-202/2008, Ruling of the Federal Arbitrazh Court of the West Siberian District dated the 21.07.2011 in respect of case No. A46-13265/2010

[11] Stolyarsky A., Samoilov E., *Ispol'zovanie zakona o strategicheskikh otraslyakh v korporativnykh sporakh* [The use of the law on strategic sectors in corporate disputes], (Korporativny yurist, 2010, No. 10), p. 53

[12] Also on this question, see Stepanov D. I., *Sleduet li dopuskat' annulirovanie obyazatel'nogo predlozheniya pri pogloshcheniyakh?* [Should we allow the cancellation of a mandatory bid in takeovers?] (Zakon, 2009, No. 10)

[13] A. A. Kuznetsov, *Obyazatel'noe predlozhenie: voprosy zashchity prav aktsionerov* [The mandatory bid: questions of protecting shareholders' rights] (Russian Supreme Arbitrazh Court Bulletin, No. 12, December 2010), p. 29

[14] On the question of the difficulties in proving damages caused and the scale of such damages in Russia, see Savenkova O. V., *Vozmeshchenie ubytkov v sovremennom grazhdanskom prave* [Recovery of damages in modern civil law] (*Ubytki i praktika ikh vozmeshcheniya* [Damages and recovery practices], *Sbornik statei* [Collected articles], Chief Editor M. A. Rozhkova, Moscow, 2006)

[15] Ruling of the Presidium of the Russian Supreme Arbitrazh Court dated the 13.09.2011, No. 443/11 in respect of case No. A08-2788/2008-21

[16] Shvyrkov, O., *Korporativnoe upravlenie v Rossii v 2011 godu: starye problemy i novye vyzovy* [Corporate governance in Russia in 2011: old problems and new challenges] (National Corporate Governance Report, issue V, Moscow, 2012, pp. 101-126)

[17] Boiko, T., *Otvetstvennost' mazhoritarnogo aktsionera pri vytesnenii minoritariev* [Obligations of a majority shareholder when squeezing out minority shareholders] (Korporativny Yurist, 2008, No. 11)

[18] The inadmissibility of using a formal approach to resolving disputes has been pointed out on numerous occasions by the Constitutional Court of the Russian Federation. See, for instance, the Decision dated the 16 July 2009, No. 940-O-O, and the Ruling dated the 14 July 2003, No. 12-P

[19] Point 9 of art. 19.5 of the Code of Administrative Procedure prescribes a fine for failure to comply with FFMS directives – for officials this ranges from 20 to 30 thousand roubles, and for legal entities this ranges from 500 to 700 thousand roubles.