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Merger Control: Getting the Deal Cleared in Russia

Russia's merger control regime does not differ substantially from its analogues in Western Europe and North America. The regime does, however, have its peculiarities, awareness of which can be essential to get a transaction cleared smoothly and on time. The purpose of this note is to present an overview of the merger control framework and the scope of its application, including the events triggering filing obligations, applicable notification thresholds, and specific issues relating to the treatment of joint ventures, intra-group restructurings and foreign investment restrictions.

Key Issues

1. LEGAL FRAMEWORK

The merger control regime is regulated in the Federal Law No. 135-FZ On Protection of Competition (the "**Competition Law**"), which entered into force on 26 October 2006, replacing two earlier laws regulating competition in commodity and financial markets of 1991 and 1999, respectively.

In May 2007, significant legislative amendments on turnover-pegged fines and leniency were introduced into the Russian Code on Administrative Offences. In April 2008, Russia's Federal Antimonopoly Service ("**FAS**") adopted a revised merger notification directive. In November 2008, technical amendments were made to the Competition Law to provide for coherence between the merger control regime and Russia's new foreign investment regime, which was introduced in April 2008. Finally, in July 2009, the so-called "Second Antimonopoly Package" was adopted, which resulted in far-reaching amendments to the Competition Law, the Code on Administrative Offences and other legislative acts. In the context of merger control, the Second Antimonopoly Package increased notification thresholds, introduced exemptions to the general Russian rule that intra-group transactions are also subject to pre-closing merger control, and significantly broadened the scope of merger control to encompass foreign-to-foreign transactions. The federal government has also adopted implementing regulations setting certain merger control thresholds for financial organisations not fixed by the Competition Law. These were last revised in December 2009. Currently a "Third Antimonopoly Package" is being considered and will likely be adopted in 2011.

2. STRUCTURE OF THE MERGER CONTROL REGIME

2.1 Transactions Subject to Merger Control

While the basic principles of the merger control regime that existed until 2006 were retained in the Competition Law, the relevant pre-closing notification and post-closing notice requirements were significantly revised. One major improvement was that in respect of acquisitions the merger control requirements only apply in cases where the acquisition of a new or increase of an existing stake crosses certain thresholds (25%, 50% and 75% in the case of joint stock companies and 33%, 50% and 66% in the case of limited liability companies). In other words, notification is no longer required for each and every increase of an existing stake (previously acquisition of even a single share above the 20% threshold required notification).

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The current rules consist of a set of notification requirements applicable to three main types of transactions: (i) acquisitions of shares, participatory interests, assets or rights relating to commercial organisations (see section 3.1.1 below); (ii) acquisitions of shares, participatory interests, assets or rights relating to financial organisations (see section 3.1.2 below); and (iii) establishment, merger or accession of/between commercial/financial organisations (see section 3.1.3 below).

For those transactions to which notification requirements apply, (i) pre-closing notification may be specified, whereby implementation of the transaction must be suspended until clearance has been given; (ii) submission of a post-closing notice may be required, or (iii) no clearance by FAS may be required, depending on certain threshold criteria pegged to the balance sheet value of assets of the entities involved in the transaction, their turnover, and/or entry of specific entities into the Russian register of undertakings holding a market share of more than 35% in the relevant market (the "**Register**").

2.2 Treatment of Intra-group Transactions

It is a peculiarity of Russian merger control that it also extends to transactions implemented between entities belonging to the same group of entities. The Competition Law maintains this principle of the previous regime and – despite much criticism – does not generally exempt intra-group transactions from merger control.

The Competition Law provides for a simplified procedure under which intra-group transactions that normally require a pre-closing notification and suspension of performance until clearance is received only require a post-closing notice. In order for a group to benefit from this simplified procedure, the following preconditions must be met:

(a) a list of all the entities that comprise the group of entities must be submitted to FAS (at least one month before the relevant transaction). This list will be published by FAS on its official website;

(b) as of the date of performance of the relevant transaction the list must be correct and up to date, without any changes in the group; and

(c) the relevant transaction must be implemented within the group only.

Generally, the simplified procedure can significantly ease and accelerate the implementation of transactions. In practice, however, few foreign groups are able to avail themselves of this procedure.

Of greater practical importance is an exemption that was introduced as a part of the Second Antimonopoly Package in August 2009. According to this exemption, intra-group transactions are no longer subject to pre-transfer merger clearance if the transfer is to occur vertically between a controlling parent entity and its subsidiary. The exemption also applies if an entity will be vertically 'shifted' across a chain of parent or subsidiary entities, provided, however, that the entities involved are connected through shareholdings of more than 50% at each level. It is important to note that such vertical intra-group transfers are still subject to the post-transfer notice requirements, to be submitted within 45 days after implementation of the transfer (see section 3.1.2(b) below). Moreover, the exemption is narrowly worded and cannot be applied to any other types of intra-group transactions. Nonetheless, in practice the exemption has proven to be an effective tool for pre-sale restructurings and carve-outs to enable foreign-to-foreign transactions to be implemented more expeditiously.

2.3 Treatment of Joint Ventures

Russian merger control does not set out specific rules applicable to the establishment of joint ventures. Joint ventures are reviewed within the general legal framework. In other words, the creation of a joint venture is treated as an acquisition of assets, shares or rights by the joint venture company from its founders and/or third parties. In many cases the notification requirements relating to the establishment and merger of entities may be applicable when establishing a joint venture (see section 3.3 below).

In addition to new merger control requirements, the Competition Law introduced a revised clearance procedure for agreements restricting competition. Joint venture agreements, shareholders agreements and certain other agreements relating to the creation of joint ventures which could potentially restrict competition in Russia may be voluntarily submitted to FAS prior to their implementation in order to obtain a clearance or individual exemption. The applicable procedure is comparable to the former "Form AB procedure" before the European Commission.

2.4 Treatment of Foreign-to-Foreign Transactions

Russian competition law follows the "*effects doctrine*" and the notification requirements may also apply in case of foreign-to-foreign mergers.

Until August 2009, merger clearance in Russia was required if a foreign-to-foreign transaction met both of the following criteria: (1) it resulted in the acquisition of shares or assets of Russian companies, or direct or indirect control over Russian companies; *and* (2) it results or may result in the restriction of competition in Russia.

This structure was, however, reformed as a part of the Second Antimonopoly Package, which turned these two formerly cumulative criteria into alternative requirements. In addition, the second criterion was modified, which is expected to result in broader application of the Russian merger control rules by FAS. It is now sufficient that a transaction "affects"

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competition in Russia, while, previously, it was required that the transaction "restricts or may restrict" competition.

To date FAS has not issued any official clarification as to how it interprets the revised requirement. Based on its current practice, one may, however, surmise that a foreign-to-foreign transaction falls within the Russian merger control regime where the target entity directly or indirectly controls any Russian entities, owns assets located in Russia or has substantial turnover from operations in Russia.

On the whole, the changes mark a departure from the previous regime; the amendments to the extraterritoriality provision of the Competition Law were specifically incorporated to extend its scope to a broader range of foreign-to-foreign transactions. It remains to be seen, however, how FAS will treat transactions where the parties' turnover in Russia is very small, where their activities neither overlap nor strengthen vertical integration, or where the effects on competition in Russia are otherwise insignificant.

2.5 Foreign Investments Regime

In April 2008, Russia introduced a new regulatory regime for foreign investments in strategic sectors of the country's industry. The Federal Law No. 57-FZ On the Procedure of Foreign Investment in Companies Having Strategic Importance for National Defence and State Security, dated 29 April 2008, establishes special notification requirements and clearance procedures relating to such foreign investments. As a rule, these notification requirements are separate from and do not interfere with the merger control regime. Where transactions require clearance under both regimes, FAS will, however, postpone its merger control review until clearance under the foreign investment regime is obtained. If a foreign investment is blocked, this will also serve as a basis for FAS to deny merger clearance.

3. NOTIFICATION REQUIREMENTS

Within the framework described above, the Competition Law provides for the following notification requirements related to specific types of transactions:

3.1 Acquisition of Stakes, Assets and Rights

3.1.1 Transactions Subject to Merger Control

The following types of acquisitions are subject to merger control by FAS. Special rules exist for acquisitions relating to financial organisations (see section 3.2 below).

Acquisition of voting shares in joint stock companies

(a) The acquisition by an entity (group of entities) of voting shares in a joint stock company, where such entity (group of entities) is acquiring the right to dispose of more than 25% of such shares, where prior to the acquisition such entity (group of entities) does not hold any or holds no more than 25% of the voting shares of that joint stock company (this rule does not apply to the founders of joint stock companies upon their establishment);

(b) The acquisition of voting shares of a joint stock company by an entity (group of entities) that is able to dispose of 25% to 50% (inclusively) of the voting shares of that joint stock company, where such entity (group of entities) will thereby acquire the right to dispose of more than 50% of such voting shares;

(c) The acquisition of voting shares of a joint stock company by an entity (group of entities) that is able to dispose of 50% to 75% (inclusively) of the voting shares of that joint stock company, where such entity (group of entities) will thereby acquire the right to dispose of more than 75% of such voting shares;

Acquisition of participatory interests in limited liability companies

(d) The acquisition, by an entity (group of entities), of participatory interests in the charter capital of a limited liability company, where such entity (group of entities) will thereby acquire the right to dispose of more than 1/3 of the participatory interests in the charter capital of that limited liability company, where prior to the acquisition such entity (group of entities) does not hold or holds less than 1/3 of the participatory interests in the charter capital of that limited liability company (this rule does not apply to the founders of limited liability companies upon their establishment);

(e) The acquisition of participatory interests in the charter capital of a limited liability company by an entity (group of entities) that is able to dispose of 1/3 to 50% (inclusively) of the participatory interests in the charter capital of that limited liability company, where such entity (group of entities) will thereby acquire the right to dispose of more than 50% of the participatory interests in the charter capital of that limited liability company;

(f) The acquisition of participatory interests in the charter capital of a limited liability company by an entity (group of entities) that is able to dispose of 50% to 2/3 (inclusively) of the participatory interests in the charter capital of that limited liability company, where such entity (group of entities) will thereby acquire the right to dispose of more than 2/3 of the participatory interests in the charter capital of that limited liability company;

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Transfer of assets

(g) Obtaining by an economic entity (group of entities) as a result of one or several transactions of production and/or intangible assets from another economic entity that is not a financial organisation, where the balance sheet value of the assets being transferred exceeds 20% of the balance sheet value of the total production and intangible assets of the transferor (a statutory exemption from this rule exists for (i) land plots and (ii) buildings, unfinished structures and other facilities, premises and parts thereof, except where such assets are used for industrial purposes);

Acquisition of control by other means

(h) The acquisition of rights by an entity (group of entities), as a result of one or more transactions, which enable that entity (group of entities) to determine the conditions on which another economic entity does business or to carry out the functions of the executive body of another economic entity.

3.1.2 Applicable Procedure

Pre-closing Notification

The acquisitions listed in section 3.1.1 above are subject to a pre-closing notification requirement and their performance must be suspended until clearance by FAS, if:

(i) the aggregate balance sheet value of assets of the acquiring entity (and its group) and the target (and its group) exceeds RUB 7 billion (approximately EUR 167 million) and at the same time the balance sheet value of assets of the target (and its group) exceeds RUB 250 million (approximately EUR 5.9 million); or

(ii) the aggregate turnover of the acquiring entity (and its group) and the target (and its group) during the last calendar year exceeds RUB 10 billion (approximately EUR 238 million) and at the same time the aggregate balance sheet value of assets of the target (and its group) exceeds RUB 250 million (approximately EUR 5.9 million); or

(iii) either the acquiring entity or the target (including their group members) are included in the Register.

Post-closing Notice

The acquisitions mentioned in section 3.1.1 above are subject to a post-closing notice within 45 days upon performance, if:

(i) the relevant transaction does not require a pre-closing notification in accordance with the above thresholds or pursuant to a special intra-group exemption (see section 2.2 above); and

(ii) the aggregate balance sheet value of assets, or the aggregate turnover during the last calendar year, of the acquiring entity (and its group) and the target (and its group) exceeds RUB 400 million (approximately EUR 9.5 million); and

(iii) the aggregate balance sheet value of assets of the target (and its group) exceeds RUB 60 million (approximately EUR 1.4 million).

The threshold criteria set out above were increased as a part of the Second Antimonopoly Package, the aim bring to exempt small transactions from merger control. In light of the broadened extraterritorial application of the Competition Law (see section 2.4 above) and FAS's literal interpretation of the statutory provisions, one must, however, conclude that scrutiny of foreign-to-foreign transactions has been increased rather than lessened.

3.2 Acquisitions Relating to Financial Organisations

With respect to acquisitions relating to financial organisations, the notification requirements are almost identical to the requirements relating to commercial organisations as set out in section 3.1.1 (a) - (h) above. However, in addition to differences in the wording of the various provisions, the following should be noted:

(a) The Competition Law does not fix thresholds for the balance sheet value of assets of the financial organisations involved as set out in section 3.1.2 (a) above. The applicable thresholds are set by the federal government and are currently fixed at:

(i) RUB 33 billion (approximately EUR 785 million) for credit institutions;

(ii) RUB 3 billion (approximately EUR 71.4 million) for leasing companies;

(iii) RUB 2 billion (approximately EUR 47.6 million) for private pension funds;

(iv) RUB 1 billion (approximately EUR 23.8 million) for stock and currency exchanges;

(v) RUB 500 million (approximately EUR 12 million) for mutual insurance companies and consumer credit cooperatives;

(vi) RUB 200 million (approximately EUR 4.8 million) for insurance companies (except in relation to medical insurance), insurance brokers, professional securities markets participants, investment funds, unit investment funds, specialised depositaries of investment funds and

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specialised depositaries of private pension funds; and

(vii) RUB 100 million (approximately EUR 2.4 million) for medical insurance companies and pawnbrokers.

(b) As regards a transfer of assets, the Competition Law does not fix the 20% threshold as referred to in 3.1.1 (g) above. The applicable threshold has been set by the federal government and is currently fixed at 10%.

(c) As regards post-closing notice requirements, the Competition Law does not fix thresholds for the balance sheet value of assets of the acquiring entity as referred to in section 3.1.2 (b) above. The thresholds have been set by the federal government and are currently fixed at:

(i) RUB 2.5 billion (approximately EUR 60 million) for credit institutions;

(ii) RUB 1 billion (approximately EUR 23.8 million) for leasing companies;

(iii) RUB 500 million (approximately EUR 12 million) for private pension funds and stock and currency exchanges;

(iv) RUB 200 million (approximately EUR 4.8 million) for mutual insurance companies and consumer credit cooperatives;

(v) RUB 100 million (approximately EUR 2.4 million) for insurance companies (except in relation to medical insurance), insurance brokers, professional securities markets participants, investment funds, unit investment funds, specialised depositaries of investment funds and specialised depositaries of private pension funds; and

(vi) RUB 50 million (approximately EUR 1.2 million) for medical insurance companies and pawnbrokers.

The above thresholds are regularly reviewed by the federal government on the basis of recommendations by FAS and Russia's Central Bank, which are submitted by 1 May each year. The next revision can, therefore, be expected to take place after 1 May 2011.

3.3 Establishment, Merger and Accession

3.3.1 Pre-closing Notification

A pre-closing notification and suspension of an establishment, merger or accession until clearance by FAS is required in the following cases:

(a) The merger of commercial organisations or accession of one or several commercial organisations to another commercial organisation, where the aggregate balance sheet value of the assets of the commercial organisations involved in the merger/accession (including the groups to which they belong) exceeds RUB 3 billion (approximately EUR 71.4 million), or their aggregate turnover (including groups) for the preceding calendar year exceeds RUB 6 billion (approximately EUR 143 million), or one of the commercial organisations involved in the merger/accession is included in the Register.

(b) The merger of financial organisations or accession of one or several financial organisations to another financial organisation, where the aggregate balance sheet value of the assets of the financial organisations involved in the merger/accession (including their groups) exceeds the applicable threshold set by the federal government, which is currently fixed at:

(i) RUB 24 billion (approximately EUR 571 million) for credit institutions;

(ii) thresholds for other financial organisations are the same as set out in section 3.2 (a) (ii) - (vii) above.

(c) The establishment of a commercial organisation, where (i) its charter capital is paid with shares/participatory interests and/or assets (excluding funds) of another commercial organisation, or the commercial organisation that is being established acquires shares/participatory interests and/or assets of another commercial organisation on the basis of the transfer act or separation balance sheet and acquires such rights or assets as provided for in section 3.1 above with respect to these shares/participatory interests and/or assets, and (ii) the aggregate balance sheet value of assets of the founders (including the groups to which they belong) and of the entities (including their group) whose shares/participatory interests and/or assets are being contributed to the charter capital exceeds RUB 7 billion (approximately EUR 167 million), or the aggregate turnover of all these entities exceeds RUB 10 billion (approximately EUR 238 million) during the last calendar year, or the commercial organisation whose shares/participatory interests or assets are being contributed to the charter capital is included in the Register.

(d) The establishment of a commercial organisation, where (i) its charter capital is paid with shares/participatory interests and/or assets of a financial organisation and the commercial organisation being established acquires such rights or assets as provided for in section 3.2 above, and (ii) the balance sheet value of assets of the financial organisation whose shares/participatory interests and/or assets are being contributed to the charter capital exceeds the applicable threshold set by the federal

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government as described in section 3.2 (a) above.

3.3.2 Post-closing Notice

A post-closing notice of a merger/accession is required in the following cases:

(a) Where a new commercial organisation is being established as a result of a merger or accession, where the aggregate balance sheet value of assets or the aggregate turnover for the preceding calendar year of the entities whose activities are to be discontinued as a result of the merger, or that are involved in the accession, exceeds RUB 400 million (approximately EUR 9.5 million);

(b) Where a new financial organisation is being established as a result of a merger of financial organisations or accession of one or several financial organisations to another financial organisation, where the aggregate balance sheet value of the assets of the financial organisation whose activities are to be discontinued as a result of the merger, or that are involved in the accession, does not exceed the threshold referred to in section 3.3.1 (b) above.

4. APPROVAL PROCESS

4.1. Procedure and Timing

The review process consists of a 30-day review period, which may be extended by a further two months in order to carry out an in-depth review of the transaction. Within the first 10 days after submission of a pre-closing notification, FAS is entitled to return the notification should it find it to be incomplete. Once the 10-day period has expired, the notification can be considered accepted by FAS.

Russian merger control provides for an obligation to suspend the implementation of a transaction until pre-closing clearance by FAS has been obtained. Unlike in many other jurisdictions, transactions are not automatically cleared if the review period elapses and FAS has not taken a decision.

FAS is not always able to comply with the statutory review periods. As a result of the low asset-related thresholds, FAS struggles with an extensive workload of notifications to be reviewed. For example, in 2008, nearly 6,000 notifications requiring pre-closing clearance were filed with FAS, with post-closing notifications adding to this total. Before 2004 there was no certainty whatsoever as to the amount of time FAS might take to render a decision. In recent years, FAS's practices have significantly improved and decisions have normally been rendered within the statutory periods. However, there have been exceptional cases where a review has taken up to six months.

With respect to informal pre-notification talks, the following should be pointed out: Normally, transactions are notified without pre-notification talks with FAS. Unlike with many Western cartel authorities, it is not standard practice to submit information memoranda in advance in order to sound out FAS's views. However, the situation is different with respect to transactions in strategic industries or which may be politically sensitive. With respect to such transactions, it is advisable to inform the relevant state bodies, including FAS, at an early stage to ensure that the transaction receives the necessary support in order to go through.

It should be pointed out that the confidentiality of a transaction cannot be guaranteed from the date information is submitted to FAS. While FAS officially denies that confidential information on transactions is passed on to the media or third parties by FAS officials, there have been cases where information has been leaked to third parties or published in Russian newspapers the day after it was submitted to FAS officials. Finally, just like other Russian state bodies, FAS is not free of corrupt practices, and the head of FAS has explicitly raised the issue of corruption within the organisation on various occasions.

4.2. Documentation and Formal Requirements

The competent authority dealing with merger control matters is FAS, which consists of a central office located in Moscow and 82 subdivisions in most of Russia's regions. Notifications relating to foreign-to-foreign transactions are dealt with by FAS's central office in Moscow.

The obligation to notify is incumbent upon:

(a) the acquirer of shares/participatory interests/ assets/control in cases of acquisitions;

(b) the surviving entity in cases of mergers and accessions; and

(c) the founders in cases of notifiable establishment of a company.

If an acquisition is to be implemented through special-purpose vehicles, the acquiring entity must be incorporated and legally existing in order to be able to make the filing.

As regards the content of a notification, Russian filings are highly technical and formal. A notification will normally consist of an entire lever arch binder of documents on the acquirer's group, the target, their business activities and the transaction. FAS filings do not contain much information on the definition of the relevant markets and potential effects on competition. However, notifications are accompanied by numerous schedules and annexes detailing the Russian activities of the parties and their corporate documents.

Pre-closing notifications can be made on the basis of draft share purchase agreements, which need not be signed. As regards post-closing notices, the executed

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documentation must be provided. The notification and all supplemental documentation must be submitted in Russian. All foreign documentation must be notarized, apostilled and translated into Russian. As a consequence, in order to prepare a notification one should, normally, allow a time frame of 3-6 weeks.

Filing fees are nominal and only exist for pre-closing notifications. Currently the fee is RUB 10,000 (approximately EUR 240) per pre-closing notification and must be paid prior to submission of the notification.

4.3 Substantive Test and Remedy Practice

There are two major grounds on the basis of which FAS is entitled to prohibit the implementation of a notified transaction: (i) FAS comes to the conclusion that the notification contained incomplete or misleading information, or (ii) implementation of the transaction results in a restriction of competition on the relevant market, in particular through the creation or strengthening of a market-dominating position.

Where the applicant has submitted a complete and correct notification, FAS would normally apply the dominance test, i.e. check whether a dominant position is created or strengthened. Until August 2009, there existed a minimum market share threshold of 35% for sole dominance, below which a company could not be considered to hold a dominant position. Under the revised regime, the 35% threshold continues to be the main criterion. FAS, however, can also treat companies holding smaller market shares as dominant, provided that certain market conditions are fulfilled. In addition, where a market is oligopolistic in nature, any company holding a market share of more than 8% may be assessed under collective dominance rules.

As a rule, FAS is not permitted to take into account any measures to protect industries or other policy considerations outside the sphere of competition regulation. In practice, however, the possibility that FAS may apply other industrial policy considerations as a part of its merger control review cannot be fully excluded. In May 2008, a special regulatory regime was introduced for foreign investments in 42 so-called "strategic" sectors of the Russian economy (see section 2.5 above). This regime is separate from merger control and has led to more transparency and a greater focus of the merger control regime on competition aspects.

Following the review of a notification, FAS may:

(a) clear the transaction unconditionally;

(b) where the transaction may result in the creation or strengthening of a dominant position, clear the transaction subject to post-closing conditions, which are typically behavioural in nature;

(c) where the transaction relates to a merger or accession in accordance with Russian corporate law, impose conditions that are to be fulfilled prior to implementing the transaction (up to a maximum period of 8 months);

(d) refuse clearance, if the transaction results or may result in the creation or strengthening of a dominant position; or

(e) refuse clearance, if the notification contains incorrect or misleading information.

In practice, there have only been few refusal decisions in relation to transactions involving foreign acquirers. It is, however, not uncommon that notifications are refused if FAS considers a notification to contain incorrect or misleading information. Therefore, care must be taken when preparing a notification and submitting additional information to FAS.

Similarly to the EU regime, the parties may offer certain undertakings to address competition concerns raised by FAS. In addition, it is a standard practice of FAS to grant clearance subject to certain conditions which must be fulfilled upon implementation of the transaction. There exists a set of conditions that can often be found in FAS decisions. The conditions are almost always behavioural rather than structural in nature. Only in exceptional cases, does FAS require the applicant to dispose of parts of the target business.

5. OUTLOOK

Over the last few years Russian merger control has grown into a sophisticated regime that is similar to those in Western Europe and North America. Significant peculiarities remain, e.g. with respect to the treatment of intra-group transactions, the definition of groups of entities, the risk of refusal on formal grounds and FAS's preference for behavioural undertakings. Various amendments to the Competition Law meant to address some of these issues are currently being discussed and may be adopted in the course of 2011. But in light of the major reforms of 2006 and 2009, it may be expected that the overall framework will likely remain unchanged at least for the next one or two years.

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