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Summary of the Speech of Dr. Andrey Gorodissky at the First Russian and CIS Mergers and Acquisitions Conference of the International Bar Association

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It is a well-known fact that during the past 10 years practically all major M&A transactions have been made on the level of non-Russian holding companies-residents of various countries, primarily belonging to the Anglo-Saxon legal system. For obvious legal and practical reasons, English law was chosen by the parties to those transactions as the governing law of their respective share purchase contracts. Very few significant M&A transactions were governed by Russian law. One of the reasons for such situation is that the rules of Russian law are insufficiently developed and adopted to the modern requirements and standards of making such transactions. We lack an extensive court practice that would support and guide the development of our contractual practice in this area. However, we are witnessing the emergence of a certain trend towards a more wide use in Russian law governed acquisition contracts of clauses very similar to representations and warranties. There is a great variety of approaches and discussions among Russian practitioners in this regard, but the main issue of all discussions is the issue of enforceability. The concept and the notion of representations, warranties and indemnity were perfectly explained to us in Mr. Jankov's representation. I would like to analyze briefly whether the clauses in question could be used and be enforceable here in Russia as they are or whether they need to be modified in a way that would give them the enforceability effect.

For this purpose I prefer to start with a literal interpretation of those legal terms.

It appears that Russian law does not know the legal term "representation". It is translated into Russian as "заявление" (declaration, statement). I do not think there is any close equivalent in our legal terminology which has the same or similar meaning. This also applies to the legal term "warranty" which, as a rule, is translated as "гарантия", but in our law it has a different meaning associated primarily with a bank guarantee. The translation of

the legal term “indemnity” as “возмещение” or “освобождение от ответственности” has an entirely different meaning from Russian law perspective.

Although our law does not have rules which could be interpreted as direct or close equivalents of representations and warranties in English law, some similarities can be found and this primarily concerns the seller’s ownership rights to shares, which rights the seller must transfer to the buyer free and clear of any third-party rights (unless the buyer agrees to accept the shares with encumbrance). The seller’s failure to comply with this requirement of law gives the buyer the right to claim adjustment of the price or termination of the contract and recovery of damages. This is a direct prescription of law.

In addition to this, Russian law stipulates that transactions made as the result of delusion or deception may be invalidated on a claim of the aggrieved party which also has the right to have damages recovered.

The permissible broad interpretation of certain provisions of our Civil Code gives a good ground to believe that in some other areas typically covered by representations and warranties in the English contractual practice (as advised in Mr. Jankov’s presentation), such as:

- the target company’s ownership rights to real estate, intellectual property and other assets (including financial assets),
- its tax liabilities, contracts material for its business,

the parties to a Russian law share purchase contract can provide for the obligation of the seller to sell its shares in the target company which is in a certain condition stipulated by the contract. In other words, the description of the target company’s and its assets’ condition should be an integral part of the material characteristics of the object of the contract.

In this connection it is important to emphasize, I believe, that any statement of facts and any assurance that those facts are true can only be enforceable under Russian law if they can be qualified as civil law contractual obligations.

Therefore, certain areas that are usually covered by English representations and warranties clauses will most probably be unenforceable under Russian law and will remain ignored by courts as mere declarations that have no legal effect. This concerns, first of all, statements regarding availability of all requisite corporate approvals for execution and delivery of the contract and statements regarding a general capacity to enter into the transaction.

The requirement of Russian law to obtain corporate approvals for major and interested-party transactions gives rise to the issue of validity of the entire contract the Russian company is a party to. It is important to note that in such a case the contract may be considered as invalid regardless of whether it is a Russian law or an English law contract with the representations, warranties and indemnity clauses.

<u>Remedies under Russian law</u>

1. Breach by the seller of the obligation to transfer the title to the shares free and clear of any third-party rights – the buyer may claim adjustment of the price or termination of the contract and damages.

2. Breach by any of the parties to the contract of its obligations thereunder (in full or in part) – the aggrieved party may claim damages and penalties (if penalties are

stipulated by the contract). A court may decrease the penalty claimed, if it is clearly not commensurable with the consequences of the breach.

3. The contract executed by a party as the result of delusion or deception may be invalidated on a claim of the aggrieved party which also has the right to claim damages.

4. By "damages" Russian law understands actual losses (a causal link between the breach of the obligation and the loss should be proved by the claimant) and lost profit (to be proved by the claimant)

Conclusions

1. In case of a cross-border acquisition where one party to the transaction is a Russian company and the other party is a foreign company, it is recommended to make the choice of governing law in favor of English law, because Russian law is not yet developed enough to meet the international standards of making such deals. The choice of English law is valid for the Russian company, subject to a few exceptions (e.g., public policy).

2. Particular attention should be paid to the legal due diligence of the Russian company as to its power and authority to enter into and perform the share purchase contract, and the availability and validity of all Russian law corporate approvals (where necessary), despite the representations, warranties and indemnity clauses the contract may contain, because any non-compliance in this respect can entail invalidation of the entire contract, including those clauses.

3. It is recommended to enter into an arbitration agreement in favor of one of the international commercial arbitration institutions, as Russia is a member of the 1958 New York Convention but does not have an international treaty on enforcement of court decisions with most of the countries.

4. In case both the seller and the buyer are Russian companies, and the intention of both parties is to use in their contract legal instruments similar to English representations and warranties, and in order to make the respective provisions of the contract enforceable, it is advisable to draft those provisions in a way that would make them to be undoubtedly qualified as civil-law contractual obligations rather than just the statement of facts and the assurance that the facts are true.