



**ASSOCIATION OF EUROPEAN BUSINESSES IN
THE RUSSIAN FEDERATION**

Ulitsa Krasnoproletarskaya 16 bld. 3, Moscow, 127473
Tel.: +7 495 234 27 64, ext. 124 Fax: +7 495 234 28 07
info@aebrus.ru www.aebrus.ru



AEB M&A WORKING GROUP NEWSLETTER

Prepared by the Association of European Businesses in cooperation with mergermarket.com

Issue 3, October 2010

INTRODUCTION FROM THE CHAIRMAN

The positive M&A trend that began to make itself felt in the spring of 2010 is gathering more steam as we enter the thick of the autumn business season. The gradual economic recovery in Russia is one obvious reason, but there are still more relevant deal triggers ahead.

One of them is the necessary disposal of numerous industrial assets accumulated by large state banks during the financial crisis, as insolvent borrowing companies were forced to transfer ownership to their creditors. Another is the much awaited wave of privatization of key government assets, as described elsewhere in this issue. And a third still is the return of external growth for several foreign strategic acquirers, primarily from Western Europe, for whom Russia is still the growth market closest to home.

These factors mean that we are bound to see interest from foreign investors towards assets belonging to the so-called "strategic" sectors, another topic covered in this newsletter. Since its enactment in 2008, the Governmental Commission for the Control of Foreign Investments, presided by the Russian Prime Minister in person, has worked fairly smoothly. Only a fraction of close to seventy acquisition demands made by foreign investors in these sectors were eventually turned down, in fact such instances can be counted on the fingers of one hand.

This simple statistic should go some way in reassuring foreign investors that Russia is not such a hostile land for M&A after all, certainly less than it is given credit for.

Joel Lautier


Chairman of the AEB M&A Working Group

PART I. TOP DEALS

Top 10 Russian Announced M&A deals for Apr 1 - Jul 31

Announcement Date	Bidder Company	Target Company	Target Dominant Sector	Seller Company	Deal Value (US\$m)
30-Jun-10	KazakhGold Group Limited	OJSC Polyus Gold	Energy, Mining & Utilities		10,238
14-Jun-10	Kaliha Finance Limited; Aerellia Investments Limited; and Becounioco Holdings Limited	JSC Uralkali (53.2% Stake)	Industrials & Chemicals	Madura Holding Limited	5,199
13-May-10	OAO Rostelecom	CenterTelecom OJSC	TMT	Svyazinvest Telecommunication Investment Joint Stock Company	2,309
12-May-10	OAO Rostelecom	Uralsvyazinform JSC	TMT	Svyazinvest Telecommunication Investment Joint Stock Company	1,970
23-Apr-10	OAO Rostelecom	Sibirtelecom OJSC	TMT	Svyazinvest Telecommunication Investment Joint Stock Company	1,750
13-May-10	OAO Rostelecom	North-West Telecom	TMT	Svyazinvest Telecommunication Investment Joint Stock Company	1,449
12-May-10	OAO Rostelecom	OJSC VolgaTelecom	TMT	Svyazinvest Telecommunication Investment Joint Stock Company	1,134
25-Jun-10	Mobile TeleSystems OJSC	OAO Comstar United TeleSystems (38.03% Stake)	TMT		1,030
26-Jul-10	Andrey Kobzar (Private Investor)	National Container Company LLC (50% Stake)	Transportation	Far Eastern Shipping Company	900
21-May-10	OAO Rostelecom	Svyazinvest Telecommunication Investment Joint Stock Company (25% Stake)	TMT	OAO Comstar United TeleSystems	867

Notes:
 Based on deals announced between 01 April 2010 and 31 July 2010, including lapsed and withdrawn bids
 Based on the dominant target company geography being Russia
 Data correct as of 20-Aug-2010
 Activities excluded from table include property transactions and restructurings where the ultimate shareholders' interests are not changed



M&A in Russia has still not quite picked up after the crisis of 2008, both in terms of number and value of deals. The total value of deals has slightly gone up but the number of deals has hardly crossed the threshold of 50 deals per quarter, while the usual pre-crisis numbers since 2007 were no less than 75.

The second quarter of 2010 seems a pleasant exception with a total value of the deals as high as USD 29.3bn. This high number is attributed to a very few of large deals including the acquisition of Polyus Gold by Kazakhgold (USD 10.7 bn), the consolidation of Svyazinvest regional operators under Rostelecom (over USD 10 bn) and the acquisition of the controlling stake in Uralkali by a group of investors (USD 5.5 bn).

Needless to say that the acquisition of Polyus Gold (part of a strategy for an IPO by benefiting from the existing listing of Kazakhgold in London, as well as raising controversy and legal investigations in Kazakhstan) or the consolidation of regional state telecom companies by Rostelecom to a large extent represent only a regrouping of existing ownership structures.

DEAL OF INTEREST

Prepared by Natalya Morozova, Vinson & Elkins LLP

In smaller deals, an interesting development is the formation of a joint venture in July 2010 between Integra Group, a leading Russian onshore oilfield services provider, and the seismic business division of Schlumberger WesternGeco to provide land seismic acquisition services and interpretation and data processing in Russia, Kazakhstan, Uzbekistan and Turkmenistan with WesternGeco taking a minority stake in the joint venture.

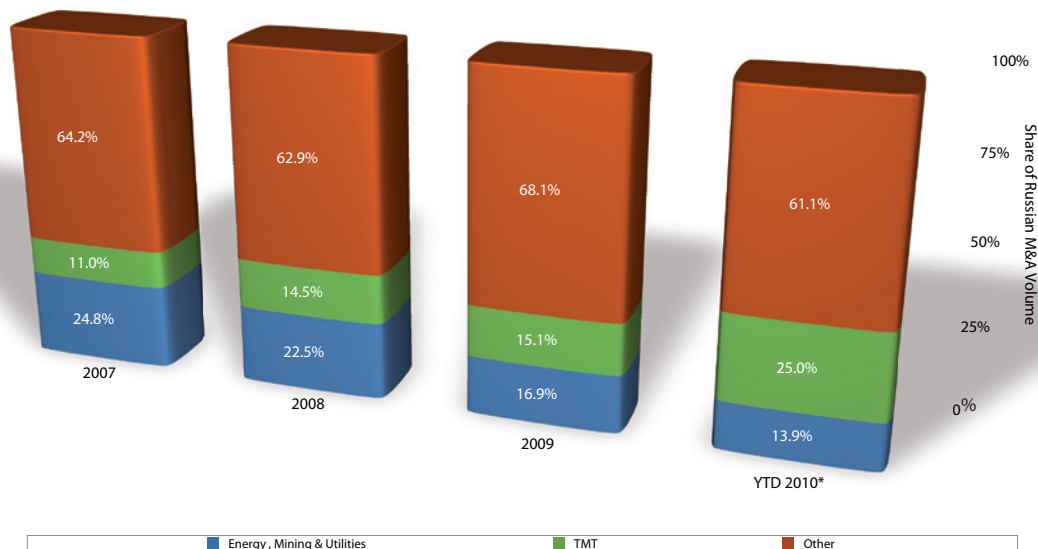
Integra will be responsible for the day-to-day management of the company but key strategic and investment decisions will be taken by the board of directors where both shareholders will be represented.

This is a landmark transaction showing the willingness of the two service providers to combine their capabilities and expertise in various jurisdictions in a hope to benefit from the created synergies, as well as to create additional business opportunities and increase their client base.

PART II. M&A in Russia by Sector

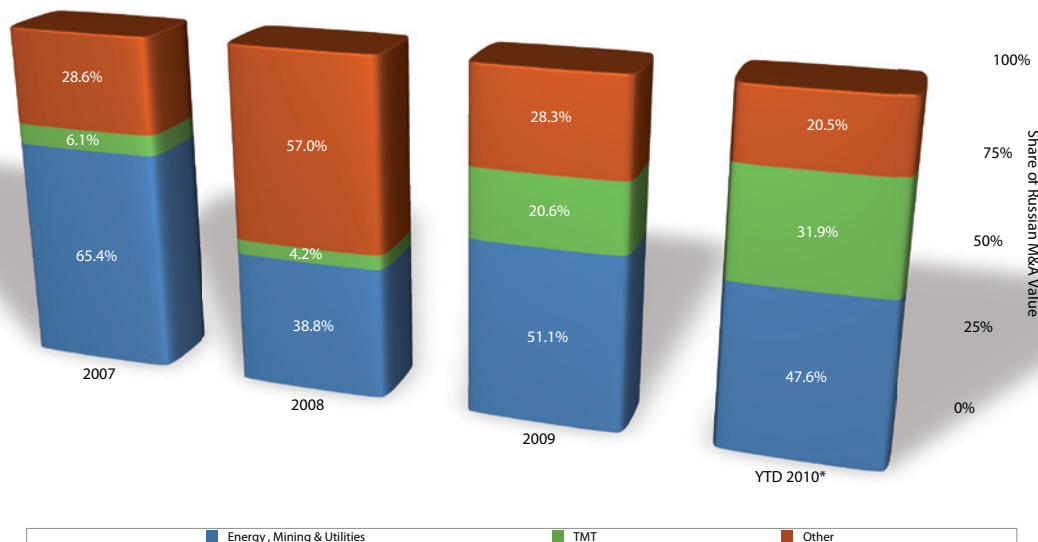
Russian M&A: Share of Total M&A Value

Source: mergermarket: Announced, excluding lapsed and withdrawn deals



Russian M&A: Share of Total M&A Volume

Source: mergermarket: Announced, excluding lapsed and withdrawn deals



COMMENTARY:

In the previous issue of the newsletter we looked at the composition of the deal landscape in 2009 and early 2010. In this newsletter we look into the dynamics of this.

As you can see, the deal landscape continues to be dominated by energy, mining, utilities and telecommunications with other industries typically accounting for less than a third of the value of

the deals (with only exception of 2008 which was partly influenced by crisis-inspired restructurings). At the same time, in terms of the number of the deals, industries other than energy, mining, utilities and telecommunications account for almost two thirds of the deals.

At the same time, a gradual shift from energy, mining, and utilities to telecommunications is apparent. We expect that the continuing reform in the sector (consolidation at Rostelecom etc) will continue reinforcing this trend.

PART III. FEATURE - PRIVATIZATION



Key Russian privatizations require additional changes to legislation - analysis

The large-scale privatization planned by the Government of Russia requires additional changes in legislation and approvals by the country's president, a number of Russian lawyers told Mergermarket.

All the eventual disposals are subject to the adoption of the federal property privatization plans, several government decrees and even the adoption of federal laws, according to one lawyer.

Transneft, United Grain Company, Russian Railways, as well as Rosneft are included in the list of strategic enterprises to be sold, and will require a specific resolution by President Dmitry Medvedev before the government can proceed, several Moscow-based lawyers said.

Depending on the individual company involved, the size of the stake to be sold and the identity of the investor (Russian or foreign, private or state-owned), a bidder may need to get preliminary anti-trust consent from the Russian Federal Antimonopoly Service, the first lawyer said. Privatization of companies that are defined as strategic will also be subject to approval by the Government Commission for Foreign Investment Control, the individual and other lawyers confirmed.

The current legal framework for privatization in Russia is fairly developed and comparable with that in Western countries, the first lawyer said. The new law on privatization was adopted in 2001, and was further amended with the latest changes having come into force this summer, Yulia Kuzmicheva, a lawyer with KPMG, added.

The recent changes in the law have broadened investors' options, specifically increasing the number of privatization tools available, she said. The new law provides for a number of instruments which are designed to secure the transparent and efficient privatization process (e.g. disclosure requirements, mandatory audit valuation of state assets to be privatized, various privatization structure options), the first lawyer said.

The new legislation provides transparent rules and procedures for the valuation of assets, added a second Moscow-based lawyer.

However, the new privatization legislation is yet to be tested, the first lawyer noted. Legal practice in Russia is vague and sometimes contradictory, he added. There have been numerous attempts by the authorities to challenge the results of the previously completed privatization processes, some of them resulting in favour of the state.

The most high profile cases (such as challenging the Domodedovo airport privatization) could only be resolved in the course of a review by the High Arbitration Court, the second lawyer said.

A different potential issue is that currently there are numerous legislative acts regulating privatization of certain types of assets, instead of one single universal act, according to analytical group Investcafe.

Things have changed since the 1990s, but matters are by no means transparent and/or efficient by Western standards and there are various potential pitfalls as a result, a third lawyer said. Most importantly, there is no guarantee that the state might not simply decide to renationalize a privatized asset in future, particularly if the asset is made profitable or otherwise valuable following privatization, the lawyer added.

Most commercial legal transactions in Russia usually have an offshore structuring element, which means that foreign investors can have some comfort to be able to enforce their foreign law agreements, for example in the London Court of Arbitration. In principle, damages for breach of such an agreement could also be sought.

As previously reported, the Russian government is considering privatization of a number of state-owned assets. Companies being discussed in the media as objects for potential privatization includes stakes in the oil pipeline operator Transneft (27.1%); oil producer Rosneft (24.16%); VTB Bank (24.5%); Sberbank (9.3%); Russian Railways (25% minus one share); Pochta Rossii; FSK UES; RusHydro; Sovcomflot; and Rosselkhozbank; as well as agricultural and industrial companies Rosagroleasing, and OZK (United Grain Company); and Rosspirtprom.

by Alexander Čajčyc and Maria Petrova in Moscow

PART IV. TIPS FROM PROFESSIONALS



PROTECT INTEREST DEDUCTIBILITY USING DOUBLE TAX TREATIES

Prepared by Andrey Shpak, Tax Partner, Goltsblat BLP

Historically, Russia has been relatively generous when establishing limitations on deductibility of interest - the interest deductibility cap on foreign loans for more than 15 years has never been below 15%.

However, the Russian President has recently signed a new law (Federal Law No 229-FZ dated 27 July 2010), according to which the interest deductibility cap for loans in foreign currency decreases effective 1 Jan 2011 from 15% pa to 0.8 of Central Bank of Russia rate - ie based on the current Central Bank rate effectively to 6.2% pa.

If your existing loans (or the loans you plan to attract to finance the Russian business) are denominated in foreign currency and bear an interest higher than the above threshold, you will be affected.

One obvious solution could be to replace loans in foreign currency to loans denominated in Russian Roubles, where the interest cap is retained at the level of 1.8 of Central Bank of Russia rate ie based on the current Central Bank rate effectively at 13.95% pa. The obvious downsides to this solution are the foreign exchange risk (for intra-group financing), as well as higher interest rates that are typical for Ruble-denominated loans (if you attract third-party financing).

Luckily, Protocol to the Russia-Netherlands double tax treaty allows for full deduction of arms-length interest if the Russian borrower is directly or indirectly owned by a Dutch parent.

This gives an opportunity to introduce a Dutch holding company into the structure in order to benefit from these Dutch treaty interest deductibility provisions.

Similar provisions are contained in double tax treaties signed by Russia with the UK, Germany, Belgium, New Zealand, Canada and France (although most of them require direct ownership in the Russian subsidiary claiming the deduction as opposed to the Dutch treaty where an indirect ownership is also acceptable).

As a side benefit, these provisions may also help you with overriding Russian domestic thin capitalization rules - as of now there exists extensive court practice with courts supporting such override based on double tax treaty provisions.



IMPLEMENT APPLICATION OF LAW ON STRATEGIC INVESTMENTS

Prepared by Ilja Ratschkov and Tatiana Galakhova, Noerr OOO

In recent months the Russian arbitrazh courts have rendered a number of interesting decisions that highlight the case law in applying the Federal Law On The Procedure of Making Foreign Investments in Companies of Strategic Importance for Ensuring the Country's Defence and State Security (the "Law").


"Preliminary" agreement can require consent of the governmental commission

In the action of Telecominvest1 against other shareholders of MegaFon OAO the court has clarified that the law bans not only the actual acquisition of control over a strategic company, but also the creation of legal prerequisites for such acquisitions, which means, not only performance, but the conclusion of the transaction as well.

Shareholders of MegaFon OAO - TeliaSonera Aktiebolag, Sonera Holding B.V. and TeliaSonera Finland OY, on one side, and Altimo Holdings and Investments Limited and Alfa Telecom Turkey Limited, on the other, entered into a joint venture agreement which implied among other things, that the parties transfer the shares in MegaFon OAO, directly or indirectly belonging to them, to the new company, and determined the conditions and procedure for this transfer, as well as the procedure for implementation of control over MegaFon OAO by the new company.

The participants of the disputed agreement argued in court that the agreement was of a rather preliminary character and did not entail any changes in the structure of ownership of shares in MegaFon OAO. Consequently, the agreement should, as alleged, not be regarded as a transaction which would need to be concluded in accordance with the requirements of the Law, and for that reason was concluded in the absence of a preliminary agreement.

However, the court, regardless of "inconsequent reasoning" of the defendants, came to the conclusion that the defendants, indeed, concluded a transaction – the joint venture agreement, which



was, in the opinion of the court, nothing but a transaction, since it had all the characteristics, provided by the current civil laws of the Russian Federation with respect to transactions.

As noted by the court, the law bans not only the actual acquisition of control over a strategic company, but also the creation of legal prerequisites for such acquisition, which means, not only performance, but the conclusion of the transaction as well. At the same time, it does not matter whether the parties actually have the ability to perform the transaction. Even in the event the transaction has not been performed, it is considered invalid from the moment of its conclusion.

The court drew a conclusion that the agreement also endowed companies of TeliSonera with civil law rights to the extent that their implementation would result in acquisition of control over the newly established company, and, consequently, over MegaFon OAO. Based on this, the parties should have obtained the preliminary consent to this transaction.

Acquisition of shares under a mandatory offer

The professionals are well familiar with the problem of acquisition of shares in strategic companies on the basis of a mandatory offer. Thus, Art. 84.2. of the Law on Joint-Stock Companies imposes an obligation on a person who has acquired (taking into account shares held by this person and their affiliated parties) over 30% of the total amount of shares in an open joint-stock company, to make a public offer to other shareholders of respective types of shares or holders of securities convertible into shares, in order to buy-out such securities from them.

However, the current edition of the Law hinders such buy-out as it provides for the necessity of a preliminary consent from the governmental commission prior to the transaction. There is already an established court decision practice regarding the declaration of transactions aimed at the buy-out of shares from minority shareholders on the basis of mandatory offers. For example, the Highest Arbitrazh Court of the Russian Federation has recently confirmed² that Russian company Kores Invest OOO (belonging to Syntes group) did not have a right to buy shares from minority shareholders in the amount which would entail the establishment of control over the strategic company TGK-2 (OAO), without the consent of the authorized state body. The background of the case is as follows. After Kores Invest OOO bought over 30% of the shares in TGK-2 OAO from RAO EES Russia, it made an offer to the other shareholders of TGK-2 OAO pursuant to Art. 84.2. of the Law on Joint-Stock Companies and subsequently concluded share purchase agreements with more than forty of them. However, Kores Invest OOO later filed a number of lawsuits in court seeking

invalidation of the share purchase agreements based on Art. 7 of the Law. According to Art. 7 of the Law, share purchase agreements pertaining to shares of strategic companies which result in the acquisition of the right to dispose of, directly or indirectly, more than 50% of the total number of votes falling on voting shares of a strategic company, are subject to a preliminary consent. The court has sustained the claims and declared the transactions invalid for violation of the Law. The result of such action was that Kores Invest OOO has successfully avoided the buy-out of shares from minority shareholders at a rather high pre-crisis price.

Similar decisions had already been rendered earlier. For example, in early 2009, the Arbitrazh Court for the City of Moscow invalidated³ a number of share purchase agreements pertaining to shares in TKG-4 OAO. The action was filed by ONEXIM HOLDINGS LIMITED (controlled by Mikhail Prokhorov) that had previously bought shares in TKG-4 OAO from Deutsche Bank AG, Clearstream Banking S.A. and other minority shareholders.

Interestingly, a bill aimed at amending the Law was reported to have already been presented before the Government of the Russian Federation. One of its clauses is directed at eliminating the existing conflict of laws. Once the relevant amendments are introduced, a foreign investor first will be obliged to complete the transaction which is mandatory for him, after which he will have to apply to the authorized body in order to get a post-transaction consent. At the same time, the governmental commission will be empowered to reject its consent to the establishment of control over a strategic company, if it finds such control undesirable.

What can companies do in the above situation until the progressive amendments are in force?

The Civil Code of the Russian Federation offers an option to implement a contract under a condition. In this way, the foreign investor can purchase shares from the other shareholders, but may not vote proportionally according to the shares he holds until the consent is granted by the governmental commission. If such consent is declined, the company will have to sell the shares.

RUSSIAN M&A FORUM

On October 12th, 2010 Mergermarket/Financial Times group, partner of the AEB M&A working group, held its first "Russian M&A Forum" at Marriott Royal Aurora Hotel in Moscow.

This inaugural event featured leading industry figures who explored the dealmaking landscape in Russia and created lively discussions on sourcing distressed debt opportunities and getting a deal done.

To view the report please go to: http://www.mergermarket.com/PDF/GBLP_Russia_2010.pdf

CONTRIBUTORS:

Natalya Morozova - Partner, Vinson & Elkins LLP

Rel: + 7 495.544.5800

Email: nmorozova@velaw.com

Andrey Shpak, Partner, Goltsblat BLP

Tel.: +7 495 287 44 44

Email: Andrey.Shpak@gbplaw.com

Ilja Ratschkov, Partner, Noerr OOO

Tel.: +7 495 7995696

Email: Ilja.Ratschkov@noerr.com

Tatiana Galakhova, Senior Associate, Noerr OOO

Tel.: +7 495 7995696

Email: Tatiana.Galakhova@noerr.com

Anton Konnov, Partner, Allen & Overy Legal Services

Tel.: +7 495 725 79 00

Email: Anton.Konnov@AllenOvery.com

Yulia Kuzmicheva, Lawyer, KPMG

Tel.: +7 495 937 44 77

Email: ykuzmicheva@kpmg.ru

Rob Hartley – CIS Bureau Chief, Mergermarket / dealreporter

Tel.: +44 (0) 7739 805 980

Email: rob.hartley@mergermarket.com

Alexander Čajčyc, Reporter, Dealreporter (Mergermarket Group)

Email: alexander.cajcyc@dealreporter.com

Maria Petrova, Reporter, Mergermarket

Email: maria.petrova@mergermarket.com

EDITORIAL BOARD CONTACTS:

Joel Lautier - Chairman of the AEB M&A Working Group, CEO,

RGG Capital, Strategy Partners

Tel.: +7 495 730 7747

Email: joellautier@gmail.com

Elena Kuznetsova - Committees Coordinator, AEB

Tel.: +7 495 234 27 64 ext. 124

Email: elena.kuznetsova@aebrus.ru

Andrey Shpak – Deputy Chairman of M&A Working group,

Partner, Goltsblat BLP

Tel.: +7 495 287 44 44

Email: Andrey.Shpak@gbplaw.com

Oxana Vladislavskaya - Deputy Chairperson of the AEB M&A Working group, BSGV

Tel.: +7 495 720 67 00 ext. 06553

Email: oxana.vladislavskaya@socgen.com

