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# AEB M&A WORKING GROUP NEWSLETTER

Prepared by Association of European Businesses in cooperation with [mergermarket.com](http://mergermarket.com)

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## **INTRODUCTION FROM THE CHAIRMAN**

After a particularly rough winter, even by Russian standards, spring has finally settled in. For business, the Russian winter effectively lasted for the entire year of 2009 and many have been hoping that the change of season will bring about a significant rise in economic activity, alongside a much-awaited rise in temperature. Most macroeconomic forecasters expect a GDP growth in Russia between 3% and 5% for the current year, and see this trend remaining stable at least until 2012.

Stable growth being the preferred environment for M&A activity in any market, a surge in M&A deals is thus to be expected starting from this year onwards. As the prime driver of the Russian economy, the oil & gas sector normally sets the pace for other economic activities and constitutes the focal point of this present newsletter. As you will read elsewhere in this issue, large state banks that became owners of significant oil & gas assets as a result of the crisis are now looking in earnest for strategic buyers of these assets, which means we can look forward to intense M&A activity in the coming months in that particular industry.

However, as the crisis made painfully clear, the Russian economy is in dire need of diversification and modernization. Nolens volens, substantial investments will have to be made and stimulated by the Russian government in transport and energy infrastructure, healthcare and telecommunications, to name but a few of the obvious choices. Having the government as a well-disposed partner, rather than as a stern supervisor as often happens in the sector of natural resources, opens new and attractive prospects for foreign investors. This should set the stage for some interesting cross-border deals in the near future.


**Joel Lautier**

Chairman of the AEB M&A Working Group

# PART I. TOP DEALS

Announcement Date	Bidder Company	Target Company	Target Sector	Seller Company	Deal Description	Deal Value (US \$m)	Deal Value (€m)
5-Jan-10	Mikhail Gutseriyev (Private Investor)	NK Rusneft OAO	Energy, Mining & Utilities	En+ Group Ltd	Mikhail Gutseriyev, the Russia based private investor with interests in the oil and chemical sector, has acquired NK Rusneft OAO, the Russian oil producing company, from En+ Group Ltd, the Russian holding company with interests in Mining and Energy, for a consideration of US\$ 6,600m (including debt of US\$ 6,000m). En+ Group is the Energy division of Basic Element, which in turn is owned by Oleg Deripaska, a Russian private investor. The sale will allow Oleg Deripaska to reduce some of the debt owed. Deripaska purchased Rusneft from Gutseriyev for US\$ 3bn in 2007, taking a US\$ 2.7bn loan from Sberbank.	6,600	4,595
2-Dec-09	Russia Real Estate Fund LP	Gostinichnaya Kompania (51% stake)	Leisure	The Moscow City Government	Russia Real Estate Fund LP the Russian investment fund owned by the American businessman Mr Ronald Lauder, the heir to Estee Lauder cosmetics company, has agreed to acquire a 51% stake in Gostinichnaya Kompania, the Russia based hotel holding company, from The Moscow City Government for a consideration of RUB 31bn (US\$ 1061m). The Moscow government has contributed stakes in 15 hotels to Gostinichnaya Kompania. The holding company will manage and overhaul the hotels.	1,061	705
13-Jan-10	Integrated Energy Systems	Volzhskaya TGK OAO (62.43% stake)	Energy, Mining & Utilities		Integrated Energy Systems (IES), the Russia based energy company, has agreed to acquire a 62.43% stake in Volzhskaya TGK OAO (TGK-7), the listed Russia based company engaged in the production, distribution and sale of electric and thermal energy, for a consideration of RUB 25.36bn (US\$ 863.93m). As per the terms of the agreement, IES will acquire 18.735bn shares of TGK-7 at an offer price of RUB 1.354 per share (US\$ 0.046). The offer price represents a premium of 0.2% over TGK-7's closing share price of US\$ 4.6 as of 12 January 2010, one day prior to the announcement, and a premium of 4.8% over TGK-7's closing share price of US\$ 0.044 as of 11 December 2009, one month prior to the announcement. The offer period is valid for 70 days from 12th January 2010. Earlier in 2008, IES had agreed to acquire a 37.5% stake in TGK-7 from Unified Energy Systems of Russia, the listed Russian energy group.	864	595
1-Dec-09	GlobalTrans Investment Ltd	OOO BaltTransServis (50% stake)	Transportation	Transportation Investments Holding Ltd	GlobalTrans Investment Ltd, the Russian freight transportation services company, has agreed to acquire an indirect 50% stake in OOO BaltTransServis, the Russian railway transportation service operator, from Transportation Investment Holding Ltd (TIHL), the Cyprus based privately-owned transportation and infrastructure group in Russia with strategic interests in rail transportation and port operations, for an equity consideration of USD 250m. Under the terms of the agreement, TIHL will transfer 5/9 stake of its 100% holding in a Cypriot based holding company, which in turn owns a 90% stake in BTS. With this transfer, GlobalTrans will indirectly hold a 50% stake in BTS, while TIHL will indirectly hold a 40% stake, and an unrelated third party will hold the remaining 10%. In addition to the transaction, GlobalTrans will raise US\$ 175m through GDRs with one GDR representing an interest in one ordinary share. TIHL holds a 50.1% stake in GlobalTrans and it will continue to hold the same level of shareholding in GlobalTrans post offering. The net proceeds from the offering will be used to acquire new rolling stock and for general corporate purposes. BaltTransServis has a fleet of 9,686 units of rolling stock, which includes 9,042 rail tank cars, 595 gondola (open top) cars and 49 locomotives as of 30 June 2009. For the year ended 30 June 2009, BaltTransServis had an EBITDA of US\$ 52.3m and net debt of US\$ 19.7m. The acquisition is in line with GlobalTrans' strategy to balance its business portfolio. The acquisition is subject to the completion of the placement of GDRs.	270	179
7-Dec-09	Konditerskiy Dom Vostok	Sibirsky Bereg	Consumer	Maybond Limited	Konditerskiy Dom Vostok (KDV), the Russia based producer and distributor of confectionary, has acquired Sibirsky Bereg, the Russia based maker of toasted snack foods, from Maybond Limited, the Cyprus registered holding company, and Sibirsky Bereg's management team, for an undisclosed consideration estimated to be in the range of US\$ 200m to US\$ 300m, excluding debt. Sibirsky Bereg's management team consists of Mr Vadim Sukharev, chairman, Mr Alexander Ladan, director, and Messrs Yuri An and Alexander Kychakov, members of Sibirsky Bereg's board. Each of these investors previously held a 12.25% stake in Sibirsky Bereg. Maybond Limited is also owned by these investors. Sibirsky Bereg reported revenues of US\$ 225.2m and EBITDA of US\$ 22.87m in 2007.	200	135
29-Dec-09	VTB Bank JSC	Sistema-Hals ZAO (40.62% stake)	Real Estate		VTB Bank has launched a mandatory offer to acquire a 40.62% stake in Sistema-Hals ZAO, for a total consideration of RUB 3.35bn (EUR 79.15m). VTB Bank, the listed Russia based company headquartered in Moscow, is a commercial bank. Sistema-Hals ZAO, the listed Russia based company headquartered in Moscow, is a company engaged in development, asset management and facilities management. Terms: RUB 736.69 (EUR 17.37) per Sistema-Hals ZAO share. The implied equity value of the transaction is approximately RUB 8.26bn (EUR 194.88m). The offer represents a discount of 20.55% based on Sistema-Hals' closing price on 28 December 2009 of RUB 888.13 (EUR 20.88) per share, one day before the announcement. The offer represents a discount of 24.88% based on Sistema-Hals' closing price on 27 November 2009 of RUB 920 (EUR 21.27) per share, one month before the announcement. Expected completion: The offer acceptance period will last for 70 days from 28 December 2009. Background: VTB Bank has a total ownership of 59.38% in Sistema-Hals ZAO. In April VTB Bank acquired an initial 19.5% stake and later exercised its call option to purchase a further 31.5% stake. VTB Bank also has an indirect ownership of 8.15% through its subsidiary Hals Finans. Other shareholders: AFK Sistema holds a 19.45% stake, the management has a 3.3% stake with the remaining 17.86% being freefloat. Update 29 December 2009: The Board of Directors of Sistema-Hals ZAO recommends its shareholders to accept the mandatory offer of VTB Bank.	114	79
22-Dec-09	Mobile TeleSystems OJSC	Eurotel Russia	TMT	Effortel Russia Group	Mobile TeleSystems OJSC, the listed Russia based provider of mobile cellular communications services, has agreed to acquire Eurotel Russia, the Russia based provider of fixed line telecommunication services, from Mortfield Holdings Limited, the Cyprus based holding company of Effortel Russia Group, the Russian telecom and internet services provider, for a total consideration of US\$ 110m. Mobile TeleSystems received approval from the Russian Federal Antimonopoly Service for the acquisition of Eurotel filed by Mobile TeleSystems on 2 December 2009. The consideration includes a certain amount payable by the end of February 2011 if Eurotel satisfies certain conditions set forth in the agreement. The acquisition is consistent with MTS' strategy of providing new and better services to its customers and will extend its network to around 35,000 kilometers. UPDATE 24 December 2009: Mobile TeleSystems has completed the acquisition of Eurotel Russia.	110	77
11-Dec-09	Premier Energy Corporation	Speckrit LLC	Energy, Mining & Utilities	Rossgaz LLC	Premier Energy Corporation, the listed US based company engaged in the exploration and production of oil and gas properties, has agreed to acquire Speckrit LLC, the Russia based company engaged in oil exploration, from Rossgaz LLC, the Russia based company engaged in the exploration of oil properties, for a cash consideration of US\$ 65m. Under the terms of agreement, Premier Energy will acquire all securities and retire outstanding debt for US\$ 65m. The acquisition is in line with Premier Energy's strategy to enhance its presence in oil, gas and condensate production in Russia. Premier Energy owns a 51% stake in Karbon CJSC, the Russia based company which holds exploration and production licenses for the North-Kopanskoye Field in the Orenburg Region in the Volga-Urals Basin and has agreed to acquire the remaining 49% stake from Rossgaz. Post acquisition, Premier Energy will require an additional US\$ 45m for evaluation and development of the acquired oilfields.	65	44
22-Dec-09	Gazovye Magistrali Tyumeni	Authorities of Tyumen Region (369 Gas Pipeline Systems in Tyumen)	Energy, Mining & Utilities	Authorities of Tyumen Region	Gazovye Magistrali Tyumeni, the Russia based gas pipeline operator and a subsidiary of METROPOL Investment Financial Company Ltd, the Russia based financial services company, has acquired 369 Gas Pipeline Systems, from Authorities of Tyumen Region, the Russian regional authorities, for a consideration of US\$ 48.3m. Gazovye Magistrali will acquire 345 gas pipelines for US\$ 15.3m and 24 gas pipelines for US\$ 33m.	48	34
10-Feb-10	Atomenergomash OJSC	Petrozavodskmash Corporation	Industrials & Chemicals	Leonid Beluga (Private Investor)	Atomenergomash OJSC, the Russia based company which manufactures machinery and equipment for nuclear power plants, and a subsidiary of JSC Atomenergoprom, the Russia based integrated company which consolidates civil assets of the Russian nuclear industry, has acquired Petrozavodskmash Corporation, the Russia based manufacturer of equipment for the nuclear industry, from Leonid Beluga, the Russia based private investor and CEO of Petrozavodskmash, for an undisclosed consideration, estimated between RUB 1.4bn (EUR 33.54) and RUB 1.9bn (EUR 45.54m). Atomenergoprom is wholly owned by Rosatom State Atomic Energy Corp, the Russia based federal agency. As per the terms of the agreement, Atomenergomash will pay part of the consideration in cash and part by issuing its shares, which represent a 7% stake in company. Petrozavodskmash reported annual revenue of RUB 1.75m (EUR 41.94m) in 2008.	46	34

Notes:  
Based on announced deals, including lapsed and withdrawn bids  
Based on the dominant geography of the target company being Russia  
Based on deals announced between 01 December 2009 and 15 February 2010  
Activities excluded from table include property transactions and restructurings where the ultimate shareholders' interests are not changed  
Source: mergemarket



The M&A landscape continued to be relatively quiet over the last few months with a number of rather small executed deals. There are two notable deals: one in oil & gas and another in real estate.

Mikhail Gutseriyev (Private Investor). The largest announced deal during the period was acquisition of NK Russneft by Mikhail Gutseriyev from En+ controlled by Oleg Deripaska - is hardly representative of the M&A activity overall. In 2007 En+ acquired NK Russneft. However according to En+ the real transfer of ownership didn't ever take place, as was subject to allowance by state authorities, which was not obtained in due time. Thus time to fulfill terms of the deal of 2007 expired and the deal was cancelled.

Russia Real Estate Fund LP JV. The Moscow authorities at the beginning of 2009 made some public efforts to attract investments into the hotel segment. The city government decided to establish the Gostinichnaya Kompaniya (Hotel Company), which

would bring together all the hotel assets owned by the city. In December 2009 Russia Real Estate Fund managed by Ronald Lauder (American cosmetics heir) structured one of the largest joint venture transactions (US\$1.06 billion) in the history of Russian real estate market. Under the terms of the transaction the venture will manage a range of 15 hotel projects across the city, including 100% in GAO Moscow, 51% in Intour Renaissance, 50% in Slavyanskaya Hotel and Business Center LLC, 49% in DekMos (Moskva Hotel), 30% in SP MetroPol 100% in Hotel Russia JSC. This is a milestone cross border M&A deal which signifies the growing interest of foreign capital towards the Russian real estate market. It is too early to decide to which extent this will change the landscape of the Moscow hotel business, which historically has been dominated by luxury offerings with little offered to tourists and business travellers in more affordable segments. It would be interesting to see whether this deal will help make Moscow more affordable for visitors.

## DEALS OF INTEREST

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### Total-NOVATEK JV project

In February 2010, Total Termokarstovoye B.V. (Total S.A. group of companies) completed the acquisition of 28% in ZAO Terneftegaz, previously a wholly-owned subsidiary of OAO NOVATEK. By the end of 2010, Total will subscribe for additional 21% share in the company which will bring Total to 49%. ZAO Terneftegaz holds an exploration and production subsoil license to Termokarstovoye gas condensate field. The field reserves are estimated at 47.3 billion of cubic meters of gas and 10.3 million tons of condensate. The JV will complete exploration and develop the field. The total investment is estimated at approximately \$1 billion. The project was blessed by Prime Minister Putin in June 2009 when he stated at the broadcasted meeting with the CEOs of both Total and NOVATEK that, although the field has the capacity to become strategic, Total is welcome to acquire 49% in the project at the early stage of exploration and development.

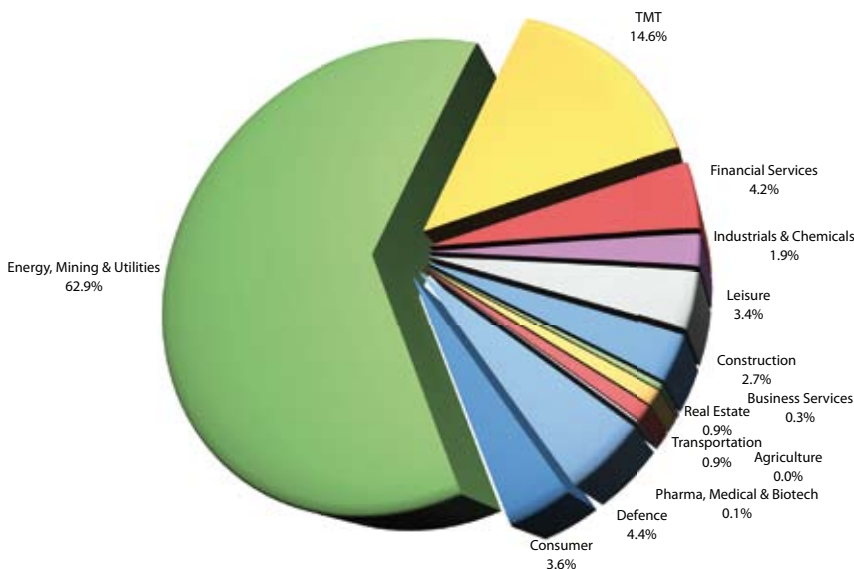
### RusEnergy Investment Group & Suntarneftegaz JSC

In October 2009, a subsidiary of a Russian-Chinese company RusEnergy, Investment Group registered in Hong Kong, acquired 51% of the shares of Suntarneftegaz Closed Joint Stock Company (Russia, Yakutia) to obtain control over two natural gas fields in Eastern Siberia. Suntarneftegaz's reserves are estimated at 154.1 million tonnes (conventional hydrocarbons). Based on the declared gas reserves of the target company, the value of the acquired stake could amount to 300 million US dollars.

This transaction is the first case when a Chinese company succeeded in acquiring a controlling stake in a Russian company with substantial natural gas reserves. However, this transaction can be complicated by the fact that, according to some media resources, the Russian Federal Agency for Subsoil Use may be considering revoking Suntarneftegaz's licence for one of the gas fields the company owns.

# PART II. CHART OF NEWSLETTER

## Mix of Announced Russian Deals by Industry Sector Jan 09 to Mar 10 - Value

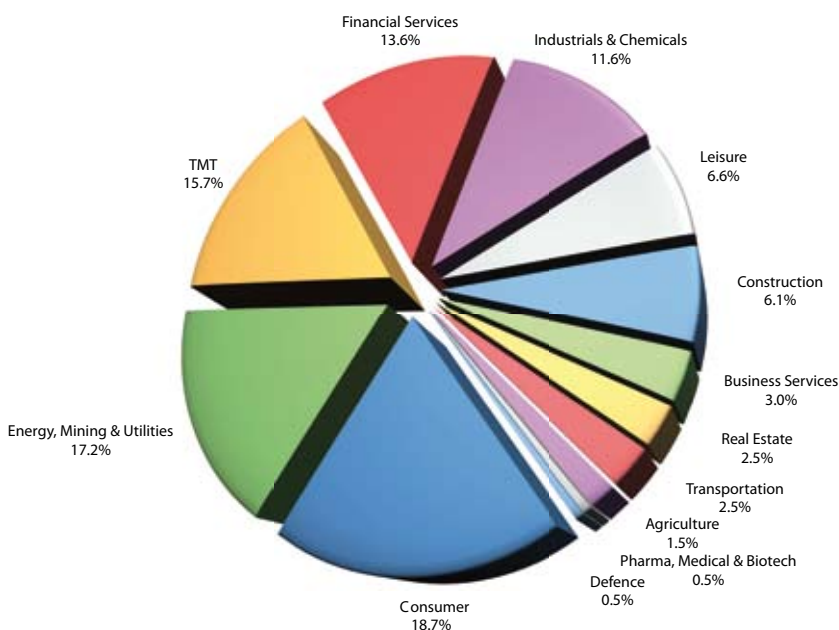


Source: mergermarket  
Announced, excluding lapsed and withdrawn deals

## COMMENTARY:

M&A in Russia in 2009 and 1Q10 has been defined by a small number of significant deals in energy, mining and utilities. There have been 34 deals in these sectors (17.2% of the total volume) with a total value of over USD 20bn (62.9% of the total value of deals of the period). The most significant deal has been the sale of Russneft by En+ back to its founder Mikhail Gutseriev for a consideration of USD 6.6bn (including debt of USD 6bn). Soon after this deal, Mikhail Gutseriev has sold 49% in the company to AFK Sistema for USD 100m. AFK Sistema, in turn, has acquired companies of the Bashkirian Oil and Energy Group for a total cash consideration of USD 2.5m, which was the third biggest deal in the period. Gazprom has exercised its option to acquire 20% of Gazprom Neft from ENI for about USD 4.1bn, which has been the largest cash deal in the period.

## Mix of Announced Russian Deals by Industry Sector Jan 09 to Mar 10 - Volume



Source: mergermarket  
Announced, excluding lapsed and withdrawn deals

The second-largest sector in terms of deals value has been telecommunications & media. There has been a comparable volume of deals in this sector (31 deals), but their total value was only about USD 4.7bn (14.6%) of the total amount. The largest deals here have been the acquisition of a 40% stake in Rostelecom by Vnesheconombank from KIT Finance for about USD 2.2bn. One more key deal was closing of the acquisition of a controlling stake in Comstar UTS by MTS from its parent AFK Sistema for a consideration of USD 1.27bn.

The consumer sector has been the sector with the largest amount of deals during the period. These were rather small deals with an average size of just above USD 30m and with the biggest being the acquisition of Paterson by X5 Retail Group for about USD 380m.

# PART III. FEATURED SECTOR - RUSSIAN OIL SECTOR: TRENDS AND PROSPECTS 2010

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Russian oil sector 2010: Asset sales by state banks to be defining factor; Gazprom Neft, Bashneft to actively seek buys

- Gazprom Neft and Bashneft likely to seek to upstream acquisitions
- TNK-BP expected to look for downstream buys in countries neighbouring Russia
- Gazprom, Lukoil and Rosneft eyeing foreign upstream and downstream assets
- Taxation and oil fields access limitation seen as harming oil production in Russia

M&A activity in the Russian oil and gas sector this year will be defined by companies picking up troubled assets following the economic crisis, a sector banker and an oil and gas advisory source told this news service. In the first line, it will relate to upstream assets in various regions of Russia, the sources said.

Many oil and gas assets have landed on the balance sheets of major state banks in the wake of the financial crisis, the advisory source noted. These assets could potentially be interesting for companies looking to acquire. Sberbank, for instance, will be selling significant non-core assets, he added. As the market picks up, the banks are getting the opportunity to gain reasonable money for assets formerly pledged, he noted.

According to media reports, Sberbank Capital, Sberbank's IB arm that is managing non-core assets formerly pledged at Sberbank, plans to sell all non-core assets by year end. These are valued at USD 4bn and include Urals Energy and a stake in Avrova Oil Company. However, Urals Energy would not be interesting for Bashneft, the listed oil Russian company controlled by conglomerate AFK Sistema, because of their location, a Russian oil and gas analyst suggested. VTB, another state bank, has also been reported to have certain oil and gas assets, including Geotransgas and Urengoi Gas Company.

Beyond that, there are very few upstream companies left in Russia that could become targets, the analyst said. The only significant minor oil producer left is Alliance Oil Company (formerly West Siberian Resources), which could potentially be targeted by a larger company, she suggested.

## Gazprom Neft and Bashneft in need of upstream assets


Gazprom Neft, the state oil company, is in need of increasing oil production, the analyst said. The company wants to get oil winning licenses from its parent Gazprom. Gazprom Neft acquired Sibir Energy in 2009, but Sibir's oil reserves are currently at their peak. Gazprom Neft will therefore need to look for acquisitions of upstream assets, she suggested.

Gazprom Neft's net income for third quarter 2009 amounted USD 846m. For the same period, the company's cash and cash equivalents totaled USD 981m, its total current assets USD 6.98bn and its short-term liabilities USD 8.14bn.

Bashneft will probably be looking at upstream assets in order to be able to supply its refineries. This is also the rationale behind acquiring Russneft, the analyst said. The problem is that Russneft's oil production is split in several minor parts located in different parts of the countries, while Bashneft's refineries are mostly concentrated in central Russia. In addition, Russneft oil fields reserves are also getting exhausted. Bashneft may consider swapping the Russneft assets but could face challenges with it at this stage, the analyst said. M&A could therefore come on Bashneft's agenda, she noted.

## Lukoil, Gazprom and Rosneft seeking opportunities abroad

As previously reported, Lukoil has made foreign expansion its



priority, planning aggressive growth in its oil and gas production outside Russia. By 2015, Lukoil's overseas production is expected to more than double.

Meanwhile, Gazprom will not be interested in a further increase of gas production because the gas market has dropped, the advisory source said. Therefore, the company will probably concentrate on projects like the Nord Stream pipeline, on which construction started this week, he added. Besides that, gas retail assets in Europe could be interesting for Gazprom. The company may look for acquisitions or joint ventures with European players in gas retail, the source further noted. However, it is not clear whether Gazprom will succeed in this, he said.

Companies that already have big oil reserves, like the listed state-controlled Rosneft, will rather develop greenfield projects, the analyst said. As a result, Rosneft could only be eventually interested in downstream assets in the Asian-Pacific region which is of strategic importance for the company, the analyst noted. Rosneft's Asian interests are related to the fact that the company will be exporting oil to East Asia countries through the ESPO pipeline, the advisory source added. The analyst, however, pointed out that Rosneft has been looking at several assets there but has not made any acquisitions. This means that they would rather eventually construct refining facilities in Russian Pacific seaports, she suggested. Rosneft will also be targeting downstream assets in the US and Europe for diversification purposes, the advisory source added.

There is also potential for cross-border M&A in Russian oil and gas, the analyst noted. In 2009 there have been a couple of acquisitions of minor Russian oil companies by Asian players. Indian company ONGC notably acquired Imperial Energy and similar deals could take place in 2010.

## TNK-BP looking for downstream

TNK-BP, the private oil company, jointly owned by UK listed BP and the Russian consortium AAR (Alfa Group, Renova Group and Access Industries), is in the opposite situation to Bashneft and Gazprom Neft and needs more refining capacity for its oil, the analyst said. There are currently no refineries up for sale in Russia; therefore, TNK-BP would have to look for refineries in neighbouring countries, she said.

The company is notably reported to have expressed interest in refineries in Russia, Belarus and Kazakhstan, the countries that recently formed a customs union. According to media reports, the company could have better chances of making acquisitions in Belarus, particularly to increase its stake in the Mozyr Refinery. The

government of Belarus has announced wide privatisation plans, with Mozyr Refinery being named as one of the companies where the state could sell its stake.

In any case, TNK-BP has significant amounts of cash potentially available and is in a good position to make acquisitions, said the sector banker. TNK-BP posted 2009 EBITDA of USD 9bn and net profits of USD 5bn. According to reports, TNK-BP could also soon sell Kovykta field to the Russian state investment vehicle Rosneftegaz for USD 700m to USD 900m.

TNK-BP has been reported as targeting both upstream and downstream assets as eventual targets for acquisition in 2010.

## Tax legislation remains generally unfavourable for oil production in Russia

Russian oil companies are currently being traded much cheaper than their foreign peers, the analyst said. For instance, Russian companies are currently traded for about USD 5 per barrel of proved reserves, while western peers cost about USD 30 and emerging markets companies cost about USD 36.

This is because of high taxes on oil production in Russia, the analyst suggested, adding that improvement on taxation has been expected for quite a long time. However, the government has only been taking small individual steps such as cancelling export duties for Eastern Siberian oil or lowering the natural resources winning tax (NDPI) in several regions.

A working group of market specialists is due to prepare proposals for the government to adjust the taxation of oil production, the analyst explained. While the group was expected to present its proposals late 2009, this move has now been postponed to 2011.

There are no indications that the Finance Ministry plans to liberalize taxation of the oil industry, the analyst noted. The Finance Ministry has been reported to be planning to cancel the tax exemption for East Siberian oil field.

In addition, the Russian legislation only allows state companies to access strategic oil fields, the analyst said. This means that even Lukoil is not able to access them, she added. This is a factor that could force Russian oil companies to seek opportunities abroad, the analyst said.

The average oil price for 2010 is expected to be about USD 73 per barrel, the analyst added.

by Alexander Čajčyc, Mergermarket

# PART IV. TIPS FROM THE PROFESSIONALS

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## LEGAL ASPECTS IN M&A

*Prepared by Alexander Zharskiy, Partner,  
ALRUD Law Firm*

### Carefully manage the time for the transaction filing

In current practice, obtaining clearance of an M&A transaction subject to state control under both the Competition Law and the Law on Strategic Investments may take up to 6-8 months from submission of the application to the FAS. This should be taken into account by the potential foreign investor, as the clearance procedure may substantially delay the execution of the transaction and even make it non-lucrative for the investor.

### Evaluate the risk of the transaction to fall under the Law on Strategic Investments

The practice of application of the Law on Strategic Investments is still developing, but several potential foreign issues investors may face are already clear.

Though the scope of regulation of the Law on Strategic Investments seems to have a detailed description, it has embraced some spheres of business activity which, as one can assume, were not intended to be so strictly regulated by the state authorities.

One of such spheres is banking sector. Credit organizations fell under the regulation of the Law on Strategic Investments due to the provision of services related to information ciphering. Almost all Russian banks are engaged in this activity since ciphering systems are used in bank-client relations, interbank financial telecommunications and other spheres. As it was not intended to impose such strict state control over banking sector, the Governmental Commission adopted the decision granting the simplified procedure of consideration of the applications related to credit organizations. Such applications are considered presently only by the FAS and the Federal Security Service, and the Governmental Commission is notified about the adopted decisions.

However, financial organizations (other than banks) also providing the information ciphering and maintaining the equipment remain necessary for it.

Remember that scope of regulation of the Law on Strategic Investments is also broadly interpreted by the state bodies not only with regard to the object of the transaction, but also with regard to its subject. The foreign companies with Russian residents as their beneficiaries are also concerned as foreign investors and thus M&A transactions accomplished by such companies are also subject to filing under the Law on Strategic Investments.

### Procure the notarial certification of the Share Purchase Agreement concluded under the conditions precedent

The new Law on LLCs provides for the possibility to conclude an agreement which sets out an obligation for one of the parties to conduct a transfer of a participatory share in a charter capital of an LLC if certain conditions occur or another party performs the consideration (i.e. a Share Purchase Agreement, concluded under a condition precedent (CP)). Implication of paragraph 3 sub-clause 11 clause 21 of the Law on LLCs also provides that such agreement may be concluded in a written form, and the notarial certification is required only for a transaction concluded on its basis and focused on the transfer of participatory shares. But as practice shows, notaries do not support such comprehension of the law.

Division of preliminary Share Purchase Agreements and Share Purchase Agreements concluded under CPs implies uncertainty in determination of the form of the Share Purchase Agreement concluded under a CP and the form of an agreement on execution of rights of participants of an LLC (sub-clause 3 clause 8 Law on LLCs), under the provisions of which the participants acquire shares of other participant or sale their own shares upon occurrence of certain conditions.

It may be advised to conclude deals on sale / purchase of participatory by way of execution of the said agreements in presence of the notary with their simultaneous certification rather than by way of exchanging offers and acceptance.

### Face up the necessity of personal attendance of the Pledgor's Chief Executive Officer in the place of execution of the Share Pledge Agreement

Keep in mind that there is the necessity of the Pledgor's CEO to attend personally the place of the transaction certification. The

absence of the Pledgor's CEO in the place of execution of the transaction may entail the refuse in its certification.

To certify the transaction the notary shall deliver to the Federal Tax Service the application signed by the Seller's or Pledgor's Chief Executive Officer (in case of a legal entity) in the presence of the notary. This application may not be signed by a representative under the power of attorney (POA).

However, the Share Purchase Agreements (instead of pledge ones) may be accomplished by the representatives acting in accordance with POA.



## TAX ISSUES IN OIL & GAS INDUSTRY

Prepared by Albina Maksimenko,  
Manager, M&A Tax, KPMG

The significant tax risks identified in the course of tax due diligence could result in (i) a refusal of the buyer to conclude the deal; (ii) a decrease in the purchase price of the target company or (iii) inclusion of specific tax indemnities and warranties in the sale-purchase agreement.

The following significant industry specific tax aspects should be considered for oil and gas deals in order to protect the buyer against potential negative tax consequences of acquiring the Russian target company.

In Russia oil and gas businesses often have a vertically-integrated structure. Therefore, we recommend analyzing the tax risks relating to non-deductibility of expenses due to a lack of economic justification, and transfer pricing risks resulting from transactions between related parties (including but not limited to the sale of licenses to subsidiaries from parent companies or vice versa). Such risks could apply to all types of Russian companies operating in the oil and gas industry.

### Exploration companies

Due to the specifics of their activities, exploration companies frequently incur expenses without generating revenue for a long period of time.

The Russian Tax Code stipulates specific treatment for different types of expenses, including expenses on development of natural resources. The Russian Tax Code also limits the period of utilization

of accumulated tax losses to a ten-year period following the period when the tax losses were incurred. In practice the majority of exploration companies do not report expenses for profits tax purposes in a timely manner but instead treat such expenses as deferrals. As a result, such companies could lose the right to deduct part of the expenses incurred for profits tax purposes. Therefore, in the course of tax due diligence we recommend analyzing the target company's tax losses to be carried forward, their nature and the period of their origination, and to assess their recoverability.

For the same reasons it is advisable to test the expenses treated as deferrals for tax purposes and Russian statutory accounting in order to determine (i) whether such deferrals meet the general criteria for deductibility for profits tax purposes (i.e. economic justification and documentary support) and (ii) the reasons for non-recognition of such expenses as current period expenses for profits tax purposes.

Another key issue relates to the recoverability of VAT assets. Notwithstanding that since 1 January 2006 input VAT may be claimed for offset based on VAT invoices issued by the supplier, provided that the purchases were recorded for Russian statutory accounting purposes and used for VAT-able activities, some exploration companies do not claim input VAT for offset in the case of an absence of output VAT in order to avoid disputes with the tax authorities. It is advisable to claim input VAT for recovery in the period in which it is incurred as the target company loses the right to offset input VAT upon the expiration of 3 calendar years following the period when it could offset such VAT.

### Mining companies

During the tax due diligence of Russian mining companies the application of the 0% Mineral Extraction Tax (MET) rate should be analyzed. The 0% MET rate may be applied to (i) oil extracted from certain deposits stipulated by the Russian Tax Code (provided that the volume of extracted oil does not exceed a certain amount specified by the Russian Tax Code and the period of deposit development does not exceed the specified period of time. In some case the coefficient of depletion is also taken into account); (ii) associated gas; (iii) losses of oil or gas extracted within the limits stipulated by the competent state authorities.

Specifically for Russian oil mining companies, in the course of tax due diligence we recommend analyzing the correctness of application of the coefficient of depletion (if less than 1), which characterizes the depletion level of each licensed subsurface area for the purpose of MET calculations.

## Refinery companies

As in recent years Russian tax legislation relating to excise tax has been subject to frequent changes, including changes in the administration procedure and excise tax rates, we recommend analyzing calculations of excise tax in course of tax due diligence of Russian refinery companies.

The above significant industry-specific tax aspects should be considered for oil and gas deals in order to protect the buyer against potential negative tax consequences of acquiring the Russian target company.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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