



SALANS

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GLOBAL CORPORATE CLIENT REPORT

Sector Focus:
Capital Markets &
Financial Institutions



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Introduction

In this issue of our Global Client Report, we focus on financial institutions and capital markets. We also review recent key developments in the legal environment affecting corporate activity in the USA, Western and Eastern Europe and China.

All Eyes on the Financial Markets

Financial institutions face a multitude of legal and regulatory changes and related compliance challenges in numerous jurisdictions. International commercial banks, insurance companies, investment, pension and hedge funds are all struggling in the economic and political fallout triggered by the collapse of Lehman Brothers.

In many key regions, financial institutions have to concentrate on savings and are hiving off some of their valuable assets to repay governmental aid. Others are seizing this opportunity to consolidate the market.

Over the last 12 months, the Salans Global Corporate Group along with our Global Financial Institutions Sector Group have been busy with assisting financial institutions in adapting to the shifting landscape of regulatory and compliance issues that face the industry. We have been helping with restructuring, sale or acquisition transactions, especially in emerging markets.

“Go East”

Emerging economies in Europe and Asia are providing an outlet for investment in companies searching for capital. We can observe that this trend is causing a significant impact on the IPO and M&A landscape globally, dramatically shifting the focus of investors from the traditional Western markets to the high growth markets of Asia and Eastern Europe.

Companies from emerging countries are becoming significant players on the global financial markets. Among the top 10 IPOs in Europe in 2010, three came from Eastern Europe, whereas in 2009 only one did.

According to the Ernst & Young Global IPO Update, at the end of the third quarter of 2011 almost 40% of the IPO value globally was concentrated on the Chinese stock exchanges.

In Europe, the Warsaw Stock Exchange has taken pole position in number of IPOs, including alternative markets, and the runner-up slot, in terms of aggregate IPO values. PWC IPO Watch Europe places it ahead of the London Stock Exchange and only behind NYSE Euronext.

Large emerging economies are offering ever-increasing quantities of high quality assets to leading international investors. AIB sold its Polish jewel, BZ WBK Bank, listed on the Warsaw Stock Exchange, to Santander Bank for EUR 3 billion. Nestle's has offered USD 1.7 billion to buy Hsu Fu Chi International, a leading Chinese candy manufacturer, listed in Singapore.

This issue features four articles on emerging trends in the IPO and public take-overs market. Siegfried Neumuller, Deputy Head of the Equity Capital Markets at Raiffeisen Centrobank AG, is our guest columnist in this issue. His article focuses on the capital markets preferred for initial listing by companies from the Commonwealth of Independent States (CIS).

We also report on the present public take-overs code in Poland and its envisaged

major changes. These aim to adjust the take-over rules in the much larger scale of transactions on the Warsaw Stock Exchange. We discuss the listing of Ukraine issuers on the Frankfurt Stock Exchange, which competes with London and Warsaw in attracting growth companies from Eastern Europe.

We remind both issuers and underwriters about Rule 10b-5, which sets a fundamental principle of US securities laws: proper disclosure of material facts in offering documents. This will apply when potential investors in such offerings request, as a condition to their participation, a "10b-5 letter".

UK Bribery Act Affects Global M&A Activity

Companies now need to engage in an in-depth, multi-jurisdictional anti-bribery analysis as part of the standard due diligence in connection with mergers, acquisitions and securities offerings. This increased level of review is driven primarily by the introduction of new anti-bribery tools, notably the U.K. Bribery Act, and increased enforcement activities under the existing anti-bribery laws – the U.S. Foreign Corrupt Practices Act in particular.

These affect virtually all major investment transactions on private and public markets throughout the US, Europe and Asia, due to the significant role played by US and UK based investors and private equity houses.

Not only US and UK companies but also their targets, investment partners and local advisors in all jurisdictions must understand the compliance hurdles imposed by the US and UK anti-bribery legislation. Read our lead article to find out how this will affect you.

Laws Under Review in Emerging Markets

Governments in emerging markets are revising and modernizing commercial and corporate codes to improve their environments for doing business and to encourage foreign investment. We report on Poland's desire to modernize the public take-over code, and on recently enacted modifications to existing commercial laws or adoption of new commercial codes in Turkey, Ukraine and Azerbaijan.

Avoid Reefs in China

China continues to attract foreign investments but remains a challenging

market for newcomers. Our China corporate team has been kept busy by our international clients with structuring their investments and business operations there. We also have been helping investors to surmount the major problems they face through having no appropriate planning beforehand. Our major report covers the legal and tax issues that habitually arise when multinational companies restructure or reorganize their operations in China by debt restructuring, mergers or asset and stock sales.

We hope you enjoy this issue of the Global Corporate Report. If you would like more information on the topics covered in any of the articles, we encourage you to reach out to the author or your regular contact at Salans.

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The Global Corporate Group

Our Global Corporate Group combines over 300 attorneys located in 21 offices in 16 countries, fluent in all aspects of business law and in over 30 languages.

We advise on mid-market and premium transactions through a global and well positioned network of offices stretching from New York to Shanghai. We represent clients on their international expansion and cross-border investment projects throughout the United States, Western Europe, CEE/SEE, Russia/CIS and China.

We work across a broad spectrum of manufacturing, retail and service industries with a unique expertise in Energy, Life Science, Luxury Goods and Financial Institutions.

We advise clients in the following areas of corporate practice:

- Mergers & Acquisitions
- Corporate Finance
- Private Equity

- Corporate Governance
- Corporate Dispute Resolution
- Corporate Structures and Strategies

Our goal is to provide focused, efficient and affordable legal solutions that will enable our clients to achieve their strategic goals and commercial objectives. We deliver on time, on target and on budget.

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Our Financial Institutions Group provides advice on a full range of legal issues relating to the operational activities of banks and other financial institutions. Our clients range from international and domestic banks, insurance companies, securities' dealers, investment and pension fund managers, through to hedge funds.

We advise some of the world's most prestigious institutions on a full array of legal issues including:

- Form and structure of activities affecting financial institutions
- Operational activities
- Regulatory and compliance issues
- New products and financial services
- Dealing with the administrative authorities

Assistance with the Form and Structure of Activities affecting Financial Institutions

Our team offers assistance with the form and structure of activities affecting financial institutions, covering, among other things, the creation and liquidation of branch offices and representative offices, including those of foreign financial institutions.

Assistance with Operational Activities

We give financial institutions advice on internal and external processes, their reporting requirements, interest rate and credit risk management, the institutions' funds, subordinated loans and banking secrecy regulations. We also have broad experience in dealing with special purpose reserves, compliance with the provisions of retail banking (including consumer protection), foreign exchange laws, and many other areas relating to regular activities undertaken by financial institutions.

Assistance with Regulatory and Compliance Issues

Our team can provide assistance with internal regulations, including help on preparing, reviewing and updating regulations and procedures that cover the activities of banks and other financial institutions in light of changing provisions regarding banking law.

Assistance with New Products and Financial Services

Our knowledge of the risks, dangers and problems faced by banks and other financial institutions in the course of business, means that we are well-placed to counsel our clients on preparing and introducing new products and services, in areas such as consumer finance, debentures, mortgage bonds, securitisation, factoring, franchise and leasing.

Assistance in Litigation before the Administrative Authorities

We can assist financial institutions and banks, their managers and their employees involved in investigations or sanction proceedings before administrative authorities, including compliance issues and allegations of market abuse.

Extending the Powers of the Financial Markets Authority (AMF): Implementing an Administrative Settlement in the Sanctions' Procedure

After discussions lasting many years, and following the enactment of law N°2010-1249 of 22 October 2010 on banking and financial regulations, the AMF finally has the power to conclude settlements under a so-called administrative settlement procedure (the “*composition administrative*”). The decree N°2011-968 explaining the implementation of such a procedure was published in the Official Journal of 18 August 2011 and became applicable immediately.

Under the administrative settlement procedure, at the same time the AMF Board (the “*Collège*”) sends a statement of objections (a “*notification des griefs*”) to implicated persons, it can also make an offer to implement an administrative settlement.

The power to settle granted to the AMF by the new law was accompanied by an increase from 10 to 100 million euros in the maximum sanction that could be imposed by the Enforcement Committee (the “*Commission des sanctions*”).

Scope of Power to Settle

Market abuses are excluded from the scope of the administrative settlement: it exclusively covers breaches of professional obligations committed by the regulated entities placed under its control (investment services providers, financial investment advisors, etc.).

Reaching Agreement with the AMF's Secretary General

Any implicated person has one month in which to accept or refuse to follow

an administrative settlement procedure. Starting from the date of acceptance, the AMF's Secretary General and the implicated person have four months in which they must reach an agreement.

The agreement with the AMF's Secretary General includes an obligation to be assumed by the relevant person to pay a sum of money to the Treasury. This sum cannot exceed the maximum amount of the fine that can be legally imposed. No other details are given about the terms of the agreement, particularly the question of whether it can be disclosed on an anonymous basis.

Validation by the Board

Agreements must first be validated by the AMF Board. If validation is refused, the AMF Board can ask the Secretary General to submit a new draft agreement to the person concerned, which will then have to be concluded within one month of the refusal notification.

Approval by the Enforcement Committee

Once an agreement has been validated

“**The power to settle granted to the AMF by the new law was accompanied by an increase from 10 to 100 million euros in the maximum sanction that could be imposed by the Enforcement Committee**”

by the Board, it goes to the Chairman of the AMF's Enforcement Committee for approval. The agreement is made public once it has been approved.

Decisions by the AMF Board and the Enforcement Committee are subject to the usual rights of appeal.

If the AMF Board does not validate the agreement, or if the Enforcement Committee does not approve the sanctions, or if there is a breach of the agreement, a statement of objections is sent to the Enforcement Committee. This triggers the implementation of the normal litigation procedure.

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Review of Past CIS IPOs – Where do companies choose to list?

As of the end of September 2011, 65 companies from the Commonwealth of Independent States (CIS) are listed on the Main Market of the London Stock Exchange, with the majority of them having Russian operations. What started with the Gazprom's Depositary Receipt listing in 1996 has become increasingly popular for many companies from the CIS; raising capital via an Initial Public Offerings (IPO) on a foreign stock exchange.

On a more regional view, companies from the CIS have been among the most active in the larger Central- and Eastern European region in recent years, but compared to other CEE markets, companies headed for foreign stock exchanges to conduct their IPO. This article takes a closer look at the past IPO activities of CIS issuers. Based on the past experience, the focus of the analysis is on issuers from the Russian Federation, Kazakhstan and the Ukraine. Several aspects important in order to understand the tendencies of companies from these countries to head for foreign stock exchanges will be looked at; including the state of the local stock markets, the legal framework for IPOs and the change in preferences over time, and sector-dependent patterns.

Legal Framework for IPOs

In order to fully understand the structures of past CIS IPOs it is important to have a closer look at the legal framework for conducting IPOs in CIS countries. Unlike Western European jurisdictions, in certain set-ups companies have no free choice where to list, but instead can only add a dual listing to the mandatory domestic

listing. Both in Russia and the Ukraine, joint stock companies registered domestically, have to list on the local stock markets and only additionally might seek a dual listing on a foreign stock exchange. In addition, the regulator of the Russian Federation, the Federal Financial Markets Service (FFMS), poses a number of limitations on a company's ability to offer its shares to foreign investors¹. If domiciled abroad, it will not be bound by these regulations

“In the last ten years issuers from CIS have frequently tapped foreign stock markets in order to raise capital or place existing securities”

and it can seek an exclusive international listing without being required to offer the shares to domestic investors. As a consequence, many of the Russian and Ukrainian companies have chosen to go for an off-shore structure in order to

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Business Schools at the University of Minnesota and the Vienna University of Economics and Business.



¹According to the current FFMS order the maximum amount of shares or other securities that Russian issuers can place on foreign markets is determined, inter alia, by the listing level of a Russian company on Russian stock exchange(s) (MICEX and/or RTS). The maximum limit is set at 25% for companies in listing category "A" (ie the largest and most liquid stocks). In addition the maximum percentage of shares that can be offered abroad by a company or its shareholders in an equity offering is 50%. Special conditions apply for companies from industries, which have been classified as "strategic". Similar rules exist in the Ukraine limiting the amount of shares circulated abroad to 25%.

avoid a local listing. Sticking to an on-shore structure any IPO of a Russian or Ukrainian company on a foreign stock exchange has to be structured via an offering of Depositary Receipts, as the local shares cannot be traded and settled on foreign stock exchanges.

In Kazakhstan so far no restrictions with regards to the foreign listing of Kazakh companies have been in place. However, in September 2011 the Financial Supervisory Committee of the National Bank of Kazakhstan announced that it will require Kazakh companies offering shares to list at least 20% of the securities on the Kazakhstan Stock Exchange (KASE). The new listing rule will include companies issuing shares on foreign stock exchanges and takes effect immediately.

Local Stock Markets

In the field of equities trading traditionally two stock exchanges have had a dominant position, being the Moscow Interbank Currency Exchange (MICEX) and the Russian Trading System (RTS). RTS, established as the first regulated stock

market in Russia in 1995, has more recently gained a larger market share in derivatives trading, whereas MICEX is nowadays the market leader in trading Russian stocks, having a turnover of RUB 13.3 tln, being more than four times larger than RTS. Supported by a political will for a strong consolidated domestic stock market, MICEX and RTS announced their merger in June 2011. The merger is expected to be complete in the first half of 2012.

Historically the PFTS Stock Exchange and the Ukrainian Stock Exchange were competing for the leading position in equities trading in the Ukraine. The PFTS Stock Exchange started operations six years after the Ukrainian Stock Exchange, but soon became the largest stock exchange in the Ukraine with respect to equities trading. In October 2008, a new stock exchange, the Ukrainian Exchange was established, with RTS being the main shareholder, holding 43%. Today, the Ukrainian Exchange is the leading Ukrainian stock exchange in equities trading.

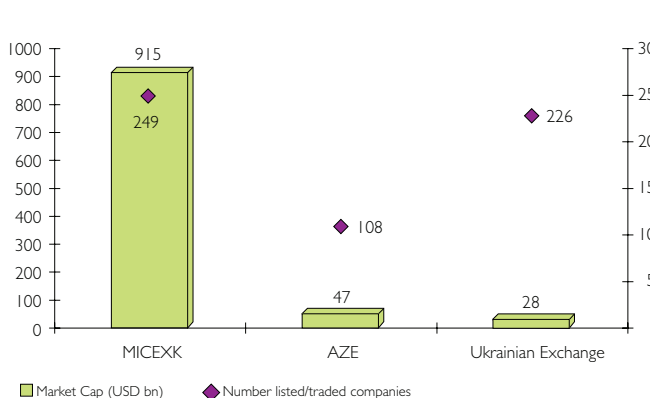
The Kazakhstan Stock Exchange (KASE) has been operating since 1993 and is the only stock exchange operating in Kazakhstan.

According to the Federation of Euro-Asian Stock Exchanges there were 108 companies listed as of end of August 2011, however the average daily trading value of around USD 5.2 mn as compared to USD 39.2 mn in the bond market is miniscule and clearly shows the lack of liquidity on the domestic stock market.

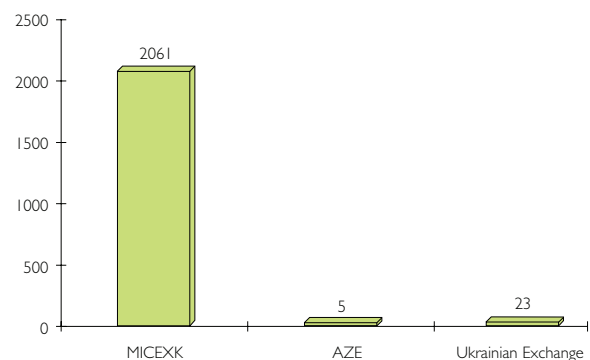
The following charts give a comparison of the size of the local stock markets measured by their market capitalisation in USD bn as of August 30, 2011², the number of listed companies³ and the trading activity measured by the daily average trading volume in stocks from January to August 2011.

As can be clearly seen from the first chart below, the Russian MICEX is by far the largest among the three stock exchanges and with a market capitalisation of USD 915 bn is in a league with the largest European Stock Exchanges.⁴ Measured in terms of average daily trading turnover in stocks, the dominant position of MICEX becomes even clearer:

Market capitalisation (USD bn)



Average daily trading volume (USD mn)



Source: World Federation of Stock Exchanges, Federation of Euro-Asian Stock Exchanges, Ukrainian Stock Exchange

²Market capitalisation data and number of listed companies for the Ukrainian Exchange are as of October 6, 2011

³This analysis focuses on the largest local exchanges in cases where more trading platforms co-exist

⁴Based on the August data of the World Federation of Stock Exchanges, MICEX ranked 6th in terms of market capitalisation behind the LSE, NYSE Euronext, Deutsche Börse, SIX Swiss Exchange and the BME Spanish Exchanges.

Review of Past CIS IPOs

For the purposes of this article all IPOs from CIS issuers from 2002 until 2011 (applying a transaction size filter of USD 100 mn for IPOs of Russian and Kazakh companies) have been analysed. Given the sizes of past IPOs of Ukrainian companies, no size filter was applied to those IPOs⁵. Furthermore, our analysis focuses on CIS IPOs in regulated markets and hence does not consider other market segments (e.g. AIM in London, New Connect in Warsaw

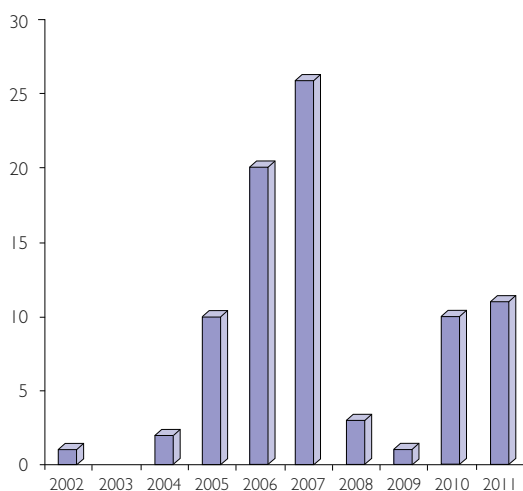
and Open Market in Frankfurt). In order to account properly for the use of offshore structures the country of operation was taken as the key parameter for the database, not the country of incorporation.

IPO Activity

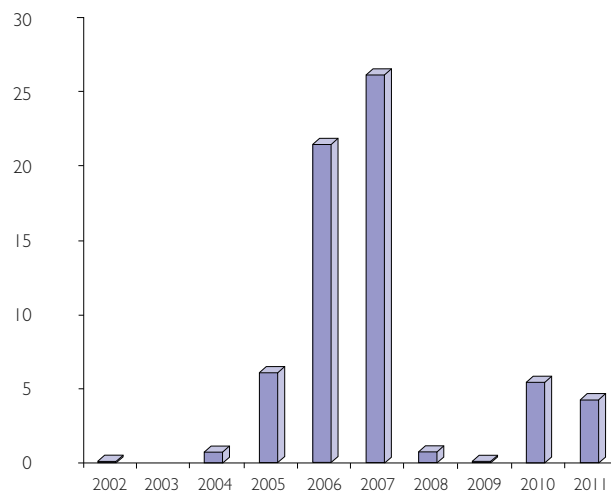
The following charts show the development of CIS IPOs between 2002 and 2011, based on the number of IPOs and the transaction sizes.

Not surprisingly, the IPO activities of CIS companies follow the general patterns of the stock markets during the period under review. After an increase in activities starting from 2004 and peaking in 2007, the financial crisis of 2008 and 2009 led to a sharp decline in IPOs during those years. 2010 and the first half of 2011 saw rising activities again, with companies from Russia and the Ukraine tapping the equity markets; however, the transaction sizes were smaller on average than pre-crisis.

CIS IPOs 2002 – 2011 number of IPOs



CIS IPOs 2002 – 2011 IPO size (USD bn)



Geographic and Sector Breakdown of IPOs

The following charts show the geographic distribution of the transactions between 2002 and 2011, based on the number of IPOs and the transaction sizes.

As can be clearly seen from the following charts, the average size of Russian IPOs is larger than the Kazakh IPOs and way larger than the IPOs out of the Ukraine. Whereas the Ukrainian IPOs had a quite substantial portion measured by the number of IPOs in 2008, 2010 and 2011, only 2008 was similarly important when

it comes to transaction size, with 2010 and 2011 showing a portion of less than 10% of overall CIS IPO size. The average transaction size of Russian IPOs was USD 892mn, Kazakh IPOs USD 867mn and Ukrainian IPOs USD 151 mn⁶.

When it comes to the sector breakdown, the materials' sector is the most dominant sector with approximately 25% of all IPOs, followed by Consumer Staples (comprising agricultural activities) with 20%, and Energy and Power (comprising Oil & Gas) with 13%.

Favourite Foreign Stock Exchanges

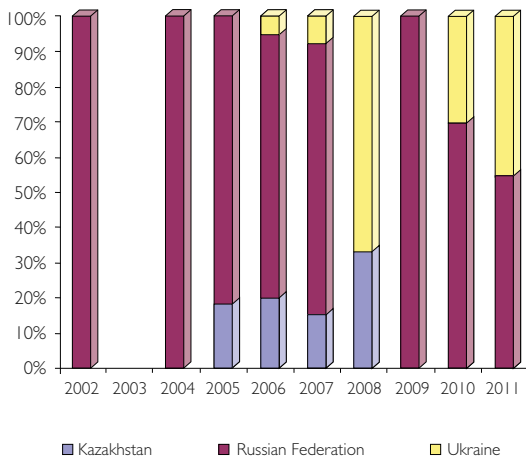
CIS issuers generally have three options regarding a stock exchange listing, it can be single listed on the local stock exchange, single listed on a foreign stock exchange using an offshore structure, or dual listed.

As mentioned in the introduction, the majority of the companies operating in the CIS decided to list on foreign stock exchanges, due to the lack of development of the local stock markets. From the IPOs analysed, only around 20% chose to single list on the local stock market. This figure

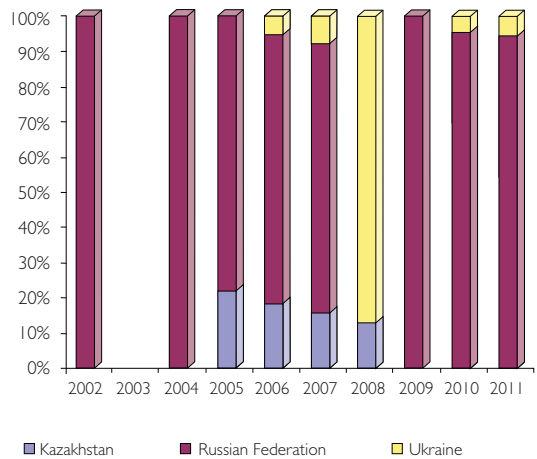
⁵The threshold of a USD 100mn transaction size was chosen based on the IPO size of Exillon Energy plc, the smallest Russian London Main Market IPO during the period under review and the IPO size of Kazakh Zhaikmunai.

⁶The average Ukrainian IPO size amounted to USD 72 mn on the Warsaw Stock Exchange and USD 330 mn on the London Stock Exchange.

Geographic breakdown by number of IPOs



Geographic breakdown by IPO size



comes down even further to a tenth when based on the IPO size, making it obvious that the option of a listing on a foreign stock exchange is a function of the IPO size. Hence, the vast majority of the companies chose to single list or dual list on a foreign stock exchange. Nearly 2/3 of the companies chose a single listing (domestic or abroad) over a dual listing. This figure turns into the opposite when based on the IPO size (i.e. 2/3 of the companies chose a dual listing). However, this needs to be seen together with the legal restrictions for domestically incorporated companies, especially in the Russian Federation.

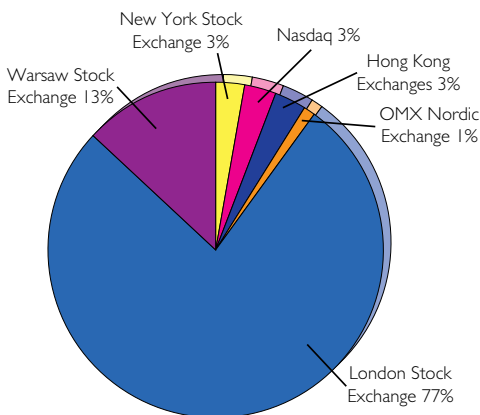
The following charts show the choice of foreign stock exchanges by CIS companies, either as a single listing or via a dual listing, during the period 2002 to 2011.

During the entire period under review, the London Stock Exchange has managed to attract most CIS issuers, with the Warsaw Stock Exchange following. When looking at the size of the IPOs the dominance of the London Stock Exchange becomes even clearer. We can also observe that the average size of the IPOs on the Warsaw Stock Exchange is much smaller than the IPOs on the other stock exchanges.

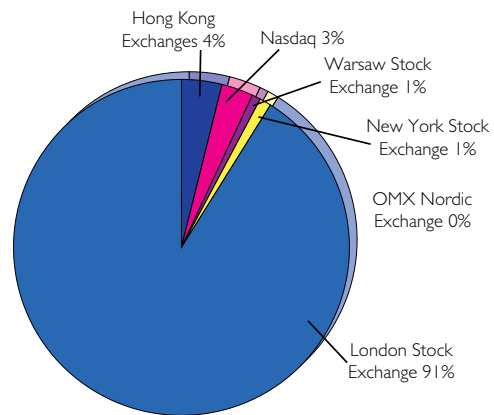
When it comes to the analysis of preferences by CIS companies over time, certain patterns are observable:

- the New York Stock Exchange after dominating previous years has lost its leading position to the London Stock Exchange.⁷ Certainly, the implementation of the Sarbanes-Oxley Act played a role in the cost-benefit analysis of CIS issuers, when choosing a listing place
- the Hong Kong Exchanges turned into serious competitors, grasping at CIS companies post-financial crisis

Choice of foreign stock exchanges based on the number of IPOs



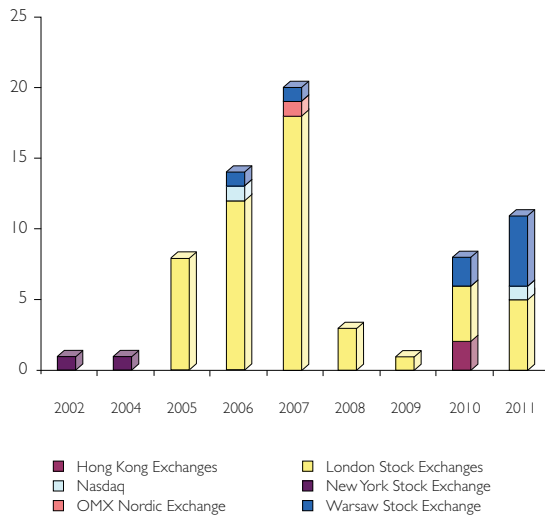
Choice of foreign stock exchanges based on IPO size



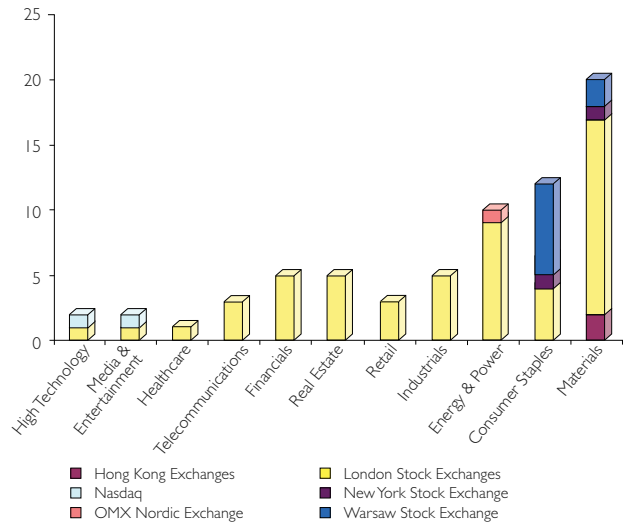
⁷This also holds true for the periods prior 2002, where the NYSE attracted a number of Russian companies such as Vimpelcom in 1996 or MTS in 2000.

Historical and Sector Breakdown of Foreign Stock Exchanges

Preferences for foreign stock exchanges based on the number of IPOs



Preferences for foreign stock exchanges based on sector activity



- the Warsaw Stock Exchange gained grounds at the expense of the London Stock Exchange, when it comes to IPOs of Ukrainian companies

Given the dominance of the London Stock Exchange, sector patterns are more difficult to conclude, but the following can be said:

- the London Stock Exchange has a dominant position across all sectors
- the NASDAQ has positioned itself as the listing platform for CIS companies from the technology sector
- the Warsaw Stock Exchange has become increasingly popular for Ukrainian companies from the agricultural and food sectors

Listing Structures

There are, in essence, two ways of listing on a foreign exchange for issuers from the CIS, either via Depository Receipts or via shares. Whereas the reason for a listing via

Depository Receipts can be easily explained by the lack of settlement infrastructure to trade original shares (e.g. companies incorporated in Russia), issuers often choose – even in cases where the listing is done via an off-shore vehicle – a listing via Depository Receipts. Potential explanations for this tendency are investors' familiarity with the Depository Receipts' structure, and lower reporting and transparency standards vis-à-vis a listing via shares.⁸

Nearly 75% of the issuers chose a Depository Receipts listing structure, out of which about half did a dual listing. This underlines that even for a single listing on a foreign exchange, which for Russian and Ukrainian companies is only possible via an off-shore structure, companies seem to have favoured a Depository Receipts' structure for the reasons given above. However, things look different for Ukrainian companies going to Warsaw. All of them have been listing the (off-shore jurisdiction) shares directly.

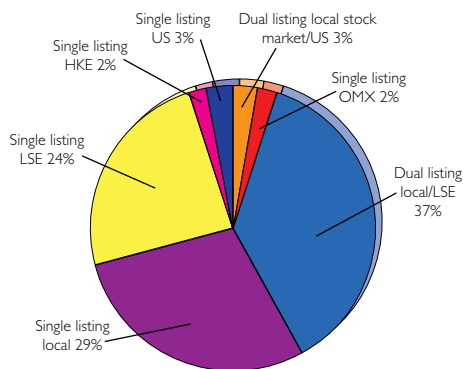
Country Analysis

It is worth having a closer look at the country specifics in choosing a foreign stock exchange. Over the period under review, 2002 – 2011, the following charts show the foreign stock exchanges chosen based on the number of IPOs by country of operation.

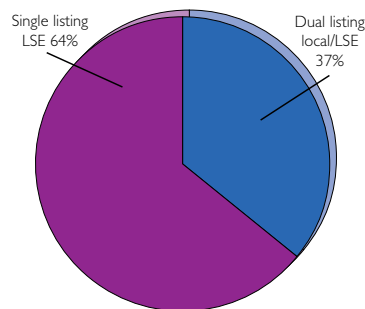
As can be seen the key preferences of Russian companies are a Dual Listing on the local market/LSE, a single listing in Russia, followed by single listings on the LSE. Kazakh companies have been focusing on the LSE, either as a single listing or a dual listing with the local market. Companies from the Ukraine have not used the local stock market, but either chose the LSE, or more recently the Warsaw Stock Exchange.

⁸This is, for example, the case for the London Stock Exchange, where a so-called "premium listing" requires higher standards than a standard listing via Depository Receipts.

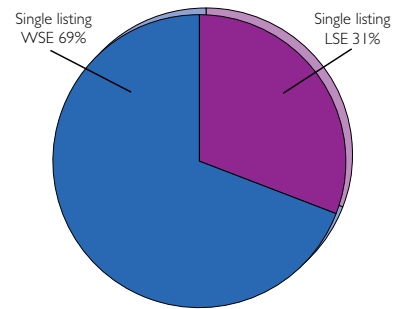
Russian Federation



Kazakhstan



Ukraine



Conclusion

In the last ten years issuers from CIS have frequently tapped foreign stock markets in order to raise capital or place existing securities. The clear preference has been the London Stock Exchange, with more than 90% measured by the IPO size, especially for issuers from the Russian Federation and Kazakhstan. However, the Warsaw Stock Exchange has positioned itself in recent years as the preferred listing platform for Ukrainian issuers, mainly from the agricultural sector. Other stock exchanges played a minor role in the choice of CIS issuers, with the Hong Kong Exchanges seeming to become more popular among CIS issuers, even though actual IPO data does not fully support this tendency. The New York Stock Exchange has definitely lost its leading position it held in the 1990s and at the start of the 2000s. The preferred listings' structures on the London Stock Exchange were Depositary Receipts structures.

So what can be expected for the next years of CIS IPOs? More recently, issuers have more and more considered upgrading their listing status on the London Stock

Exchange from a "Standard" Depositary Receipts listing to a "Premium listing" via shares⁹. As of today 10 of the CIS companies out of the 65 listed on the Main Market of the London Stock Exchange, have a "Premium listing" via shares. Now, what are the main arguments for doing a "Premium listing" via shares on the London Stock Exchange? Two key arguments can be thought of, being first investors' attention and trading liquidity, and second a higher degree of comfort for investors following the more stringent reporting and transparency rules. The ultimate target of a "Premium listing" via shares should be entering the FTSE 100 Index, the blue-chip Index of the London Stock Exchange. So far two Kazakh companies have achieved being a member of the FTSE 100¹⁰.

On the other hand, local market regulators strive to develop the local stock markets to become more attractive for issuers via different tools, such as limitations on foreign listings as in Kazakhstan, or by facilitating the listing of off-shore vehicles via Depositary Receipts (Russian Depositary Receipts) like in the Russian Federation. So far only one Russian company has used this rather new facility, so it is too early for any conclusions.

However, assuming a trend towards a "premium listing" of Russian companies on the London Stock Exchange, this facility is a key tool to convince Russian issuers of a dual listing via Russian Depositary Receipts in Russia.

Apart from local initiatives, one might expect other stock exchanges to play a more important role in the future. It remains to be seen whether Hong Kong can profit from the huge amount of capital to be tapped on the Asian market, or whether the merger of NYSE and Deutsche Börse will help to (re-)gain a major position in the CIS IPO market. In addition, one can expect other regional players, such as the CEE Stock Exchange Group, formed by Vienna based Wiener Börse, to try to get their portion of the CIS IPO market.

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⁹Some companies have revealed publicly that a "premium listing" is an alternative to the current standard Depositary Receipts listing (e.g. Evraz, Polymetal, Uralkali).

¹⁰Notably, these two companies (ENRC and Kazakhmys), incorporated in the UK, are also traded via their original shares on the Kazakhstan Stock Exchange.

UCITS Legislation

Europe's investment fund product, the UCITS, was launched by *Directive 1985/611/EEC on the coordination of laws, regulations and administrative provisions relating to Undertakings for Collective Investment in Transferable Securities*. Over the last 25 years, UCITS legislation has evolved and developed significantly, changing the market in the process.

Its aim was to integrate the EU-market for investment funds. It has broadened the investment opportunities for investors, and business opportunities for asset managers. UCITS legislation is undoubtedly a success in the European investments' funds industry.

However, recent developments in the market required the regulatory framework for European investment funds to be updated. The European Council responded by launching the UCITS IV Directive on June 2009. Member States had to transpose and apply the new provisions contained in this Directive, and their implementation measures, by 1 July 2011. The main aim of UCITS IV is to harmonise the principles on which investment fund units operate in the European market. In essence, UCITS IV strengthens the single market for UCITS funds.

This new Directive introduces a number of new solutions to help the activities of investment funds. Its most important improvements to the previous UCITS Directives relate to:

- Notification Procedures
- Fund Mergers
- "Key Investor Information" – a document that replaces the simplified prospectus

“UCITS IV strengthens the single market for UCITS funds”

- Management Company Passport
- Pooling
- Regulator to Regulator Cooperation

Notification Procedures

The “UCITS passport” rule permits the cross-border distribution of a UCITS fund in other Member States. Under the older UCITS III Directive, the transmission of UCITS funds was made by the fund itself to the host authority. The notification procedure was not easy, as the host Member State could impose additional requirements upon the transmitting fund, over and above those arising from the Directive. This pre-control of UCITS funds was perceived as a crucial regulatory obstacle when “passporting” UCITS funds into host Member States.

Now the new UCITS IV Directive has removed this obstacle, by introducing a “regulator-to-regulator” system instead. The transmission of UCITS funds is now made by the home authority to the host authority. Upon transmission of the notification file, the home Member State authority must immediately notify the UCITS.

This new notification procedure is aimed at simplifying the passport system and reducing both the time and costs associated with it.

“UCITS legislation is undoubtedly a success in the European investments' funds industry”

Fund Mergers

The existing UCITS III legislation did not foresee the need for the merging of funds on a cross-border basis. Now, UCITS IV introduces the legal framework that is needed for the cross-border mergers of funds. Under UCITS IV, the following three types of mergers are admissible:

- merger by absorption
- merger by formation of a new fund
- merger by amalgamation

The main objective of the new merger regime is to help cross-border fund mergers achieve economies of scale and increase the average size per fund.

Key Investor Information

Under UCITS IV legislation, the simplified prospectus for funds has been abolished and replaced by Key Investor Information (“KII”). The simplified prospectus was seen as a complex document that was so technical that it did not actually assist investors in making comprehensive and independent investment decisions.

The main objective of the new KII is to enhance transparency, through a short document that is written in non technical language. It is also drawn up in a common format, which makes it easy for users to

make comparisons, and has been designed to be easily read and understood by retail investors. The KII will include appropriate product information on the essential characteristics of the UCITS and should help investors to make investment decisions on an informed basis. It must include:

- identification of the UCITS
- short description of the investment's objectives
- short description of the UCITS's investment policy
- risk and reward profile of the investment
- past performance details
- details of costs and any associated charges

Investors should be able to understand all the above details without needing to refer to any other document. UCITS IV also allows the KII to be accessible in a new format – a durable medium other than on paper or online via a website.

Management Company Passport

Under the current UCITS rules, a fund manager operating in three different EU countries, would need a separate management company in each jurisdiction. However, UCITS IV introduces the "Management Company Passport" concept. Under this scheme a management company will be able to provide services in the UCITS's home Member State by establishing a branch there, or by making use of the freedom of services' regime.

As a result, under UCITS IV legislation, a management company passport gives management companies more flexibility in providing collective portfolio management services across borders, without needing to be established in the UCITS' home Member State. Management companies

“The main aim of UCITS IV is to harmonise the principles on which investment fund units operate in the European market”

will also potentially benefit from reduced costs and economies of scale, due to the fact that they will be able to sell UCITSs throughout the EU without needing to establish a full array of administrative functions in each jurisdiction. It should also be possible to consolidate existing management companies.

Pooling

The diversification requirements of the current UCITS III regulations do not allow entity pooling. However, UCITS IV allows for one or more feeder funds to pool assets in a single master fund. Subject to approval from the regulator and from investors, a UCITS feeder fund will be allowed to fully invest its assets in another UCITS (master fund).

UCITS promoters and asset managers view the "master-feeder" structure as essential to improving the efficiency of the UCITS framework through economies of scale and cost reductions. Such asset pooling allows the master UCITS to simultaneously manage assets gathered by several feeder UCITSs, each of which can still maintain a local fund presence in a range of target EU markets.

Regulator to Regulator Cooperation

Given the greater flexibility of UCITS IV, this regime is targeted at improving cooperation

mechanisms between the regulatory authorities. UCITS IV makes it possible for national regulators to exercise supervisory and investigatory powers, either directly, in collaboration with other authorities, through delegation, or by application to judicial authorities. This enhanced convergence of supervisory powers is central to UCITS IV. Its aim is to bring about equal enforcement and a common minimum set of powers across the EU. Additionally, provisions for the exchange of information, on-the-spot verification of information and mutual notifications between regulatory authorities are also set out under the UCITS IV legislation. This will enable the supervision of UCITSs on a consolidated basis. Moreover, Member States are required to impose adequate administrative sanctions and penalties for any infringements of national measures adopted pursuant to UCITS IV.

Conclusion

UCITS IV legislation brings many benefits to the EU funds' industry. It invites Europeans to invest by providing a lower risk regulatory environment, and has also made a wider range of strategies and techniques available to retail investors.

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Post-IPO Obligations of Foreign Companies Listed on the Warsaw Stock Exchange

Foreign Issuers on the Warsaw Stock Exchange (“WSE”)

The WSE is one of the most vibrant and attractive listing markets in Europe. It is of special interest to companies from Eastern Europe, in particular Ukraine.

EU regulations implemented in Poland make it straightforward for foreign companies registered in an EU Member State to list on the WSE. This is commonly done by Ukrainian companies seeking financing on the Polish market. They use Luxembourg, Cyprus or Dutch special purpose vehicles (“SPV”) whose shares are usually listed only in Warsaw. The most common structure is that a Ukrainian company’s shares are owned by a Luxembourg, Cyprus or Netherlands SPV, and the SPV’s shares are listed on the WSE. The reason for this is that you can draw up a prospectus in line with the EU Regulations applicable in each EU member state, approve it with the Luxembourg, Cyprus or Netherlands authority and passport the prospectus to Poland.

Foreign Issuers as Polish Public Companies

The Initial Public Offering (“IPO”) is just the first step on the way to building a success story. A listing brings obligations for the issuer. Generally speaking, all WSE listed companies have the status of a Polish public company and have duties to fulfil. A public company is understood to have at least one share dematerialised (i.e. in book-entry form) by way of registration with the Polish National Depository for Securities. In practice, this means that while

a public company does not have to be a listed company, all WSE listed companies are public companies.

Post IPO Obligations

All listed companies, including foreign companies, and to some extent their shareholders, board members and other bodies, have a number of obligations to meet. This includes three groups of disclosure duties:

- disclosure of current, periodical information and inside information;
- notification duties on transactions on a material block of shares; and,
- public tender obligations.

The key legislation relating to post IPO obligations is:

- (i) Act of July 29, 2005 on public offering, conditions governing the introduction of financial instruments to organised trading, and public companies (the “Public Offering Act”); and,
- (ii) Act of July 29, 2005 on trading in financial instruments and related executive regulations.

Overview of Obligations

A listed (i.e. public) company must simultaneously provide the Polish Financial

“ This information disclosure rule causes major practical problems as the simultaneous applicability of two legal regimes results in conflicts and lack of clarity ”

Authority (FSA), the WSE and the press agency with the following information:

- current and periodic information – comprehensive information in a current or periodic report, deadlines for disclosure enshrined in law;
- inside information relating to a listed company(-ies), a financial instrument(s), or acquisition/disposal of such instruments, which has not been made public but, if it was, would significantly impact the prices of financial instruments or related derivatives. Share trading by senior corporate officers is restricted during certain periods. Importantly, no-one is allowed to use inside information unless it is disclosed in line with the requirements of the Public Offering Act. This is a grey area of law, which causes a lot of practical problems.

Disclosures by foreign-listed companies may be subject to the laws of other Member

States (see below) – but their rules will be mostly similar due to EU law. However, Polish law will be applicable in all aspects, other than the scope of the information to be disclosed and the deadlines. This issue requires a case by case approach.

As regards notifications on material blocks of shares, the Public Offering Act sets out a comprehensive list of thresholds which, if achieved or crossed (up or down), trigger a notification duty. They are: 5%, 10%, 15%, 20%, 25%, 33%, 33⅓%, 50%, 75% or 90% of the total votes in a public company. Some notifications are triggered by an acquisition of a certain block of shares (votes), e.g. when an existing shareholding of over 10% of votes changes by at least 2% of votes, or an existing shareholding of over 33% of votes changes by at least 1% of votes.

Finally, there are material obligations connected to launching public tenders, when exceeding 33% and 66% of votes in a listed company. Material obligations are also associated with acquisitions of more than 10% of votes within a period of less than 60 days where an investor holds less than 33% of votes in the public company, or if an investor holding 33% or more of votes in a given public company intends to acquire shares representing over 5% of votes over less than 12 months.

Crucially, these notification obligations, and to some extent public tender obligations, apply not only to direct holders of shares, but also to indirect holders, parties acting in concert, etc. For this reason, each indirect holding should be analysed separately on a case by case basis. A change of control over an entity holding shares in a public company may also trigger a notification duty and this

“ Due performance of disclosure obligations is not easy ”

“ The WSE is one of the most vibrant and attractive listing markets in Europe ”

applies to members of the listed company's bodies and related persons/entities.

Both notification and public tender obligations, although referring to shareholders/future shareholders of a listed company, also include obligations on the part of that listed company directly: disclosing information to the Polish FSA and the public, issuing opinions on public tenders, etc.

Some Practical Problems

Importantly for foreign companies listed on the WSE, most of the above obligations must be performed in line with Polish law. To be more precise, public tenders and notifications on a material block of shares cover all Polish public companies (or more precisely the current and future shareholders, board members, etc. of such companies) and should be performed in accordance with Polish law.

This works perfectly for foreign companies listed only on the WSE. However, there are practical problems in the case of dual-listed companies – and this requires careful planning when structuring a public tender or share sale transaction so as to comply with Polish and the other venue's law.

For foreign listed companies, information disclosure obligations are specially regulated under Polish law. The rule is that Polish law is applicable. This rule is supplemented by a provision referring to foreign companies listed on the WSE, which are subject to a certain extent to the law of the mother country. (For Ukrainian companies the

mother country is usually Luxembourg, the Netherlands or Cyprus.) Consequently, the information disclosure obligations of foreign companies listed on the WSE are regulated by two legal regimes:

- obligations relating to scope and timeframes are regulated by the law of the mother country;
- all other obligations are regulated by Polish law, (e.g. obligations relating to inside information, restricted periods regulation, method of disclosing information, methods of delaying disclosure of inside information and many others).

This rule causes major practical problems as the simultaneous applicability of two legal regimes results in conflicts and lack of clarity.

There can also be some problems as to the scope of information to be disclosed in the case of dual-listed foreign companies. Although all EU member states have transposed the EU Transparency Directive, local laws vary between the different member states.

Consequently, due performance of disclosure obligations is not easy, and the FSA is very anxious about it. The FSA constantly monitors the performance of disclosure obligations by all Polish public companies. At the same time, the consequences of non-performance or improper performance are material and result in material regulatory and some litigation risks. The latter risk is expected

“ For foreign listed companies, information disclosure obligations are specially regulated under Polish law ”

“Public tenders and notifications on a material block of shares cover all Polish public companies and should be performed in accordance with Polish law”

to become material in upcoming years due to the Class Action Act in Poland: retail investors are expected to start suing listed companies for improper performance of disclosure duties (including prospectus' requirements).

The regulatory risks are high. Where a listed company's mother country is another EU member state and Poland is only a hosting country, if the WSE-listed foreign company does not (fully) perform its disclosure obligations, the Polish FSA informs the financial market authority of the mother country. If the other authority does not take action, the Polish FSA may impose a fine directly on the infringing company of up to EUR 250,000 and/or de-list its shares from the WSE (temporarily or indefinitely). There are also large fines for non-performance or improper performance of notification and public tender obligations.

Summary

Foreign companies encounter a mish-mash of Polish, EU and foreign law when performing post-IPO obligations. The problems we see in practice are complicated and have resulted to date mainly in regulatory risks.

The key elements to minimise risk are:

- analysing the legal situation of a listed company in detail with respect to post-IPO obligations;

ATTORNEY HIGHLIGHT

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Robert Michels specialises in capital markets, banking and securities law. He advises national and international clients, in particular foreign issuers from Russia, Ukraine, China and India, in connection with listings/IPOs/SPOs on European Stock Exchanges. In addition, Robert advises issuers of structured products as well as listed companies with regard to compliance and post-listing obligations. Robert began his career with Shearman & Sterling and joined Salans recently from Beiten Burkhardt, where he was also responsible for the Capital Markets group.



Robert on Salans, future projects and sport...

What do you like most at Salans?

Our different approach, which in my view includes elements such as the unique team spirit at our Frankfurt office, as well as the fantastic position Salans has in emerging markets.

What is your number 1 priority?

In my private life: my family; in my professional life: our brilliant capital markets team.

What are your goals for the near future?

In my private life, my next challenge is to run a marathon. On the professional side: to bring another Ukrainian or Russian issuer to the regulated market segment of the Frankfurt Stock Exchange with the help of the Salans network.

When I say sport, you think...

Of 1.FC Saarbrücken, a third division football team from my hometown. We almost won the championship in '52 ...

- implementing rigorous internal procedures for observing all obligations;
- ensuring sufficient employee training on the relevant internal procedures.

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Listing of Ukrainian Issuers on the Frankfurt Stock Exchange

Ukrainian companies typically access the international capital markets by:

- the placement and direct listing of the shares of a non-Ukrainian holding; or
- the placement and listing of global depositary receipts ("GDRs") representing either the listed shares of a Ukrainian issuer, or the listed or unlisted shares of a non-Ukrainian holding on an overseas exchange.

While the first wave of Ukrainian issuers, starting in 2005, was mainly oriented towards the London Stock Exchange's AIM segment, many of the Ukrainian companies in 2007 and 2008 listed in the unregulated segment (First Quotation Board ("FQB") and Second Quotation Board ("SQB") of the Open Market) of the Frankfurt Stock Exchange ("FSE"). At that time it was possible to raise up to USD 100m with a simple private placement, while transparency and liquidity back then did not seem to play a big role for the parties involved. Since 2010, the trend moved away from Frankfurt to the regulated market, mainly in Warsaw, but to a lesser extent also to the regulated and unregulated segments in London. This article addresses common prejudices about Frankfurt.

Market Segments Offered by the FSE to Issuers

The FSE, has much more to offer to issuers than just the Open Market segment. For the listing of their securities on the FSE, issuers can choose between the regulated market (General Standard/Prime Standard) and the Open Market (First/Second Quotation Board and Entry Standard) that are merely regulated by the stock exchange. In the SQB, securities are included for trading that are already listed on an exchange recognised by Deutsche Börse. In the case of GDRs, it is sufficient if the shares represented by the GDRs are listed on a recognised exchange segment (e.g. PFTS in the Ukraine). The securities in the FQB (or the shares represented, in the case of GDRs) are not listed on any other exchange recognised by Deutsche Börse.

The General and Prime Standards, which are both regulated market segments, are subject to the post-listing obligations of the EU Transparency Directive. The General Standard is comparable to the Main Markets in London and Warsaw as regards admission criteria and post-

“The General and Prime Standards, which are both regulated market segments, are subject to the post-listing obligations of the EU Transparency Directive”

listing obligations. The Prime Standard, however, imposes even stricter post-listing obligations on issuers than the EU Transparency Directive. Admission to the regulated market segments generally requires a securities' prospectus.

For the inclusion for trading in the Open Market a securities' prospectus is only needed if the issuer plans to offer securities to the public, or if the envisaged marketing measures appear to make the publication of a securities' prospectus advisable. Some trading participants acting as applicants for issuers in the Open Market, however, require a securities' prospectus from issuers seeking an inclusion in the Entry Standard sub-segment of the Open Market. Only issuers in the Entry Standard segment of the Open Market undertake to comply with certain post-inclusion obligations. No post-inclusion obligations have to be met by issuers in the FQB, and the access requirements for the FQB have been extremely low until February this year.

Markets	Listing Segments
Regulated Market (regulated by EU)	<ul style="list-style-type: none"> ■ Prime Standard ■ General Standard
Regulated Unofficial Market (Open Market: Regulated by the exchange)	<ul style="list-style-type: none"> ■ Entry Standard ■ First Quotation Board ■ Second Quotation Board

Recent Changes to FQB Requirements

Due to the diversity of the issuers included for trading in the FQB, Deutsche Börse has recently introduced two additional requirements, which do not only apply to new issuers accessing the FQB, but also to companies already traded there. Since mid-February this year, issuers have to evidence that:

- (i) their shares/GDRs have at least a (arithmetic) par-value of EUR 0.1 per share/GDR; and,
- (ii) the equity capital of the issuer amounts to a minimum of EUR 500,000. Confirmation of this has to be provided by a qualified auditor; and such confirmation may not be older than two months from the date of application.

Issuers who do not meet the new requirements may produce and publish a securities' prospectus, which is reviewed and approved by the competent authority in the European Economic Area. Companies, which were already traded in the FQB when the changes came into force, had until 30 September 2011 to evidence that they meet the new requirements, or to produce a securities' prospectus. If they failed to do either, they were delisted effective 15 November 2011.

Recent Changes to Trading Rules

In addition to (and independent of) such new inclusion requirements, from 23 May 2011, Deutsche Börse also introduced the new mandatory "specialist model" for trading. This model means that specialists are required to provide liquidity in the form of mandatory bid and ask prices. Since provision of liquidity by mandatory bid and ask prices entails that the specialist takes on a risk position, the specialists reassessed

“In the regulated markets issuers can generally tap into a wider investor pool, because some institutional investors may not invest in companies that are only listed in an unregulated market”

the issuers where they were supposed to take on this new role, and in some cases refused to do so. Since it is mandatory to have a specialist, Deutsche Börse delisted SQB and FQB listed securities where no specialist was appointed. Some Ukrainian companies have been affected by this delisting procedure in the last few months.

Issuers' Choices

In the regulated markets issuers can generally tap into a wider investor pool, because some institutional investors may not invest in companies that are only listed in an unregulated market. Furthermore, companies listed in the Open Market are limited in their marketing activities, due to the wide definition of a public offer in the EU Prospectus Directive. It has to be added, however, that many of the companies traded in the FQB/SQB abstain from showing any up-to-date corporate or financial information on their websites. Transparency, however, attracts liquidity. Therefore, the liquidity tends to be considerably higher in regulated segments where the transparency requirements of the EU Transparency Directive apply, compared to segments regulated merely by the exchange, where no or reduced transparency requirements are imposed on issuers by the exchange.

As regards Deutsche Börse, Ukrainian issuers have so far only chosen to access the unregulated segments, i.e. there is no Ukrainian company whose securities are listed in any of the regulated market segments in Frankfurt.

Liquidity at Deutsche Börse

If you look at some liquidity comparisons prepared by investment banks for Ukrainian issuers, you will find that the liquidity of Ukrainian companies traded in the FQB is directly compared to the liquidity of issuers listed in regulated segments of exchanges, mainly in Warsaw but also in London. This is, however, like comparing apples and pears, since the liquidity is in principle higher in any regulated segments. Furthermore, when looking at statistics from the World Federation of Exchanges (www.world-exchanges.org) it can be seen that when comparing the overall liquidity in equity trading, Deutsche Börse holds a leading position.

Listing of GDRs on Deutsche Börse

GDRs may be included for trading and admitted to listing in all market segments of Deutsche Börse. This is one aspect where Deutsche Börse is different from Warsaw where GDRs cannot be listed in the Main Market.

Ukrainian companies with a local listing can only access the international capital markets through GDRs. For such GDR programmes of Ukrainian listed issuers, all Deutsche Börse's market segments are accessible. Companies which have already established a GDR programme that is included for trading in the Open Market may consider accessing a higher market segment in Frankfurt, e.g. the Entry or General Standard, instead of splitting the

liquidity between shares and existing GDRs by listing the shares of their non-Ukrainian holding on another exchange.

Post-listing Obligations of GDRs in the Regulated Market

There are considerable differences between post-listing obligations in the regulated market for shares and for GDRs, especially in the General Standard. An issuer of GDRs in the General Standard, for example, is not obliged to publish its half-yearly financial reports or any interim management statements. In cases where the underlying shares are not admitted to trading on an

“The FSE has much more to offer to issuers than just the Open Market segment”

organised market, pursuant to sec. 2 para. 5 of the German Securities Trading Act (PFTS and the Ukrainian Stock Exchange do not fall under this definition), the provisions on the disclosure of directors’ dealings and those on voting rights’ notifications do not apply.

This may be an aspect that should also be

considered when the options of upgrading an existing GDR programme and the listing of shares on a European Exchange are discussed.

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Takeovers of UK Listed Public Companies

The ongoing instability in the financial markets has resulted in opportunities for cash-rich investors to acquire companies whose market capitalisation is perceived to have fallen below their real value. Potential targets may wish to take steps to protect against an unwanted offer. This article provides an overview of the regulations and procedures that apply to takeovers of companies listed in the United Kingdom.

Launching A Takeover Offer

Regulatory Framework

There are a number of rules and codes that apply to any companies, irrespective of their place of incorporation, that are admitted to a UK market (for example, the Main Market of the London Stock Exchange or AIM). Many of these relate to market conduct and disclosure requirements.

The Code

The City Code on Takeovers and Mergers (the 'Code') is issued by the Panel on Takeovers and Mergers (the 'Panel') and is designed to ensure fair and equal treatment of all shareholders during a takeover. The Code applies to all offers for companies admitted to the Main Market and AIM which have their registered office in the UK, the Channel Islands or the Isle of Man, and (in the case of companies admitted to AIM) are considered to have their place of central management and control in one of these jurisdictions. It may also apply to certain other companies.

The Code sets out a formal procedure for making an offer. It also details circumstances in which a person is required to make a 'mandatory offer' for all of a company's shares. For example, a 'mandatory offer' must be made where a person's total

holding, when added to that of any other shareholders acting in concert with him, reaches 30% or more of the company's voting shares.

There is an increasing number of listed foreign companies, to which the Code does not apply, that see the Code's formal procedures as providing them with a level of protection against takeover bids. It is not uncommon for such companies to have incorporated provisions of the Code into their constitutional documents, thereby ensuring that provisions equivalent to those of the Code will apply to any takeover.

Stake-Building and Announcements

A bidder will often build a stake in the target before launching a takeover offer. Care must be taken, where the Code applies, not to trigger the 'mandatory offer' rule. If the rule is triggered then the offer price per share cannot be less than the highest price paid by the bidder in the three month period before launching the takeover offer.

As a potential takeover offer is price-sensitive it is important that, subject to any disclosure requirements (see below), absolute secrecy is maintained throughout any stake-building exercise. The bidder should limit the number of its internal and external teams and should use a codename for the target in all communications. The

“An increasing number of listed foreign companies, to which the Code does not apply, see the Code's formal procedures as providing them with a level of protection against takeover bids”

Code requires that a public announcement be made in certain circumstances, including when rumours of an imminent offer are circulating or where a bidder's actions may have triggered an untoward movement in a target's share price.

There are detailed rules regulating the content of any announcement. An announcement should not be made without taking advice from the bidder's professional advisers. The Panel must also be consulted on any statements that are to be released before a firm intention to make an offer has been notified to the target.

Structuring the Offer

Under the Code an offer must first be communicated to the target's board of directors or to its advisers. The identity of the bidder must be disclosed at the outset. The bidder must be able to satisfy the board and the Panel that it is in a position to implement the offer in full. This will include its ability to meet any cash element of the consideration.

“Ongoing instability in the financial markets has resulted in opportunities for cash-rich investors to acquire companies whose market capitalisation is perceived to have fallen below their real value”

The majority of take-over bids are ‘recommended’ or ‘agreed’ bids, meaning that they have the support of the target’s board. This makes the conduct of the offer easier and will enable the bidder to access more detailed due diligence information. Where the board does not support the offer, known as a ‘hostile bid’, a public relations battle often ensues between the bidder and the target, and the bidder can only rely on information in the public domain for its due diligence (see the comments on ‘insider trading’ below).

Once the intention to make an offer has been announced, a formal offer document must be posted to shareholders, usually within twenty-eight days. If the target’s board supports the offer, then a letter from them recommending the offer will usually accompany the offer document. A ‘mandatory offer’ may only be conditional on the bidder receiving sufficient acceptances to enable it to acquire over 50% of the shares. Where the offer is not ‘mandatory’ the bidder can include additional conditions, such as a higher threshold of acceptances and the approval of any relevant competition authorities.

Other Considerations

Market Abuse

Market abuse is defined as certain behaviour by a company or individual, relating to securities admitted to a relevant market (including the Main Market or AIM), including insider trading, the improper disclosure of inside information, the misuse of information, or market distortion. The sanctions for breaching the rules include an unlimited fine, public censure and the payment of compensation to victims. There are also criminal offences of market manipulation and making misleading statements. The market abuse regime applies regardless of whether the Code governs the takeover offer.

The Financial Services Authority’s (‘FSA’) Code of Market Conduct states that, in the context of a takeover bid, behaviour based on inside information relating to a target does not of itself amount to market abuse. This is helpful in that it allows a bidder to undertake due diligence on the target, seek irrevocable undertakings from shareholders and make arrangements for the placing or underwriting of securities that are to be offered as consideration without fear of breaching the rules.

Insider Trading

It is a criminal offence for an individual who holds ‘inside information’ relating to securities to deal, or encourage others to deal, in those securities. ‘Inside information’ is specific information relating to securities that is not public and that would be likely to have a significant effect on the price of those securities if made public. The insider trading regime applies regardless of whether the Code governs the takeover offer.

The penalties for committing insider trading include fines and imprisonment. However, insider trading may also constitute the civil offence of market abuse and the FSA often has the option to pursue either claim.

These provisions make it difficult for a bidder to conduct due diligence on a target company during a stake-building exercise. If a bidder receives material due diligence information then it will not be able to acquire further shares in the target without breaching the insider trading regime unless:

- (i) the information is disclosed to the market by the target; or
- (ii) the bidder announces an offer for all of the target’s shares.

If the target’s board is hostile to an offer then it is unlikely to release the information and the bidder will only be able to acquire further shares by announcing an offer.

Disclosure of Dealings

In addition to the restrictions on dealing in securities imposed by the market abuse and insider trading regimes, once a takeover offer has been publicly announced any dealings in 1% or more of any securities of the target must be disclosed to the Panel. In addition neither the bidder, nor any associate of the target, may deal in the target’s securities without the Panel’s consent.

Under the FSA’s Disclosure and Transparency Rules, any person who acquires, or is entitled to acquire, control over more than 3% of the voting rights in a UK listed company, whether by a single or a number of acquisitions, must usually disclose this to the company. A further disclosure must usually be made for each

“As a potential takeover offer is price-sensitive it is important that absolute secrecy is maintained throughout any stake-building exercise”

subsequent 1% acquired or sold. The thresholds for the disclosure of holdings in a non-UK company (where its shares are admitted to trading on a UK regulated market and the UK is its home member state) are 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%.

Squeeze Out

A bidder which has, through a takeover offer to all shareholders, acquired 90% or more of the issued shares of a target incorporated in the UK has the right under the Companies Act 2006 to compulsorily acquire the shares of the remaining shareholders. Similarly, such minority shareholders have the right to require the bidder to acquire their shares. Any shares held by the bidder at the time that it posts the offer document are excluded for the purposes of this calculation.

Defending A Takeover Offer

Frustrating Action

The Code prevents a target's board from taking defensive action that would frustrate an imminent bid unless its shareholders have approved the action by ordinary resolution. This prohibition extends to issuing new shares, issuing any options or similar securities and/or disposing of any material assets. The payment of a dividend by a target company outside of its usual timetable may also constitute frustrating action. If there is any doubt as to whether a course of action would be in breach of this prohibition, then the board should consult with the Panel in advance of the action being taken.

Poison Pills

Public companies may wish to structure their business in such a way as to deter any future bid. For example, a company may wish to include change of control clauses

“The City Code on Takeovers and Mergers is designed to ensure fair and equal treatment of all shareholders during a takeover”

in its key contracts, or grant weighted voting or subscription rights. Such practices, referred to as 'poison pills', are common in the US but are harder to enforce in the UK.

Any attempt to adopt a 'poison pill' when an offer is imminent is likely to be prevented by the Code rules on frustrating action. In addition, both the Listing Authority and representative bodies of the main UK institutional shareholders (such as the Association of British Insurers and National Association of Pension Funds) have resisted the types of weighted share structures adopted in the US. As a result, even where a bid is not imminent, a 'poison pill' is unlikely to be approved by the company's shareholders.

Permitted Action

There are a number of steps that a target can take to defend against an unwanted takeover offer. These include the following:

- The target's board will want to convince shareholders that the offer undervalues the target and that the shareholders would be better rewarded by keeping their shares. Any information that is released in defence of an offer must be properly verified.
- The target should consider obtaining and publishing written statements from key shareholders who do not wish to accept the offer. Such statements may help to convince other shareholders not to accept the offer. Where the

Code applies the statements will need to be approved by the Panel.

- The board can try to encourage a competing offer from a third party (a 'white knight'). In doing so the directors will be accepting that a takeover is inevitable. Alternatively the board can try to encourage a third party (a 'white squire') to acquire a block of shares large enough to prevent the original offer from succeeding.
- Where an offer is subject to the approval of relevant competition authorities, the target can seek to provide information to the authorities demonstrating that the takeover would have an anticompetitive effect on the market. Any such information must be accurate and must not seek to mislead the authorities.

In taking any of the above steps the directors of a UK incorporated target must ensure that they are acting in the best interests of the target, otherwise they will be in breach of their fiduciary duties. Similar considerations may also apply to target companies that are not incorporated in the UK.

Our Experience

Salans' London office is experienced in acting both for companies whose shares are listed on the Main Market and on AIM, and for bidders seeking to acquire such companies. In particular, we have advised bidders on the initial stake-building exercises in their intended targets and on their subsequent offers, whether or not subject to the Code.

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The Importance of Anti-Bribery Analysis

Many companies are now undertaking an in-depth anti-bribery analysis as part of their standard due diligence prior to mergers, acquisitions and/or joint ventures. It is more important than ever to consider anti-bribery issues following the increased focus on the prevention of bribery, particularly in the United States and the United Kingdom.

The Regulatory Environment

Undertaking an anti-bribery analysis can be important and valuable for two major reasons. First, the enforcement of anti-corruption laws with global reach is increasing. The US regulators have in recent years, intensified their enforcement of the US Foreign Corrupt Practices Act ('FCPA'). The number of costly investigations has grown significantly and the fines imposed have dramatically increased. In 2010, fines for companies which settled FCPA related charges amounted to US\$1.8 billion, compared to US\$641 million in 2009. In addition, in July of 2011, the new Bribery Act 2010 (the '2010 Act') entered into force in the UK.

The 2010 Act covers a broader jurisdiction than the FCPA and contains additional substantive requirements not found in the FCPA. One of these new requirements, the imposition of liability for the failure to prevent bribery, may in and of itself, require an anti-bribery review as part of the standard due diligence prior to the implementation of mergers, acquisitions and/or joint ventures. These developments have led to increased attention by companies operating internationally on not only developing internal compliance programs and monitoring more closely the actions of employees, but also examining the compliance programs, practices and

history of target companies and joint venture partners.

Second, anti-bribery due diligence can be an effective tool for acquirers looking at targets in jurisdictions which have reputations for corruption. Certainly, in such jurisdictions not all businesses are corrupt. There are likely to be good opportunities for investment. If, by looking into the business practices of a specific target company, an acquirer and its legal counsel determine that the target is sufficiently compliant, some comfort can be taken that, notwithstanding the specific country's reputation, the target is less likely to have a corruption risk. This due diligence effort can also reveal significant business practices overall that may help the acquirer evaluate whether to proceed with the relevant transaction.

Joint Ventures

Companies entering into joint ventures should consider the implications of both the FCPA and the 2010 Act. Even minority stakeholders would be wise to exercise caution, as they may be held liable for the conduct of the venture, where regulators view the minority stakeholder as exerting significant influence on the joint venture.

It would also be prudent for each party to a joint venture to promote good governance, accurate record-keeping, and anti-bribery provisions in the joint venture to help

“Anti-bribery due diligence is a critical tool in mergers, acquisitions and/or joint venture transactions”

achieve compliance with the FCPA and the 2010 Act. If nothing else, it is desirable to have a written record of having proposed that the joint venture adopt such standards, even if such adoption does not occur. Any discomfort with the level of FCPA or 2010 Act compliance in a joint venture, including refusal by other venturers to put a compliance program in place or to conduct due diligence on third-party agents, may be grounds to consider exiting the venture.

Legal Liability

As noted above, the increased enforcement of the FCPA and the requirements of the 2010 Act together have led to anti-bribery due diligence becoming a standard part of the acquisition or joint venture processes.

In the US, the Department of Justice ('DoJ') has initiated enforcement actions where there has been inadequate due diligence regarding bribery conduct. According to the DoJ, successor liability can be imposed, in theory, for undiscovered pre-acquisition bribery at the target. In practice, however, the DoJ has imposed such liability only in cases where the bribes by the target continued after the acquisition closed. Further, if the acquirer has conducted an adequate due diligence review before undertaking the acquisition and discloses

any violations discovered during the due diligence to the DoJ, that may serve as a defense for the acquirer in such a case.

In one case, the DoJ brought charges and went to trial where the acquirer knew about corrupt activities on the part of a company into which it invested before the investment took place, yet still went ahead with the investment. The court agreed with the DoJ that the investor knew, or should have known, that it was investing in a company that had made illegal gifts and payments to the Government of Azerbaijan in order to encourage the privatization of SOCAR, an Azeri State oil company. The DoJ emphasized that the investor failed to conduct adequate due diligence, did not retain a law firm with experience in these issues and ignored clear evidence during the investment process that there was corruption in the company.

As the 2010 Act came into force earlier this year, to date there is little practical guidance (for example, in the form of court decisions) as to the approach that will be taken in its enforcement. The new offense included in the 2010 Act of 'failure to prevent bribery' opens the door for the Serious Fraud Office to look at the issue of successor liability. It is likely that the basis for future charges in this regard will be similar to that under the FCPA described above – that is, inadequate pre-closing due diligence connected with ongoing violations post-closing, or failure to respond properly to risks identified pre-closing.

Under the 2010 Act, the offense of failing to prevent bribery is committed by a corporate body if any third party bribes anyone else when performing services for the corporate body concerned. This is in addition to the offenses of directly bribing or being bribed, and it applies to both UK corporates and non-UK corporates, where the latter carries on any business in the UK. There does not need to be a link between the act of bribery and the corporate's UK business. Unlike the FCPA, there is an

“An adequate and effective anti-bribery due diligence process should be a clear and distinct component of the overall legal due diligence process”

explicit defense, in fact the only defense available, that the corporate proves that it had in place 'adequate procedures designed to prevent bribery'. Anti-bribery due diligence would very likely be considered part of an adequate procedures' program.

Due Diligence Process

An adequate and effective anti-bribery due diligence process should be a clear and distinct component of the overall legal due diligence process. As such, it would normally be conducted by outside counsel. Complete and accurate due diligence records should be kept on file. This process should run together with the general legal due diligence and start at the beginning of that process. By initiating this component early on in the diligence process, it is more likely that red flags can be identified before extensive transaction costs are incurred. This enables the acquirer to determine if those red flags are significant enough to terminate the process, or whether such violations can be cured by reporting, and by correcting internal procedures.

This process includes a range of questions to be asked of the management of the target company, interviews with and research into external sources, including but not limited to business and public records and media reports, and possibly retaining an independent investigative firm and using specialist forensic software. The questions should address the following:

- (i) Does the target company operate in a 'high risk' country? The Transparency International Corruption Perceptions Index, which measures the perceived levels of public sector corruption in 178 countries around the world, should be consulted to determine the potential for corruption in the target company.
- (ii) Does the target company operate in a high-risk industry? Are bribes culturally acceptable in any of the markets in which the target operates? What is the target's association with foreign governments? Is the target government-controlled or government-owned? Does the target provide goods or services to any government? Does the target require any government-issued licenses or permits to run its business? Care should be taken when reviewing the target's relationships with government officials, including through family, prior employment or political activity, and any such instance should be scrutinized. Similarly, any instance of a 'success fee' should be highly scrutinized.
- (iii) Does the target company have an anti-corruption compliance program in place? If so, that program should be analyzed both for the comprehensiveness of its content and the effectiveness of its implementation. Many companies, particularly new companies in emerging markets, do not have such programs at all. Others have minimal statements of 'corporate vision' or 'corporate principles', but no specific guidance to officers and employees. Until recently, even companies in developed market economies did not take these programs seriously and had no practical ability to oversee, or interest in overseeing, their enforcement.
- (iv) Are there, or have there been, any anti-corruption investigations into the target company by government

authorities? This is generally a matter of public record. Particularly in this regard, the services of an investigative company with experience in the jurisdiction of the target company can be most valuable to ensure that all such investigations are uncovered.

- (v) Is the board of the target company committed to business integrity, including the prevention of bribery and corruption? This question is especially important when looking to the nature and composition of post-acquisition management.
- (vi) Has the due diligence review uncovered any suspicious 'red flags'? Indications of potential issues may include statements contained in the reviewed documentation in which an official or other service provider requests to be paid in cash or through a personal offshore bank account, or states that he/she 'knows the right people in the industry' or has 'no facilities, but will get the job done'.

As can be seen, this process will not only reveal issues of potential legal liability and risk to the acquirer, but will also identify a company culture and way of doing business that might not be apparent from organizational charts or in-person meetings and discussions. This information could well be critical in determining whether the acquisition of the target company is compatible with the business philosophy of the acquirer. It can also be informative as to the amount of time and expense that will be needed to bring the target company up to the standards of compliance required by both the acquirer and the relevant legislation. The structure of the transaction itself might take account of the identified problems, so that they can be dealt with while enabling the transaction as a whole to proceed.

As further protection and to minimize the risk regarding corruption-related liability, the

“It is more important than ever to consider anti-bribery issues following the increased focus on the prevention of bribery, particularly in the United States and the United Kingdom”

purchase agreement used in the acquisition should include specific representations and warranties covering anti-corruption related issues. (These should include, amongst other matters, those regarding compliance with local law, that the sale proceeds will not be used to fund any illegal payments, that no corrupt payments were made, directly or indirectly, in connection with securing the necessary deal approvals, the absence of any governmental ownership of the target and the accuracy of the target's books and records.) The purchase agreement should also include a right for the acquirer to be fully indemnified on an unlimited basis for any damages it suffers caused by a breach of an anti-corruption related representation, and a termination right for the acquirer if prior to the closing, any such representation becomes untrue. However, no contractual provision will serve to fully correct a flawed due diligence process, as discussed above.

Finally, a detailed anti-bribery due diligence will highlight actions to be taken after the transaction has closed. As mentioned earlier, there may be historic violations that should be disclosed to authorities and remedial action taken. There may also be continuing violations which should be stopped immediately. The anti-bribery compliance program of the target company may need to be upgraded to meet the standards of the acquirer, and should include an effective ongoing monitoring system.

Conclusion

Anti-bribery due diligence is a critical tool in mergers, acquisitions and joint venture transactions. It can identify serious liability issues that may lead to a decision not to proceed with a transaction. It can also identify problems that must be resolved by the seller before a transaction can close. It can provide some assurance that the acquisition will be unlikely to result in legal or reputational harm to the acquirer, even in markets where corruption is high. Lastly, it can reveal deficiencies in the business approach of the target company, which will need to be improved after the acquisition closes.

The Salans Global Anti-Corruption and Economic Crime Group includes lawyers who apply the FCPA, the 2010 Act and the provisions of other jurisdictions at all stages of an acquisition, merger and/or joint venture transaction. We have extensive experience of the questions that should be raised during a due diligence process to fully investigate such matters in the most efficient manner.

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Director Liability: The Use of Corporate Directors

A company can act as a director of an English company (known as a ‘corporate director’). Individuals, who would otherwise be directly appointed as directors, can ring fence their liabilities by acting through a corporate director. The Companies Act 2006 (the ‘2006 Act’) introduced a requirement that at least one director of an English company be an individual person.

However, any remaining directors can be corporate directors. In *Holland v Revenue and Customs & Anor (2010) UKSC 51* the Supreme Court considered whether the directors of a corporate director could be liable to the underlying company for the actions of that corporate director.

Liability of De Facto Directors

The *Holland* case, decided in February 2011, related to events that occurred

before the implementation of the 2006 Act. Following an investigation, the UK tax authorities, HM Revenue & Customs (‘HMRC’), had claimed approximately £3.5 million in unpaid tax from a group of related companies. This caused the companies to become insolvent. Each company had the same single corporate director, which in turn had two individual directors. The corporate director had allowed distributions totalling £13 million to be made to the shareholders of the

“Indirect control exerted by the individual directors of a corporate director over the underlying company may be sufficient for those individuals to be deemed to be acting as directors of the underlying company even though they have not been formally appointed as such”

ATTORNEY HIGHLIGHT

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Zarko Iankov specialises in M&A and general corporate transactions, including cross-border acquisitions and disposals, as well as corporate finance transactions. He has particular experience in the areas of technology, media and communications and real estate, especially as regards transactions in Eastern Europe and the CIS. He has advised on company sales, trade sales, private equity fund investments, admissions to AIM, joint ventures, privatisations and public takeovers.

Zarko on the uniqueness of his job, memorable deals and dream trips...



What’s the best part of your job?

The variety of legal issues, industry contexts and personalities that one comes across as a corporate lawyer and in particular, given Salans’ footprint of offices, the cultural idiosyncrasies, which

add a further layer of complexity in our work.

What is the most memorable deal you ever have worked on, and why?

The acquisition by Sahaviriya Steel Group Plc of Tata Steel’s Teesside cast products’ steel manufacturing business in Redcar, North East England. In addition to the extremely complex legal tasks that our teams had to deal with, it was a transaction which resulted in the re-employment of thousands of steel workers in Teesside, a region which had been affected severely by the economic crisis and social spending cuts. This deal brought pride back to an historic steel-making region.

Is there a place you would like to visit, and why?

The North Pole for the aurora borealis.

group companies when it knew that the HMRC investigation was ongoing.

HMRC claimed that the indirect control exerted by the directors of the corporate director over the group companies was sufficient for them to be deemed to be acting as directors of the group companies, even though they had not been formally appointed as such (known as 'de facto' directors). If this was upheld then the individuals would have been liable for allowing the payment of the distributions by the group companies. It was not claimed that the individuals had acted otherwise than within their capacity and authority as directors of the corporate director.

The Supreme Court held that the individual directors had acted solely in their capacity as directors of the corporate director. It is a principle of English law that a company is a separate legal entity from its directors. If any liability arose in connection with the payment of the distributions by the group companies, then the corporate director was responsible for this, not its own individual directors. The extension of the liability of 'de facto' directors sought by HMRC was a matter for the government to determine, and it had chosen not to do so when implementing the 2006 Act.

“ The Holland case does not provide an absolute protection against liability. Had the actions of the individual directors of the corporate director caused them to be deemed ‘de facto’ directors of the underlying companies then they could have been held liable as such ”

Limited Protection

The *Holland* case does not provide an absolute protection against liability in these circumstances. The Supreme Court noted that it was necessary to examine the actions of the individual directors before reaching their decision. Had any of these actions been found to have caused the individuals to be deemed 'de facto' directors of the group companies then they could have

been held liable for the payment of the distributions. This could occur where the individuals had been involved directly in the management of the group companies.

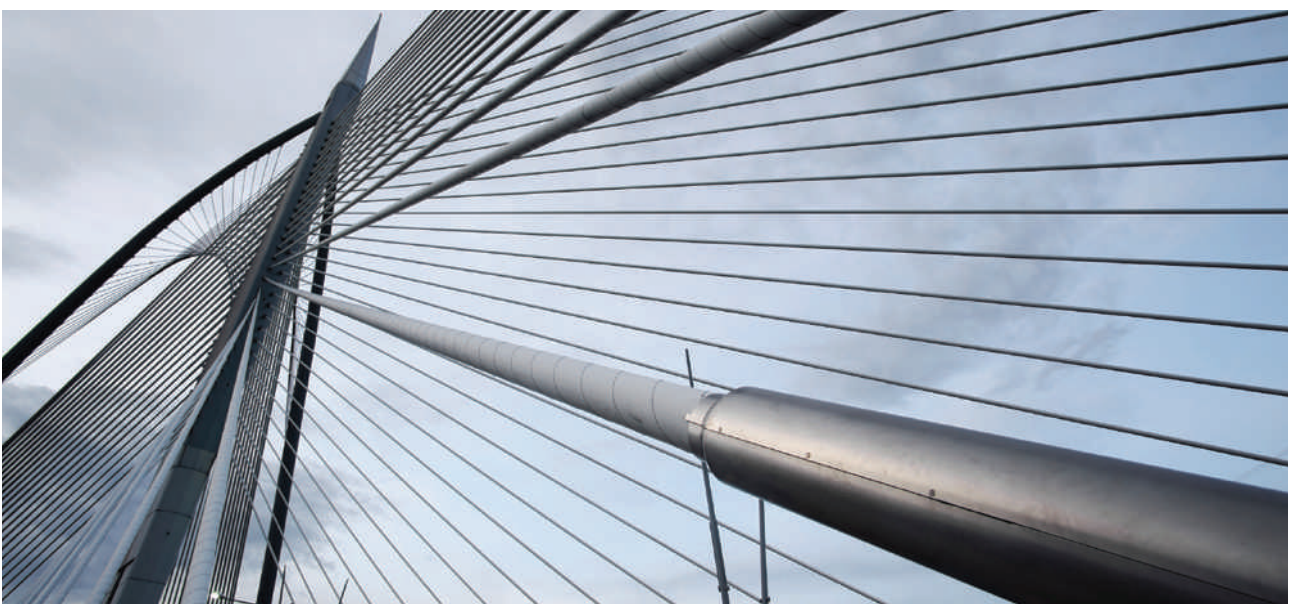
The decision reached by the Supreme Court in the *Holland* case was not unanimous. There were significant concerns raised that this judgment could enable those acting as directors to avoid or mitigate their liabilities. Two judges believed that the control over the boards of the group companies exercised indirectly by the individual directors, and the fact that they held the companies' only voting shares, was sufficient to deem them to be 'de facto' directors of the group companies. However, these views were not upheld.

Although the separation of the liability of the individual directors from the corporate director in this way may seem artificial, it does uphold a basic principle of English law. The *Holland* case represents the most recent review of the liability of 'de facto' directors.

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New Profit-Sharing Requirements in France

From 2011, companies must pay their employees a bonus whenever the amount of dividends distributed to shareholders is higher than the average dividends paid in the two preceding years (the “Dividend Bonus”).

Overview

- Companies with more than 50 employees must comply with this new rule.
- Beneficiaries are all employees with at least 3 months of seniority at (i) the company paying the dividends or (ii) any of its subsidiaries.
- The amount of the Dividend Bonus is not set by law. The only applicable rule is that it should not be “symbolic”. Examples of Dividend Bonuses recently distributed include €350 (gross) per employee paid by Vinci and €150 (gross) per employee paid by Schneider Electric and STMicroelectronics.
- The Dividend Bonus can be split equally amongst the beneficiaries or based on other allocation rules (e.g. overall compensation or number of hours worked).
- The Dividend Bonus cannot replace any other part of an employee’s compensation.
- The Dividend Bonus is not required if the dividends paid to shareholders are in shares.

Process

- The amount of the Dividend Bonus must be set within 3 months following the decision to distribute a shareholder dividend.
- Companies may wish to reach consensus beforehand with the relevant workers’ committees regarding the size of the Dividend Bonus. However, to date, the amount of Dividend Bonuses has been determined unilaterally by the distributing companies. In such cases, the company’s decision is final regardless of the position of the relevant workers committee.
- After determining the amount of the Dividend Bonus, the company must (i) file documentation on such determination with local employment authorities and (ii) send a related and detailed notice to each beneficiary.
- French law provides no specific sanction for non-compliance with this new rule. As such, the usual penalty for employers who do not comply with their obligations (“*délit d’entrave*”) would apply.

“From 2011, companies must pay their employees a bonus whenever the amount of dividends distributed to shareholders is higher than the average dividends paid in the two preceding years”

Tax/Social Status

- For the distributing company, the Dividend Bonus is (i) subject to social charges (14% of the gross amount) and (ii) deductible from corporate income. Employees must pay regular income tax on the Dividend Bonus.

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Financing by Shareholder Loans: New Risks and Limitations

German law does not contain rules comparable to the English rules on financial assistance. However, if a German company grants financial assistance to its parent or another affiliated company, the transaction will be subject to both the rules on capital maintenance and those covering interventions that have a detrimental effect on the survival of the company. Both these sets of rules which have been developed by the German courts.

This article focuses on the rules on capital maintenance, as these were subject to a major reform in 2008. Although the 2008 reform left the basic principle of capital maintenance untouched, it opened up more room for manoeuvre by introducing the notion of so-called “fully recoverable claims”.

Basic Principle behind Capital Maintenance

The basic principle behind the rules on capital maintenance is to protect a portion of a company’s capital, corresponding to the nominal share capital registered with the commercial register, from the grasp of its own shareholders. Capital maintenance rules therefore prohibit any payment to shareholders that would create a so-called “adverse balance”.

An adverse balance exists if the net assets of a company are less than its nominal capital. The net assets consist of the sum of the assets of the company, excluding prepaid expenses, minus its liabilities and provisions. These net assets will be calculated on the basis of the balance sheet.

As a result, any payment to shareholders that could potentially affect a company’s assets will be subject to capital maintenance rules. Moreover, the term “payment” is to be construed broadly,

including not only payments *stricto sensu* but also the provision of any type of collateral that benefits the parent company.

Therefore the scope of application of the rules on capital maintenance encompasses not only cases of financial assistance, but also any other type of intra-group financing, such as intra-group loans, collateral or cash pools.

“Fully Recoverable Claims”

Before the 2008 reform, the German courts took the view that any payment to shareholders was to be deducted from a company’s net assets, but any refund claim against the shareholders was not to be added to the net assets. As a result, it became nearly impossible to implement any type of intra-group financing that concentrated the available funds at a certain level of the group without incurring considerable legal risks, including the personal liability of the respective company’s directors.

The 2008 reform aimed to improve this situation by introducing the notion of “fully recoverable claims”.

The new Section 30 of the German law on limited liability companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG*) now reads:

“The capital of the company that is required

“Capital maintenance rules protect a portion of the company’s capital, corresponding to the nominal share capital registered with the commercial register, from the grasp of its own shareholders”

to maintain the share capital shall not be paid out to the shareholders. Sentence one does not apply if the payments are made under a profit and loss transfer agreement or if the payments are covered by a fully recoverable refund – or compensation claim against the relevant shareholder.”

The exception regarding fully recoverable claims opens up new possibilities for upstream financing. However, certain difficulties do still persist and these are discussed below.

Upstream Financing under the 2008 Rules

The repercussions of the new rules on upstream loans, upstream collateral and cash pools are summarised below.

Upstream Loans

Under the new legislation, upstream loans will not violate the capital maintenance rules if a payment is matched by a

“The basic principle behind the rules on capital maintenance is to protect a portion of a company’s capital, corresponding to the nominal share capital registered with the commercial register, from the grasp of its own shareholders”

compensation or refund claim that is fully recoverable. It is therefore essential to assess the impairment risk of a repayment claim against the shareholder, i.e., the risk that such a claim is not recoverable.

The main and most important criteria to consider in assessing the impairment risk are the solvability of the shareholder and the recoverability of the collateral. These must be assessed at the time of the loan payout on the basis of:

- the net assets, the financial position and the earning position of the borrower; and,
- the value of the collateral.

Furthermore, with regard to long-term loans, it is not entirely clear if the creditworthiness of the creditor and the value of the collateral at the moment of the loan payout are already enough to exclude an impairment risk. Some German commentators take the view that the loan agreements for long-term loans must provide a reporting system that allows:

- a continuous monitoring of the solvability of the borrower and the value of the collateral; and,
- an immediate termination of the agreement if the solvability of the creditor deteriorates.

Upstream Collateral

The situation is less clear with regard to providing upstream collateral. This clearly qualifies as a payment within the meaning of the capital maintenance rules. However, it is less clear when the providing of upstream collateral will be “matched by a fully recoverable refund or compensation claim”.

If a company provides collateral to the benefit of its shareholders, the corresponding refund claim is directed against the relevant shareholder(s).

The vast majority of commentators argue that the impairment risk of a refund claim needs to be assessed at the moment such collateral is provided. Therefore, it would always be permissible to provide collateral, providing the relevant shareholder is fully creditworthy at the moment that collateral is provided.

But some commentators insist that the granting of upstream collateral must be assessed at the moment of the enforcement of such collateral. However, at that point, the refund claim against the shareholder who has obtained the corresponding loan facility will almost always be impaired, i.e., not recoverable.

Commentators also dispute whether a security agreement has to provide a similar monitoring system to that needed for long-term loans.

As a result, there remains high uncertainty with regard to the legal requirements for providing upstream securities. For this reason, it remains advisable to include so-called “limitation language” in the collateral agreement. This would state that the creditor promises to refrain from an enforcement of the collateral if such enforcement would create an adverse balance.

Cash Pooling Systems

Cash pooling is qualified under German law as a series of daily loans to the company

that manages the cash pool. In particular, in cases of so-called “zero balancing” cash pools, these daily loans have to comply with the capital maintenance rules. That is to say, these loans and consequently the cash pooling are only permissible as long as the loans are matched by a fully recoverable compensation claim. Depending on the structure of the cash pool, this compensation claim may be directed only against the company that handles the cash pool, or, if the cash pooling agreement contains a guarantee, it may also be directed against the parent company of the group.

As the creditworthiness of the company which handles the cash pool, or of the parent company may change over time, it is necessary to implement a monitoring system, to ensure compliance with the capital maintenance rules. The German Federal Court of Justice stated in a decision in 2008 that a continuous monitoring of creditworthiness is required, particularly in connection with cash management systems (BGH II ZR 102/07). Implementing so-called early warning and information systems can ensure compliance with this requirement. These systems basically consist of two elements:

- the creation of an extensive reporting system that keeps each company participating in the cash pool informed about the creditworthiness of the company that handles the cash pool, and, as the case may be, of the parent company;

“There remains high uncertainty with regard to the legal requirements for providing upstream securities”

- the ability for each company to leave the cash pool upon termination, without notice, of the cash management agreement, and to claim a refund for the transferred funds.

The ability for a company to leave the cash pool at any time is not only important for compliance with the capital maintenance rules, but also for compliance with the rules on raising the registered share capital. Under the rules on raising such share capital, a shareholder does not fulfil its obligation to fully pay up the respective share if the funds paid are re-transferred to the relevant shareholder. This will regularly happen for cash pooling systems, as the funds will be re-transferred to the company managing the cash pool, which is a shareholder or a company affiliated to the shareholder.

However in the 2008 reforms, in an effort to aid the creation of cash pools, the German legislator introduced an exception to the aforementioned rules. According to the new Section 19 par. 5 GmbHG, the share capital will be considered as paid up in cases of a re-transfer of funds to the shareholder, if that re-transfer is matched by a fully recoverable claim that is due, or that may be rendered due, by termination without notice.

As a result, a cash pool will only comply with the rules on capital maintenance and on the raising of share capital if an appropriate early warning and information system has been implemented, and if the relevant company has the ability to leave the cash pool by termination without notice at any time.

ATTORNEY HIGHLIGHT

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Susanne Münch joined Salans LLP in June 2010 after working at an international law firm in Frankfurt. At university she studied German and French law and holds a Masters Degree in European Law with a specialisation in European Economic Law. Susanne specialises in the areas of mergers and acquisitions, corporate restructurings, corporate financing and compliance, charity law and commercial law. She loves travelling and exploring and has lived in Guadalajara, Mexico and Madrid.



Susanne on her career choices and dream holiday destinations...

What's the best part of your job?

At Salans I have the opportunity to work on both demanding transactions and litigation, in particular post-M&A arbitration proceedings. This allows me to use transactional experience in litigation and vice versa, thereby gaining a deeper understanding of both.

Why did you become a lawyer?

Because it is a profession that requires analytical as well as social skills.

Place you would like to visit and why?

I am planning a tour of Laos, a place which I expect to be still largely reminiscent of the historical French Indochina.



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Modifications to the Capital Companies Act

Act 25/2011, (“Act 25/2011”), dated 1 August, 2011, partially modifies the recent Capital Companies Act (“CCA”), and came into force on 2 October, 2011. This act transposes Directive 2007/36/CE of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies into the Spanish legal system.

It also includes an additional legislative change regarding Act 3/2009, on Structural Modifications to Commercial Companies (“Directive 2007/36/CE”).

These modifications simplify and reduce the organisational and management costs of commercial companies, as well as ending some unjustified differences between the legal regimes of Public Limited Companies (Sociedades Anónimas) (“PLC”) and Limited Liability Companies (Sociedades de Responsabilidad Limitada) (“LLC”). These differences were based on the different political scenarios under which the relevant governing laws were passed (in 1989 and 1995 respectively).

This brief article covers the changes to the CCA included in Act 25/2011, specifically, those changes to the legal regimes of the two most common types of company, PLCs and LLCs. These changes mainly affect:

- Shareholders' General Meetings
- Company Management Bodies
- Winding-up of PLCs
- Shareholders' exit rights
- Exclusion of shareholders

Shareholders' General Meetings

Previously, PLCs were obligated to publish the notice of a shareholders' general

meeting in the Official Gazette of the Commercial Registry, and in one of the main newspapers of the Region in which the company has its legal address. Now, this obligation has been eased since under the new regulations this notice can be published on a company's web site.

The CCA also had a contradiction between the deadline for publishing the notice of a shareholders' general meeting and the period of time legally required to hold that meeting (following a request from minority shareholders). Act 25/2011 extends the period of time when the shareholders' general meeting can be held from one month to two months.

Furthermore, the CCA established that the management body of PLCs could not deny the shareholders' right to information when such right was exercised by shareholders who represented at least 25% of the share capital. Under the new regulations, the company by-laws can now lower this to any percentage higher than 5% of the share capital.

As a result of these changes:

- PLCs now have a less expensive and more dynamic mechanism for calling shareholders' meetings
- Minority shareholders' rights have increased

“These modifications simplify and reduce the organisational and management costs of commercial companies”

Company Management Bodies

Under the CCA, certain amendments to a PLC's by-laws (such as, changes in corporate name, legal address, and the amendment or substitution of its corporate purpose) had to be published in a newspaper in order to register those amendments with the Commercial Registry. This obligation has now been removed.

Act 25/2011 enables PLC by-laws to now state two or more ways in which a company's management body can be organised, so avoiding the need for any cumbersome modifications to by-laws.

In addition, from now on, if the President of a Board fails to call a Board of Directors' meeting within one month from the date it was requested to do so, the Board of Directors shall be called to a meeting by directors representing at least 1/3 of the total members of that board.

As a result of these changes:

- It will be easier and more economical for PLCs to choose the organisation scheme they deem most convenient
- Presidents of a Board can no longer fail to call a Board of Directors' meeting when requested to do so

Winding-Up a PLC

The changes to the CAA mean that the proposed winding-up of a PLC no longer has to be published in one of the main newspapers in the region in which that company has its legal address. In addition, one of the most criticised provisions of the winding up process, that is, the obligation to sell real estate properties by public auction during the winding-up of a PLC, has been removed. Other, simpler, legal methods already exist for ensuring the proper sale of those assets.

Companies that remain inactive for more than a year shall now be legally wound-up, and the directors of the company being wound-up shall automatically become its liquidators.

As a result of these changes the winding-up process:

- Is cheaper, faster and easier
- Has been greatly simplified

Exit Rights and Exclusion of Shareholders

As a result of Act 25/2011, shareholders can now legally exit from a company if the:

- Majority of shareholders agree to a material change to the corporate purpose;
- Company does not pay a minimum dividend when its profits are derived from regular benefits that could be legally distributed to shareholders, and result from its corporate purpose (as from the fifth year of the company's incorporation).

As a result of these changes the exit rights of minority shareholders are better protected.

In addition, the by-laws of PLCs can now include further grounds for excluding shareholders from a company.

“ **The winding-up process is cheaper, faster and easier, and has been greatly simplified** ”

Participation in General Shareholder Meetings of listed companies

Transposing Directive 2007/36/CE into the Spanish Legal System guarantees that all shareholders of listed companies will be duly called to general shareholders' meetings, and that all relevant documents will be made available to shareholders sufficiently in advance of such meetings to enable them to review the papers before the meeting. It has also been made simpler to participate in shareholders' meetings via internet conference calls, so enabling foreign shareholders to take part in these meetings much more easily and to exercise their rights just as national shareholders can.

Code of Commercial Companies

Despite all the material changes outlined above, it is important to bear in mind that a crucial and ambitious modification in corporate law is currently awaiting approval. If approved, this new Commercial Code, or Code of Commercial Companies, will have a significant effect on the CCA. It will update and unify all commercial applicable laws currently in force in Spain, which, due to their dispersion and outdated applicability, require substantial amendment and reorganisation. In fact, the preamble of the CCA pointed out that it was actually passed with a transitory aim.

However, until the new Commercial Code is approved, the above modifications to Act 25/2011 are welcome since they grant significant advantages in managing and operating Spain's capital companies.

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Restructuring Business Operations in China: A Legal and Tax Overview

Many multinational companies have grown rapidly in the Chinese market over recent years. Now, more and more foreign investors are realising that their Chinese operations need restructuring or reorganising due to their size. However, some restructuring transactions can have tax consequences.

In 2009 China's State Administration of Taxation ("SAT") issued Circular concerning Several Issues on Enterprise Income Tax of Enterprise Restructuring¹ ("Circular 59"). This circular defines a "restructuring" as:

A transaction outside an enterprise's daily business operation but which has caused significant changes to an enterprise's legal structure or business structure, including 1) change in legal form; 2) debt restructuring; 3) share acquisition; 4) asset acquisition; 5) merger; and 6) split.

Under Circular 59 companies wishing to restructure their Chinese operations have the following options for dealing with enterprise income tax ("EIT"):

- General treatment ("General EIT Treatment"). This imposes EIT on the fair market value ("FMV") of the shares or assets transferred in the restructuring.
- Special tax treatment ("Special EIT Treatment"). This allows the transactions to be performed at book value, which in effect means that tax effects are deferred. However, Special EIT Treatment can only be applied if certain conditions are fulfilled.

When planning to restructure their operations companies should focus not only on EIT but should also consider the other taxes and legal implications that

could arise from the restructuring. This article highlights the general considerations that companies must take into account when planning any restructuring operations that involve foreign investors or foreign invested enterprises ("FIEs") in China.

Share Transfer

Generally speaking, the transfer of shares in a FIE is subject to the approval of the Ministry of Commerce ("MOC") or its local counterparts. According to Company Law, and subject to an individual company's articles of association, if a shareholder in a company intends to transfer its shares to a third party it must first obtain consent

“When planning to restructure their operations, companies should focus not only on EIT but should also consider the other taxes and legal implications that could arise from the restructuring”

from over half of the company's original shareholders. These shareholders have a right of first refusal over the transfer of any shares to a third party. However, if the company is a Chinese-foreign equity joint venture ("EJV") or a cooperative joint venture ("CJV") that consists of at least one Chinese party and one foreign party,

	Major Preconditions	Major EIT Consequences
General EIT Treatment		<ul style="list-style-type: none"> ■ The transferor must recognise a gain or loss from the share transfer; ■ The transferee must book the FMV of shares transferred as their tax basis.
Special EIT Treatment	<ul style="list-style-type: none"> ■ The shares transferred must be at least 75% of the total shares of the target company; ■ The transferee must pay at least 85% of the total transfer price by shares ("Share Consideration"). 	<ul style="list-style-type: none"> ■ The transferee must book the tax basis of the shares transferred as their original tax basis; ■ The transferor must book the tax basis of the Share Consideration as the original tax basis of the shares transferred.

¹Circular Cai Shui (2009) No. 59

any share transfer is subject to specific restrictions. In this instance, share transfers must have the unanimous approval of the original shareholders in the EJV or CJV. This means that any of the original shareholders (notably the Chinese party) in the EJV or CJV has the right to veto a share transfer.

The EIT implications of a share transfer are different depending on whether it is subject to general or special tax treatment.

A cross-border share transfer to which Special EIT Treatment is applied is subject to further restrictions. For example, a foreign company that transfers the shares of a Chinese subsidiary to another foreign subsidiary that it owns 100% (for instance a holding company) will only qualify for Special EIT Treatment if it complies with two additional preconditions:

- The amount of EIT to be withheld by the Chinese tax authorities must not be affected by the restructuring;
- The acquirer of the shares in the transferred company must commit to the tax authority that it will not transfer those shares for at least three years after the restructuring.

Foreign investors should also be aware of legal difficulties that exist if performing a share swap between a Chinese company and a foreign company. Certain restrictions in the approval procedure with the MOC and the foreign exchange authority could bring additional risks to a deal. Currently share swaps between two FIEs are still very difficult to implement².

Asset Transfers

An asset transfer made by a company does not normally require unanimous approval from its shareholders unless the company's articles of association state otherwise.

Under Chinese tax rules³ for assets to be subject to Special EIT Treatment the assets must be directly relevant to the business operation of the relevant enterprise, for example, intangible assets, account receivables and investments. As a result, the transfer of single assets might not qualify for Special EIT Treatment. Please refer to the different EIT treatments of the asset transfer in the table below.

	Major Preconditions	Major EIT Consequences
General EIT Treatment		<ul style="list-style-type: none"> ■ The seller must recognise a gain or loss from the asset transfer; ■ The buyer must book the FMV of asset transferred as their tax basis.
Special EIT Treatment	<ul style="list-style-type: none"> ■ The transferred assets must be at least 75% of the total assets of the seller; ■ The buyer must pay for the assets by Share Consideration which must be at least 85% of the total transfer price. 	<ul style="list-style-type: none"> ■ The transferee must book the tax basis of the assets transferred as their original tax basis; ■ The transferor must book the tax basis of the Share Consideration as the original tax basis of the assets transferred.

In addition, the transfer of real estate or intangible assets (for example, patents or trademarks) may attract turnover taxes, such as Value Added Tax ("VAT") or Business Tax.

Merger

A foreign investor may choose to merge two or more of its Chinese subsidiaries during a restructuring operation. Under Chinese law, a company merger can be

one of the following:

- A merger by absorption, in which a company absorbs one or more companies, causing the latter to be dissolved;
- A new establishment merger, in which two or more companies merge in order to form a new company, and the original companies are dissolved.

A merger between FIEs is subject to MOC approval⁴.

Chinese law requires the post merger company to assume all the rights and obligations of the pre-merger companies. However, in some circumstances, tax rules restrict the merged company from inheriting certain tax features from the pre-merger companies (for example, carry forward loss or tax benefits).

The income tax treatment of a merger differs depending on whether it is subject to general or special tax treatment.

²MOC on 4 May 2011 publicised a draft of the Administration Rules on Equity Contribution related to Foreign Invested Enterprises to seek public opinion. These rules are expected to set up a framework to enable foreign investors to contribute their equity in a Chinese subsidiary to another company in China.

³SAT's No. 4 Public Notice of 2010

⁴The merger may not be approved unless the merging parties' investors have paid up the registered capital of the FIEs, and the FIEs have commenced business.

	Major Preconditions	Major EIT Consequences
General EIT Treatment		<ul style="list-style-type: none"> ■ The post-merger company must book the FMV of the assets and liabilities of the merged company as their tax basis; ■ The merged company must be dissolved; both the merged company and its shareholders must pay EIT calculated by the tax rules for dissolution; ■ With certain exceptions, the post-merger company cannot continue to enjoy the EIT incentives of the merged company; ■ The profit and losses of the two companies under the merger cannot be set off.
Special EIT Treatment	<ul style="list-style-type: none"> ■ At least 85% of the total consideration must be Share Consideration; or no consideration if the merger is under common control. 	<ul style="list-style-type: none"> ■ The post-merger company must use the original tax basis of the assets and liabilities of the pre-merger company as their tax basis; ■ The post-merger company may, subject to certain limitations, inherit the EIT treatment of the pre-merger company, e.g. loss deduction, revenue recognition, and EIT incentive; ■ The profit and losses of the post-merger company and the merged company can be set off, subject to certain limitations.

As with an asset restructuring, a merger also attracts turnover taxes.

Split

Subject to MOC approval, an FIE that is classed as a company may be split into two or more companies⁵. This does not apply to FIEs that are not companies.

There are two possible types of split:

- A 'surviving split' in which the original company survives and one or more new companies are set-up;
- A 'new establishment split' in which the original company dissolves and two or more new companies are set up

Chinese law requires both the original pre-split and the post-split companies to be jointly liable for the obligations of the original company, unless a debt repayment agreement has been signed with the creditors of the pre-split company.

The table below shows the EIT consequences of a surviving split under the two different tax treatments:

⁵The authority may not approve the split unless the pre-split company's investors have paid-up its registered capital, and the company has commenced business.

ATTORNEY HIGHLIGHT

BENNY PANG – Managing Partner, Salans Hong Kong

Benny Pang specialises in corporate finance and securities law in Hong Kong, focusing on equity capital markets, and mergers and acquisitions. Benny has worked on a broad range of corporate transactions with private and public corporations. He has substantial experience representing issuers and underwriters in equity fundraising transactions, including share placements, rights issues and open offers.

Benny Pang on his career choices and most memorable deals...

Why did you become a lawyer?

Frankly speaking, it was by accident. I was studying dentistry when I finished high school and planning to become a dentist. I did not undertake clinical work and changed field after almost three years of dentistry. I ended up doing law and became a lawyer.

Do you see yourself having a career outside law?



I always wanted to have my own café and restaurant. If I have a choice, that would be my ultimate career outside law.

Most memorable deal you ever had worked on, and why?

It would be the IPO of China COSCO (a State-Owned Enterprise of the PRC) in Hong Kong. I led the deal from Hong Kong with over 80 lawyers from around the world taking part in the deal. Due to the complexity of the international reorganisation and the size of the deal, that IPO won the Deal of the Year Award in 2005 and I made a lot of friends working on the deal.

	Major Preconditions	Major EIT Consequences
General EIT Treatment		<ul style="list-style-type: none"> ■ The split company should book the assets split-off at FMV; ■ The shareholders of the surviving company must pay EIT as if the consideration it received is distributed from the surviving company; ■ The surviving company and the split company cannot set-off their profit and loss.
Special EIT Treatment	<ul style="list-style-type: none"> ■ The shareholding ratio of the shareholders in the surviving company must remain unchanged from that in the split company; ■ Both the surviving company and the split company must not substantially change their business after the split; ■ At least 85% of the consideration to the shareholder(s) of the surviving company must be paid by Share Consideration. 	<ul style="list-style-type: none"> ■ The split company must use the original tax basis of the assets and liabilities split-off as their tax basis; ■ The split company must, subject to limitation, inherit the EIT treatment related to the split-off assets, e.g. loss deduction, revenue recognition, tax incentive; ■ The accumulative losses relating to the split-off assets can be allocated to the split company to offset its future profit; ■ The shareholder(s) in the split company must book the tax basis of its new shares in the split company as the tax basis of its original shares in the surviving company proportioned according to the split ratio.

Splitting a company also has turnover tax implications in China.

Debt Restructuring

Circular 59 defines a debt restructuring as a transaction in which a creditor makes a concession to its debtor, pursuant to a written agreement or court judgment, when the debtor is in financial difficulties.

Chinese law does not specifically regulate debt restructuring, but does require MOC approval for debt-to-equity conversions.

In principle, a debt restructuring under General EIT Treatment should be handled in two steps when calculating the taxable income. These steps are different

depending on the type of debt restructuring as shown below. If it qualifies for Special EIT Treatment, the taxable income from a debt restructuring can be allocated over a period of 5 years. Further EIT payment deferrals may also be available for debt-equity conversions.

Debt-to-Equity Conversion	Payment of Debt by Assets
Step 1: Repayment of debt	Step 1: Transfer of assets
Step 2: Capital investment	Step 2: Repayment of debts at the assets' FMV

“**Planning the successful restructuring of business operations in China requires a comprehensive assessment of the various legal and tax issues that apply to each specific situation**”

Conclusion

Planning the successful restructuring of business operations in China requires a comprehensive assessment of the various legal and tax issues that apply to each specific situation. As the legal and tax intricacies will always be challenging, a certain level of due-diligence should be exercised when planning a company restructuring. It is also essential that the various authorities are consulted.

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Financial Assistance in the Czech Republic

Based on EU law requirements, the Czech Commercial Code restricts joint stock companies (“a.s.”) from providing financial assistance. Although EU law does not expressly require it, the Czech Commercial Code also applies the same restrictions to limited liability companies (“s.r.o.”).

Under the Commercial Code, financial assistance is defined as the provision of advance payment, loan, credit or other monetary performance, or the granting of security by a company for the purpose of acquiring its own shares (or shares in its controlling entity). Current case law tends to define the “purpose of acquiring its own shares” rather broadly. Also, what is relevant is not the “purpose” stated in the respective legal documents, but the actual purpose of the whole arrangement based on factual circumstances.

A violation of the financial assistance rules can result in both civil and criminal liability of the corporate directors and invalidity of respective agreements (security) or other legal actions.

Until recently, any form of financial assistance was strictly prohibited. However, this changed in July 2009 when the Commercial Code was amended to allow financial assistance, subject to conducting a whitewash procedure, i.e. satisfying statutory conditions, as follows:

- (i) the financial assistance must be provided under usual business transactions' terms, i.e. at arm's length. (In practice, banks often require an expert opinion confirming that this condition has been met.)
- (ii) the financial assistance must not result in the immediate insolvency of the company.
- (iii) the Board of Directors/Executive

Directors must prepare a written report on the financial assistance, setting out the reasons it was provided, its conditions, the risks and benefits for the company, and why it is in the interest of the company. This report must be made available to the public by submitting it to the Collection of Deeds of the Commercial Register.

- (iv) the company's General Meeting must approve the financial assistance. (For joint stock companies, this must be approved by a 2/3 majority of the votes of all shareholders.)

Importantly, a limited liability company may not provide financial assistance if it has any uncovered losses. This condition disqualifies companies in financial distress from granting any financial assistance, as they have no funds to cover their losses.

Furthermore, a joint stock company may provide financial assistance only if its Articles of Association allow it to do so and if the company meets the following additional requirements:

- (i) its Board of Directors must investigate the financial standing of the receiver of the financial assistance;
- (ii) a report by the Board of Directors must state the price the shares will be acquired at using the financial assistance. The report must also include the results of the investigation conducted pursuant to the requirements noted in item (i) above. (If financial assistance

is provided to certain related persons. (e.g. to the company's controlling person or person acting in concert with the company), the report must be reviewed by a reputable independent expert.)

- (iii) the price for the shares acquired by means of the financial assistance must be fair.
- (iv) as a result of the financial assistance, the company's equity must not decrease below the amount calculated as the company's registered capital decreased by the unpaid portion of the registered capital and increased company's funds, which may not be distributed to shareholders.
- (v) the company must create a special reserve fund equal to the amount of the financial assistance. (This is the condition that most often disqualifies companies as in many cases they do not have enough disposable funds to satisfy such a condition.)

The market standards relating to the whitewash procedure are not yet settled and there is currently no case law to provide sufficient guidance. However, banks are becoming increasingly receptive to transactions involving financial assistance, subject to all the conditions imposed by the whitewash procedure being satisfied.

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“Banks are becoming increasingly receptive to transactions involving financial assistance, subject to all the conditions imposed by the whitewash procedure being satisfied”

Slovak Republic: Statutory Bodies – Do You Know your Rights and Obligations?

Position of a Statutory Body in the Slovak Republic

Legal acts for a legal entity can be taken by those individuals who are authorised to do so, whether by operation of law, pursuant to an agreement on the establishment of the legal entity, or in accordance with a company's founding deed. A company demonstrates its will vis-à-vis third parties through its statutory bodies, namely:

- in limited liability companies by the *Executive Director*
- in public commercial companies by one or more *members*
- in limited partnership companies by *general partners*
- in cooperatives and joint-stock companies by the *Board of Directors*
- in organisational units (components) by the *heads of the organisational units (components)*

The same can also be said about a company's procurator holder, who is an individual having powers similar to those pertaining to a statutory body.

In the course of acting in such a capacity, the procurator holder and the statutory body have a great deal of responsibility and carry out a number of authorisations and duties, on the civil-law and administrative levels, but particularly on the criminal level.

Who Can Be A Statutory Body?

In the Slovak Republic, any individual (natural person) without a criminal record who is capable of taking legal acts may become a statutory body. Statutory bodies can either be citizens of the Slovak Republic or foreign nationals, but these latter need to have a residency permit enabling

them to stay in the Slovak Republic. (This requirement does not apply to citizens of EU and OECD Member States.) A statutory body may be a member of a company, or an individual from outside the company.

Exercise of Powers by Statutory Bodies

Rules on the exercise of powers by Statutory Bodies are provided primarily in the Commercial Code, or in a company's Founding Agreement, Memorandum of Association, Articles of Association, or in resolutions adopted by its General Meeting. The relationship between a company and its statutory body is a commercial-legal relationship, not a labour-law relationship. Details may be provided for, *inter alia*, in a written contract on a function's performance (holding an office), but the conclusion of such a contract is not mandatory. If such a contract is not concluded, relationships are regulated by provisions applicable to mandate agreements; however, if such a contract is concluded, it must be approved by the company's General Meeting.

A statutory body is entitled to receive compensation for performing its functions, with the amount of such compensation being determined by the company's General Meeting. However, if this compensation is

“The relationship between a company and its statutory body is a commercial-legal relationship, and not a labour-law relationship”

not determined, a statutory body would be entitled to receive remuneration in line with that typically provided in the market.

Ways in which a Statutory Body can Act on Behalf of a Company

Primarily, a statutory body can act on behalf of the relevant company, which must at all times be registered in the Commercial Register. There are a number of different methods by which a statutory body can act on behalf of a company, including acting independently, jointly, or in some other manner.

Acts that can be taken by a statutory body on behalf of its company may be restricted by the company's Articles of Association or its Memorandum of Association, or by a decision by either the company's General Meeting or its Supervisory Board. However, such restrictions are ineffective vis-à-vis third parties.

Company Management

The key component in performing the function of a statutory body is managing the relevant company. The statutory body is obligated to act with due care and in compliance with the interests of the

company and all its members. This means that a higher level of knowledge, abilities and experience, the so-called *professional qualification* is required. Collective statutory bodies make decisions by a majority of their members' votes.

Duties

The most important obligations of statutory bodies are to:

- duly keep the company's books and records;
- arrange for all available information relating to the relevant subject-matter to be available for decision making purposes, and ensure such information is taken into consideration in making a decision;
- report to the Commercial Register any and all changes to facts concerning the company registered therein;
- deposit stipulated documents to the Collection of Deeds within 30 days of their execution;
- keep a list of members;
- provide the members with information about the company and its matters, and ensure access to company documents;
- decide the company's reserve fund;
- submit financial statements, and a proposal for either distributing the profit, or, for covering the losses, (whichever the case may be) to the General Meeting for its approval;
- convene the General Meeting and suggest adoption of suitable measures in cases where company losses exceed one third of its registered capital;
- file a motion for declaration of a bankruptcy order without undue delay if they learn that the company is bankrupt;
- pay insurance contributions in cases stipulated by special legal regulations;
- in stipulated cases observe the ban on competition;

- observe the prohibition on concluding business transactions relating to the subject-matter of the company's activities in their own name and on their own account, or of mediating the business transactions of the company for other persons/entities; and,
- abide by specific conditions of the ban on performing activities as a (member of the) statutory body and/or another body of a legal entity that has similar business activities.

What If You Fail To Fulfil Your Duties?

It is important to always bear in mind that the statutory body is personally liable for damage inflicted upon the company, or, as the case may be, upon third parties. In the case of collective statutory bodies, their members are liable jointly and severally, and a statutory body member can be exculpated only if he/she proves that in the course of exercising his/her powers he/she acted with professional care and in good faith, that he/she acted in the company's interest, or, that he/she was implementing a decision of the General Meeting, which, must however, have been made to be in compliance with legal regulations.

A company may waive its rights to compensation for damage *vis-à-vis* members of its statutory body, or, alternatively, conclude a settlement agreement with them, after three (3) years from the date when damage was caused at the earliest. It is very important that the statutory body is aware of the risk that claims relating to compensation for damage can in certain cases also be filed by a creditor of the company. This can be the case even where a settlement agreement was concluded, or where claims *vis-à-vis* a statutory body member were waived.

Many specific legal regulations, such as the Environment Act, the Construction

Act, the Act on Water Resources or the Trade Licensing Act provide for the liability of legal entities for so-called *administrative infractions* (delicts). The Administrative Infractions Act provides for the liability of individuals (natural persons) for infractions (minor delicts) committed in the course of their acting on behalf of a legal entity.

Criminal Liability

The Slovak laws, unlike those in other jurisdictions, do not recognise the criminal liability of legal entities, and thus liability is transferred to individuals (natural persons), i.e. the individual comprising the statutory body will be subject to criminal liability rather than the legal entity. In this case the so-called *subjective liability* is required, i.e. the state bodies must prove the *intention* to commit a criminal act.

Typical criminal acts that could be committed by statutory bodies in the course of performing their functions are embezzlement, breach of duties in the course of administration of another entity's property, failure to pay wages/salaries or severance monies, evasion of tax and insurance payments or failure to make such payments, fraud, loan-related fraud, insurance fraud, capital fraud, subsidy fraud, damage inflicted upon a creditor or consumer or putting them into a disadvantageous position, fraudulent bankruptcy and blameful bankruptcy, hindering bankruptcy or settlement proceedings, distorting data relating to business and commercial records (for example failing to keep the books), misuse of information in business relationships, breach of the competition ban, misuse of the rules for participating in the economic competition, as well as breaching intellectual property rights.

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Hungary/Capital Markets:

Regulated Real Estate Investment Companies

From July 2011 regulated real estate investment companies (“RREIC”) can be established in Hungary, and these can profit from significant tax benefits.

A new act that covered regulated real estate investment companies was enacted in Hungary in July 2011. This act introduces a form of real estate investment into Hungary that is already implemented in numerous other Western jurisdictions as Real Estate Investment Trusts (“REIT”). In essence, both the REIT and the real estate project companies it holds are granted significant tax reliefs or exemptions, provided they fulfil the relevant legal criteria. As a result, generally only the shareholders of a REIT are obliged to pay taxes (in connection with the dividends they receive). Similarly, a Hungarian RREIC is not a separate corporate form, but rather a Hungarian-registered *public company limited by shares* that fulfils the criteria set forth by the act, and is then registered with the tax authority as a RREIC, which is a prerequisite to receiving the improved tax benefits.

- they are only entitled to pursue real estate-related activities;
- they can only acquire real estate projects;
- insurance and credit institutions can only hold up to 10% of their shares and voting rights;
- shareholders, who can each hold no more than 5% of the shares, add up to at least 25% of the total share capital (free float), and a number of shares corresponding to at least the nominal value of the free float must have been listed on the stock exchange;
- at least 90% of the profit that can be paid out as dividends, must actually be paid out to the shareholders within 15 days of the annual report being approved.

Granting and Terminating REICC Status

Companies fulfilling the legal criteria to become a REICC can file an application with the tax authority to obtain registered status. The rights and obligations applicable to RREICs shall apply from the date the company is registered as an REICC by the tax authority.

The tax authority will de-register a RREIC from its registry if it does not remedy any non-compliance with the legal criteria covering RREICs within 90 days, materially breaches the law, does not commence its activities within 6 months of registration or

“RREICs and their project companies need only pay 2% transfer duty when acquiring real estate. In addition, they are exempt from local taxes and from corporate income tax”

fails to be active for a period of 6 months once registered.

RREIC Project Companies

Under the new act, RREIC project companies are companies that fulfil the following criteria:

- pursue real estate-related business activities and are 100% owned by a RREIC;
- pay out as dividends 100% of the profits available to be paid out;
- their repayable external financial sources do not exceed 70% of the value of their real estate assets;
- do not undertake any obligations that would restrict the payout of dividends or that would grant purchase options over their real estate portfolio.

RREICs must notify the tax authority of the names of their project companies.

Basic Criteria for Qualifying for RREIC Status

For companies to qualify as RREICs, they must primarily fulfil the following criteria:

- their corporate form must be a public company limited by shares, the initial capital of which shall be at least 10 billion Hungarian Forints, and their shares shall exclusively be ordinary shares;
- they must be registered by the tax authority as a RREIC;

RREIC Portfolios

In addition to real estates and real estate project companies, the asset portfolios of RREICs can contain bank savings, government securities, certain other securities and derivatives. However, RREIC's real estate portfolios must correspond to at least 70% of their balance sheet total. In a RREIC's portfolio, the value of an individual property, or participation in other RREICs, may not exceed 20% of its total balance sheet. In addition, the external financial sources repayable by a RREIC cannot exceed 65% of the total value of its real estate assets.

RREICs may not undertake any obligations restricting the payout of dividends or which grant purchase options for their real estate portfolio.

“From July 2011 regulated real estate investment companies (“RREIC”) can be established in Hungary and these can profit from significant tax benefits”

Mandatory real estate valuation and audit

The real estate portfolios of RREICs must be evaluated at least quarterly to assess their market value. It is also mandatory for RREICs to have their books audited. Auditors must notify not only the RREIC

but also the tax authority and the Hungarian Financial Supervisory Authority of the results of their audit, if they find any irregularities specified by the act.

Main Tax and Transfer Duty regulations on RREICs and their Project Companies

RREICs and their project companies need pay only 2% transfer duty when acquiring real estate. In addition, they are exempt from local taxes and from corporate income tax.

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New Rules Governing Criminal Liability of Management Board Members in Companies Limited by Shares

Amendments to provisions in the Criminal Code and the Commercial Company Code introducing new rules governing the criminal liability of management board members in companies limited by shares came into force on July 13, 2011 in Poland.

At the same time, the provision in Article 585 of the Commercial Company Code, providing grounds for the institution, on an *ex officio* basis, of criminal proceedings against management board members in companies limited by shares acting to the detriment of that company, was repealed.

Under the newly amended Article 296 of the Criminal Code, management board

members (and other persons which are obliged to deal with material matters or with a business activity of the company pursuant of an act, decision of a proper body or a contract e.g. a proxy who deals with business matters) managing the property or business of a company shall be criminally liable if actions detrimental to that company were the result of their:

“Now, action can be taken against members of the management board only in response to a motion by the injured party, which may be the company itself, its shareholders, or its creditors”



- Exceeding the powers granted to them (e.g. powers arising directly out of the Commercial Company Code or contractually vested in the management board members); or;
- Failing to perform their duties.

An action of a management board member (or any other person liable under the regulations referred to here) may be construed as an offence only if it results in actual damage, or if it creates the direct danger of such damage occurring. This is only provided that the damage (or potential damage) exceeds PLN 200,000.

It is important to note that, contrary to the repealed Article 585 of the Commercial Company Code, the offence referred to in Article 296 of the Criminal Code is

“**It is important to note that the offence referred to in Article 296 of the Criminal Code is not prosecutable ex officio**”

not prosecutable *ex officio*. The *ex officio* application of the former Article 585 of the Commercial Company Code sometimes created serious practical problems. This was the case when prosecutors – disregarding the position taken by the parties most concerned, such as the company at issue or its shareholders – chose to consider the

management board’s business decisions as detrimental to the company, and instigated criminal proceedings based on their own assessment. Now, action can be taken against members of the management board only in response to a motion by the injured party, which may be the company itself, its shareholders, or its creditors. The only exception is if the injured party is the State Treasury, in which case proceedings may still be instituted on an *ex officio* basis.

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ATTORNEY HIGHLIGHT

PAWEŁ GRABOWSKI
Partner, Salans Warsaw

Paweł Grabowski is a truly international attorney. Having graduated from Harvard Law School and Warsaw University, he is qualified to practice in New York, England and Wales, as well as in Poland. He joined the Salans’ team in New York and then eventually moved to the Warsaw office. In his work he has been focusing on M&A and private equity deals but has also gained significant experience in real estate transactions. On the buy side, he specialises in structuring complex joint ventures, both at the domestic and cross border level.

Paweł on his job, extreme sports and favourite drinks...

What’s the best part of your job?

Starting new projects is always very exciting as it brings new challenges.



I take a lot of satisfaction in applying my skills and experience to help my clients in facing those challenges and accommodating their goals. In fact, seeking the best solutions and negotiating the best transactions for the clients is at the same time the most engaging and rewarding part of my work.

When I say sport, you think...

Definitely kitesurfing. While it is an extreme sport, as long as you follow the prescribed safety rules, it allows you to come back with an absolutely clear head and thus achieve some true rest. Kitesurfing forces me to deal with my small weaknesses and constantly improve my skills but in the end it gives a unique sense of freedom.

What is your favorite drink?

I’d say, it is a cocktail of good humour, relaxation, laughter with friends and a drop of wine.

Poland's public take-over code to be amended

The recent IPO of the Warsaw Stock Exchange (“WSE”), as well as the increasing number of IPOs and take-overs, has attracted the attention of foreign investors in the Polish market. The WSE has already become the largest stock market in the CEE region: it has registered the highest number of IPOs each year in central Europe since at least 2004. In order to ensure that the regulations keep pace with this “hot” market, the Polish Government is set to introduce changes to the take-over regime.

On April 5, 2011, the Polish Ministry of Finance published a preliminary draft of the proposed amendments of Polish securities laws (the “Securities Law”), which envisages certain changes to the tender regulations. The changes announced will introduce a completely new tender regulations’ regime. In essence, under the proposal:

- (i) take-overs exceeding the threshold of either 33 $\frac{1}{3}$ % or 66% of shares in a listed company would require a tender offer for up to 100% of the company’s shares to be launched; and,
- (ii) the price paid in any indirect acquisition of the target’s shares would be referenced when calculating the price in the post-sale tender.

With these upcoming changes in mind, this article presents the key features of the existing take-over regime in Poland.

Obligation to launch a mandatory tender offer

Under the Securities Law, whenever a shareholder holds, directly or indirectly, more than 33% or 66% of all voting rights in a publicly traded company, that shareholder is required to launch a public tender offer for the shares representing up to 66% or 100%, respectively, of all voting rights in that company.

The shareholder must launch the tender offer irrespective of whether or not that shareholder exceeded a given threshold through a direct acquisition of shares in a public company, or through an indirect acquisition, i.e. through becoming a dominant entity towards the entity that holds the company’s shares.

The obligation to launch a tender offer also arises when the thresholds are exceeded in aggregate by shareholders “acting in concert, which under the Securities Law means a situation where:

- (i) the shares are held by a third party on its own behalf, but on the instructions or for the benefit of the given shareholder; or,
- (ii) shareholders enter into an agreement on the transfer of voting rights; or,
- (iii) shareholders enter into an agreement on the acquisition of shares or on voting in concert at the company’s general meeting or on exercising long-term policies relating to the company’s management.

In order to determine whether the votes held by the concerting shareholders exceed the relevant thresholds, the aggregate votes held by each shareholder are added together

“The tender offer must provide for an initial subscription period of 14 to 70 days, which, subject to the satisfaction of the relevant conditions’ period, may be extended up to the maximum of 120 days”

Small tender

Additionally, in certain circumstances a direct acquisition of shares in a public company may take place only through the so-called “small tender”. This is the case when the number of shares acquired results in an increased percentage in the total number of votes by more than:

- (i) 10% over a period of less than 60 days by a shareholder holding less than 33% of the total number of votes in a public company; or,
- (ii) 5% of the total number of votes over a period of less than 12 months by a shareholder holding at least 33% of the total number of votes in a public company

Under the small tender rules the acquisition must be for not less than 10% or 5 % of the total number of votes in the company, respectively.

The process

Announcement

The tender offer is an announcement to subscribe to the sale or exchange of shares in the company, addressed to unspecified addressees. It must be announced and carried out through an entity authorized to conduct brokerage activities in Poland, e.g. a brokerage house.

Tender security

The launch of a tender offer must be preceded by the establishment of a sufficient security with a bank or other financial institution in an amount equal to 100% of the value of shares being acquired in the tender process.

FSA consultations

At least 14 days prior to the opening of the subscription period, the brokerage house should simultaneously notify the Financial Securities Authority ("FSA") and the WSE of its intention to announce the tender offer, together details on the tender offer's contents. The FSA may demand the tender offer is amended or supplemented, or may request that relevant explanations of the tender offer's terms and conditions are provided. The opening of the subscription period will be postponed until the brokerage house completes all of the actions required by the FSA.

Management Board opinion

In connection with the tender offer, the management board of the target company is obliged to issue its opinion on the tender offer and on its effects on the target. The

“ The WSE has already become the largest stock market in the CEE region ”

opinion should be disclosed to the FSA and published not later than two days prior to the opening of the subscription period.

Duration

The tender offer must provide for an initial subscription period of 14 to 70 days, which, subject to the satisfaction of the relevant conditions' period, may be extended up to the maximum of 120 days.

Withdrawal of the tender offer and rescission of the subscription

Once the tender offer has commenced, it may not be terminated unless a third party announces a new tender. In such circumstances, any seller who had already subscribed to shares in the course of that tender offer may withdraw its subscription (as long as no transfer of legal title to the shares has occurred).

The risk of withdrawal by the seller is usually mitigated contractually by imposing certain obligations on the seller in the transaction documents. For instance, the seller may undertake not to withdraw its subscription, and such an obligation may be secured e.g. by a brokerage blockade and a contractual penalty.

Method of the shares acquisition

The tendering purchaser may either acquire all shares subscribed throughout the entire subscription period, or acquire only those shares that were subscribed within the first 14 days of the subscription period.

Terms and conditions

The Securities Law provides for an extensive list of terms and conditions, which every tender offer must contain. These include, in particular:

- (i) corporate data for the entity announcing the tender offer; the purchaser and the brokerage house acting as intermediary;
- (ii) a description of the shares that are the object of the tender offer;

“ The risk of withdrawal by the seller is usually mitigated contractually by imposing certain obligations on the seller in the transaction documents ”

- (iii) the minimum price per share and the payment conditions; and,
- (iv) the period of the tender, including the subscription period and the terms of its extension.

In addition to the foregoing, the tender offer may also include certain additional conditions, which are not mandatory but which may be of particular importance to the potential purchaser. For example, it could include:

- the conditions precedent of the tender offer;
- a requirement to obtain certain administrative authorizations (such as merger control clearance issued by the President of the Office for the Protection of Competition and Consumers in Poland or other circumstances which would satisfy such a condition); or,
- notifications, together with the period within which, according to the best knowledge of the purchaser, satisfaction of such conditions should occur, (although this must not be longer than the subscription period).

Nevertheless, the purchaser may still decide to acquire the target's shares, even if some of the conditions' precedents have not been fulfilled.

Amendment of the tender conditions

The tendering purchaser may amend certain conditions of the tender, e.g. the number of given types of shares to be acquired, or the period of the subscription. Such changes are subject to certain regulatory conditions and must be announced in at least one Polish national daily newspaper:

Consideration

Setting the price of shares

In a tender offer, the price per share offered by the tendering purchaser may not be lower than:

- (i) the average market price (calculated as an arithmetic average from the average daily prices weighted with the trading volume) in the last six months directly preceding the launch of a tender, during which the shares were traded on the WSE; and
- (ii) the highest price that was paid for the shares by the tendering shareholder (or its subsidiaries, or controlled entities, or the parties acting in concert with that shareholder) within the last twelve months prior to the launching of the tender.

The price per share may be lower than the price established in accordance with the above rules only when the seller, purchaser and tendering purchaser agree to that effect and only with respect to acquisitions of blocks of shares representing at least 5% of all shares of the target.

“ In connection with the tender offer, the management board of the target company is obliged to issue its opinion on the tender offer and on its effects on the target ”

In certain limited and extraordinary circumstances, when the average market price, set in accordance with the above rules, departs significantly from the fair value of the shares (such as, deteriorated financial condition of the target, the target becoming insolvent, the shareholders being paid out significant dividends, etc.), the FSA may approve a different price.

Changing the price

In the course of the tender offer, the tendering purchaser may change the price per share, not more frequently than every five working days, unless another entity announces a tender offer with respect to the same shares.

If, upon such a change, the new price is higher than the price that was previously set in the tender offer, the tendering purchaser is obliged to pay this new price to everyone who subscribed to the shares prior to the announcement of the

price change. However, subscribers, who previously acquired a right to receive a higher price than the new price, must receive the higher price.

If, however, the new price is lower than the price previously set in the tender offer before the change, the tendering purchaser is obliged to pay everyone who subscribed to the shares prior to the announcement of the price change, their original subscription price. However, subscribers who previously acquired a right to receive a higher price than the price to which they subscribed, must receive such higher price.

Exchange of Shares

Under a tender offer, in exchange for the acquisition of shares, the tendering purchaser may also offer the Polish State Treasury bonds, as well as the following types of dematerialized securities:

- (i) shares in another company;
- (ii) depositary receipts; or,
- (iii) mortgage bonds.

The rules on changing the price apply accordingly with respect to the securities' exchange ratio.

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Doing Business in Turkey – A New Chapter

The new Turkish Commercial Code, Law No.6102 (“New TCC”), was enacted on 13 January 2011, and published in the Official Gazette on 14 February 2011. It will come into force in July 2012, except for a few provisions that will come into force in due course.

The New TCC focuses on institutionalisation, corporate governance, increasing competitive power, establishing public confidence and transparency. It sets rules for commercial life in order to ensure a certain level of transparency, auditability, reliability, and corporate governance principles.

This article summarises the major amendments in the New TCC that will affect doing business in Turkey.

Group Companies

The concept of group companies that regulate the relationship between a parent company and its subsidiaries is introduced in the New TCC. Group company rules are intended to protect shareholders and creditors (who are not related to any of the companies in the group); and outline the responsibilities and liabilities of the executives in each company in the group.

Group company rules are applicable if either the controlling party (“Parent”) or the controlled party (“Subsidiary”) is located in Turkey. Control may be established, directly or indirectly, by any of the following:

- (i) holding a majority of the voting rights, or sufficient voting rights to resolve management matters;
- (ii) holding the right to appoint and/or elect the majority of the management

body (i.e. board of directors, board of managers etc);

- (iii) using voting rights based on an agreement, solely or in concert with other shareholders/partners;
- (iv) through an agreement or by other means;
- (v) through its subsidiary(ies) (i.e. indirect control).

Agreements establishing control must be registered with the competent trade registry office.

Group Company Rules

- (i) Shareholding Disclosures: A notification requirement is triggered when any direct or indirect acquisition or disposal of company shares, results in the shares owned by a person or a legal entity, (or by persons or legal entities acting in concert), crossing the thresholds of 5%, 10%, 20%, 25%, 33%, 50%, 67%, or 100% of the total shareholding. The party acquiring or disposing of the shares must notify the company whose shares it is acquiring/ disposing of. It must also notify the relevant competent authority(ies), i.e. the Capital Markets Board (“CMB”), the Banking Regulation and Supervision Agency; the Competition Board and/ or the Undersecretariat of Treasury etc. Any failure to comply with the disclosure requirements will result in

“The New TCC focuses on institutionalisation, corporate governance, increasing competitive power, establishing public confidence and transparency”

the freezing of the shareholding rights attached to the transferred shares.

- (ii) Reporting: The Subsidiary’s board of directors (“BoD”) must prepare a report within three (3) months of the start of each activity year, detailing each and every transaction, and the relationship of the Subsidiary with the Parent and the Parent’s other subsidiaries/affiliates.
- (iii) Subsidiary Assistance and Compensation: The Parent is prohibited from exercising its voting rights to force the Subsidiary to:
 - carry out transactions such as transferring its business, assets, funds, employees, claims or profits (fully or partially) to third parties;
 - undertake liabilities as surety, guarantor or otherwise;
 - make payments to third parties; or
 - resolve transactions undertaken by the Parent that cause the Subsidiary to incur a loss, decrease in productivity, or negatively affect its activities in any way.

However, an exception to the subsidiary assistance prohibition is provided in cases where the Subsidiary is compensated for its

loss. Another exception is provided in cases where an equivalent right is granted to the Subsidiary by the Parent within the same activity year; by indicating the method and timing of the compensation in the annual activity report. If there is no compensation, each shareholder and/or creditor of the Subsidiary can request compensation from the Parent, and in such cases the BoD of the Parent may be jointly liable with the Parent.

- (iv) **Absolute Control:** If the Parent, directly or indirectly, holds 100% of the shares or voting rights in a Subsidiary, then the Parent may give management-related instructions to the Subsidiary's BoD, and the BoD must be bound by such instructions. The BoD cannot be held liable for exercising the Parent's instructions. However the Parent is prohibited from giving any instructions that will result in the solvency of the Subsidiary being exceeded, or that jeopardise the existence of the Subsidiary, or cause the Subsidiary to lose its material assets.
- (v) **Reliance Liability:** The Parent is responsible for maintaining consumer confidence that is based on the reputation of the group as a whole.

Squeeze Out

- (i) **Squeeze-Out by the Parent:** A Parent who controls 90% of the share capital and has at least 90% of the voting rights in a joint stock company ("JSC") is entitled to apply to the relevant competent court and demand the squeeze out of the minority shareholder(s), if the minority shareholder(s):
 - acts in a manner to prevent the JSC's operations;
 - acts in bad faith;
 - creates perceptible disruption in the JSC; or

“While the New TCC preserves the basic principles and the types of companies, it does introduce material changes that underpin corporate governance principles and transparency”

- acts recklessly.
- (ii) **Squeeze-Out in Case of Merger:** In a merger agreement, the merging entities may offer the shareholder(s) of the dissolving company a choice between (a) obtaining shares in the surviving entity or compensation, or (b) compensation only. In this latter case the minority shareholders in the dissolving entity will not be entitled to obtain shares in the surviving entity, but instead will be paid “squeeze-out compensation.” In order to exercise this squeeze-out compensation, the dissolving entity must have approved the merger agreement by at least 90% of the votes.

Privileged Shares

Privileges in voting rights may be created by:

- (i) providing extra shareholding rights to one share;
- (ii) providing additional rights in the articles of association (“AoA”), that are not provided in the New TCC; or
- (iii) granting extra voting rights to certain shares or share groups.

In principle, privileges can be attributed to shares and not to shareholders; the only exception to this rule is the appointment

of BoD members. The New TCC gives shareholding groups, share groups and minority shareholders in JSCs the privilege to appoint BoD members, provided such a right is included in the company's AoA.

Privileges in voting rights are limited to a maximum of 15 votes for one share. This limitation can be eliminated by the competent court if there is a just reason, or it can be proved to be necessary for institutionalisation purposes. However, voting privileges cannot be exercised in resolutions for AoA amendments, the appointment of transaction auditors, resolutions regarding release, or filing for responsibility actions.

Company Law

General

While the New TCC preserves the basic principles and the types of companies, it does introduce material changes that underpin corporate governance principles and transparency.

- (i) **Limiting a Company's Legal Capacity:** Under the New TCC the doctrine of *ultra vires*, which limits the legal capacity of a company to the field of activity specified in its AoA, has been abolished.
- (ii) **Incorporation of Companies:** Contrary to the Turkish Commercial Code, Law No. 6762 (“Former TCC”), required a minimum of five (5) shareholders in JSCs and a minimum of two (2) partners in limited liability companies (“LLC”). However, the New TCC allows both JSCs and LLCs to be incorporated with just one shareholder/partner. For the purposes of transparency, the name, home address and citizenship of the sole shareholder/partner must be registered with the competent trade registry and published in the Turkish Trade Registry Gazette (“TTRG”). In addition, in order to protect the company assets, the sole

shareholder/partner must execute a written agreement for each transaction entered into with the company.

(iii) Capital in Kind Contributions: Rules regarding capital in kind contributions have also been amended in the New TCC. Under the Former TCC, shares issued in exchange for capital in kind could not be transferred for two (2) years. The New TCC has no such limitation; moreover the types of items that can be contributed as capital in kind have also been expanded. All assets, including intellectual property rights and domain rights, can now be contributed as capital in kind:

- unless the assets are encumbered by any rights in *rem* or otherwise;
- as long as the assets are cashable; and,
- as long as the assets are transferable.

However, service performance, personal labour, commercial reputation and non-due receivables cannot be contributed as capital in kind.

Transactions with Shareholders

In principle shareholders/partners are prohibited from being indebted to a company, unless the debt arises out of transactions that fall within the ordinary conduct of business of both the company and the shareholder/partner; and are made on an arm's length basis.

Public Company Rules for Private JSCs

- (i) Public Offer: The New TCC allows the founders of a private JSC to make a public offer within two (2) months of registering the JSC with the competent trade registry office, in accordance with the applicable capital markets' legislation.
- (ii) Registered Share Capital: A JSC can implement a registered share capital system. This authorises a BoD to increase the company's share capital up to a ceiling that has been previously determined by the company's general assembly of shareholders.
- (iii) Cumulative Voting System: The New TCC allows a cumulative voting system to be used in JSCs' general assembly meetings. This allows shareholders to aggregate their votes for a single nominee for the BoD.

Acquisition of its Own Shares

The Former TCC did not allow companies to acquire their own shares, although there were a few exceptions to this rule. The New TCC preserves this restriction and its exceptions in principle. However, in line with European Union regulations, the New TCC now allows companies to acquire their own shares, or establish pledges over their own shares, for up to 10% of the total share capital. In order to do this a company must observe certain procedures,

in particular, a company acquiring its own shares must allocate the consideration for such acquired shares in its reserves, until the shares are sold or disposed of in any other way.

Financial Assistance

Under the New TCC, any transaction relating to advances, lending or guarantees between a company and a third party, are null and void, if those transactions are made to acquire its own shares. However, this restriction does not apply to transactions made by credit and financial institutions or to transactions made for employee stock option plans.

Audit

Under the Former TCC, each JSC had to have an internal auditor, although that auditor did not need to be an expert; whereas LLCs with less than 25 partners did not need an auditor. Now, under the New TCC, a new independent auditing mechanism has been introduced, which means audits must be performed by independent audit firms, sworn financial advisers, or independent accounting financial advisers. The scope of these audits includes the auditing of financial statements and/or consolidated financial statements, and a company's annual report. These audits must be performed in accordance with the Turkish Auditing Standards, which contains identical rules to those in International Auditing Standards.



Another amendment introduced by the New TCC is the introduction of special auditing measures for certain types of transactions. Such transactions include, incorporation, capital increase and decrease, merger, spin-off, converting company type, or issuing negotiable instruments. Special auditing can also be requested by a shareholder, in which case, an auditor will be appointed by the competent court.

In group companies, the auditor of a Parent will also audit the financial concerns of its Subsidiary.

BoD and Managers

The Former TCC required a BoD had of a minimum three (3) members, who also had to be shareholders. Under the New TCC, a BoD may consist of just one (1) member, and the requirement for that member to also be a shareholder in the company has also been abolished.

For LLCs, the Former TCC required partners to be managers, if no other manager was appointed. However, the New TCC provides a professional management system for LLCs, whereby at least one manager must also be a partner in the LLC.

The New TCC requires that at least one BoD member (in JSCs) and one manager (in LLCs), who is authorised to represent and bind the company, must be a Turkish citizen residing in Turkey. This rule applies even if the BoD consists of only one person, or there is only one manager.

In addition, legal entities are now allowed to become BoD members/managers. Under the Former TCC, a legal entity shareholder appointed a real person to act on behalf of it, as per the AoA. The New TCC envisages that the legal entities can be BoD members or managers, and so can be represented by real people. This will allow such legal entities to remove their representative without needing to follow corporate procedures, but

ATTORNEY HIGHLIGHT

SELIM KEKI – *Partner* Salans Istanbul

Selim Keki started his professional career in the legal department of a large Turkish conglomerate after obtaining a doctorate from Konstanz University in Germany. Prior to joining Salans, he worked at the Turkish office of an English law firm. His activities focus on M&A/ corporate and commercial law. Schooled at the French Lycée Saint-Joseph in Istanbul, Selim is fluent in English, German and French. He is passionate about football and cherishes hopes of competing on the pitch even after his 40th birthday.

Selim on his career choices, unforgettable transactions and music...

Do you see yourself having a career outside law?

I can imagine myself pursuing academic studies, teaching private law. Who knows, perhaps one day..

What's the most memorable deal you've ever worked on?

That's a no-brainer! The merger of Shell's Turkish petroleum retail business with Turkey's number four in the field: a unique deal, heavily driven by tax efficiency concerns, where we had to merge two



large, complex and heterogeneous enterprises and move all their assets along with about 2,000 retail stations, contracts, licences etc into one newly-formed entity. It required approvals from virtually all regulators in Turkey and took us nigh on three years of intensive work. For me a pleasant side effect was that it introduced me to Salans Istanbul (I was representing the other side) and eventually led to my joining the Firm.

What is on your iPod at the moment?

I mostly use my iPod while I am walking or running. For walks, I prefer audio-books (that way you can handle big books even as a busy lawyer) or classical music (Beethoven's 5th Piano Concerto or Dvorak's 9th Symphony). For running, I favour more rhythmic pieces like Paul Simon or Leo Cohen.

simply by observing the registration and announcement requirements (in the TTRG and the relevant company's website).

Online Meetings

The New TCC allows meetings for BoD, managers and the general assembly of shareholder/partners to be held by audiovisual conference calls over the internet. Online votes are also permitted.

Detailed regulations regarding online meetings will be provided in secondary legislation.

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Directors' Liability Regarding Share Transfers and Insolvency: Prevention of Tax Evasion

To try to curb tax avoidance, the Romanian Government has approved an Emergency Ordinance, which modifies, among other legal matters, the Company Law 31/1990 and the Fiscal Procedure Code. This Ordinance relates to several important corporate law matters, including the liability of company directors in the context of insolvency and share transfers.

The Emergency Ordinance's declared purpose is to strengthen the efficiency of tax collection, by restating and extending taxpayers' liability (including the relevant decision-makers within companies), and to act as a deterrent as regards tax avoidance generally. The Emergency Ordinance 54/2010 (the "Ordinance"), was adopted on May 30, 2010 and became effective as of June 23, 2010.

During 2011, the Ordinance has had a noticeable effect upon the transfer of shares in limited liability companies, as the number of such transactions decreased due to a protracted procedure set forth by the Ordinance.

Even prior to the Ordinance, directors could be held jointly liable (with the relevant company and among themselves) if they were found to have contributed

to a company's insolvency over any of its outstanding payment obligations. Cases where "the piercing of the corporate veil" with respect to directors (and shareholders) was permitted under Romanian law include ones where directors were found to have:

- (i) engaged in criminal activities;
- (ii) contributed to a debtor's insolvency, through certain regulated actions provided under the Romanian Insolvency Law;
- (iii) contributed to a debtor becoming insolvent, based on the Romanian Fiscal Procedure Code. In such cases a joint liability for the payment of fiscal debts with the insolvent debtor could be imposed.

The Ordinance specifically states that directors are jointly liable with the insolvent companies (debtors in the insolvency proceedings) in cases where they fail to fulfil their legal obligation of demanding the court opens insolvency proceedings for outstanding fiscal obligations pertaining to their mandate. As such, directors (and, in fact, anyone else involved) are jointly liable with the insolvent companies in all cases in which they, in bad faith, have caused:

- (i) the misstating and/or nonpayment of outstanding fiscal liabilities; and,
- (ii) unjust tax refunds.

The Ordinance's substantiation note

“ The Ordinance specifically states that directors are jointly liable with the insolvent companies in cases where they fail to fulfil their legal obligation of demanding the court opens insolvency proceedings for outstanding fiscal obligations pertaining to their mandate ”

reiterates the principle of directors' joint liability with the insolvent company for failure to:

- (i) fulfil their tasks and responsibilities, leading to insolvency; and,
- (ii) request the competent court to initiate insolvency proceedings in the appropriate time provided by the applicable law.

For share transfers the provisions of the Ordinance state that, upon receiving a shareholder resolution approving the transfer of shares in a limited liability company, the relevant trade register office must transmit it electronically to the National Agency of Fiscal Administration and to the relevant public finance department. The shareholder resolution must be submitted with 15 days of its issuance.

“ The Emergency Ordinance's declared purpose is to strengthen the efficiency of tax collection and to act as a deterrent as regards tax avoidance generally ”

A company's creditors, as well as any persons prejudiced by a shareholder resolution related to a share transfer, may challenge the decision, through an opposition petition. This requests the company or the shareholders, as the case may be, to compensate the creditors for the damages caused. The Ordinance stipulates that the provisions of article 62 of the Company Law 31/1990 regarding the term within which an opposition petition can be made, shall apply. Thus, the opposition petition must be made within 30 days of the shareholder resolution or the updated articles of association being published in the Official Gazette.

A share transfer will be effective as of the date either:

- (i) the opposition term expires, in the absence of any opposition being filed; or,

- (ii) a court decision rejecting the opposition petition is communicated, in cases where an interested person lodges such a complaint.

The share transfer document and the updated articles of association must be submitted to the relevant trade register office.

“During 2011, the Ordinance has had a noticeable effect upon the transfer of shares in limited liability companies”

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Vicarious Liability and Piercing the Corporate Veil in Russia

Anton Ivanov, Chief Justice of the Supreme Arbitration Court of Russia, recently proposed to his judicial colleagues that they “seriously study and examine the question of introducing into Russian court practice provisions of the doctrine of ‘piercing the corporate veil’ that are well-known in the Anglo-Saxon legal system”. In view of that proposal, it is worth considering the existing provisions for vicarious liability under Russian law, as well as how they might evolve in the future.

As one can infer from the Chief Justice's suggestion, Russia does not recognise the doctrine of “piercing the corporate veil” as such. There are, however, various statutory exceptions to the presumption of limited liability, which apply in four main circumstances:

- (i) failing to disclose status as an “affiliated person” of a Russian company;
- (ii) not fully paying up shares or participatory interests in, or overstating the value of an in-kind contribution to, the charter capital of a Russian company;
- (iii) being responsible for the insolvency or bankruptcy of a Russian company; and
- (iv) giving binding instructions to a Russian company as its “dominant company”.

Whereas the first two circumstances are easily avoided by proper disclosures and capital contributions, the latter two can easily ensnare the unwary, and so warrant closer examination.

Responsibility for Insolvency or Bankruptcy

Under the Civil Code (as well as similar provisions in the Law on Limited Liability Companies (“LLC Law”) and the Law on Joint-Stock Companies (“JSC Law”))

that apply specifically to LLCs and JSCs, respectively), a shareholder or other person “able to give binding instructions” to a Russian company “or determine its actions” is secondarily liable for the company's obligations if such person is at fault in causing the company's insolvency or bankruptcy. By way of other provisions of the Civil Code, “fault” ordinarily means negligence. Under the wording of the JSC Law, however (and arguably in tension with the Civil Code), liability in this context requires that such person have “knowingly” caused the insolvency or bankruptcy. It is not clear whether courts actually do apply a higher standard of proof for claims relating to JSCs as opposed to LLCs. In any case, even under the lesser standard of the LLC Law, courts reject claims where plaintiffs fail to establish a specific causal connection between a company's insolvency or bankruptcy and the defendants' actions.

Vicarious liability in the bankruptcy context was arguably expanded by the 2009 amendments to the Law on Insolvency (Bankruptcy), which introduced the concept of “persons controlling the debtor”. This can be read to include, for example, anyone who in the two years prior to a Russian company's bankruptcy had either a de jure or de facto ability to determine the company's actions. Such persons are liable for any instructions

“The rules of vicarious liability, must be made clear in advance, must be applied fairly and consistently, and must be balanced against the key justifications for limited liability”

given by them to the insolvent company, as well as for any preferences made by it (apparently regardless of who gave the instruction for the preference). Moreover, there is no express requirement to prove fault, and while there is an affirmative defense for acting reasonably and in good faith, it is untested. Consequently, persons that potentially control a company being sold should ensure that any of their standing instructions are duly terminated, and that the buyer has the means and intent to operate the company as a going concern. They should also ensure that they are indemnified against liability for any preference payments made by the company in the two years following its sale.

Giving Binding Instructions as a Dominant Company

The second important basis for vicarious liability applies to the “dominant company” (osnovnoe obschestvo) of a “daughter” company. A dominant company is liable for any losses that the daughter company has

suffered due to the fault of the dominant company. However, since a claim can only be asserted by other shareholders, this risk will not apply if there are no unaffiliated shareholders directly in the daughter company. (This is just one of several reasons to structure joint ventures in Russia offshore.) A dominant company is also liable if it is at fault in causing its daughter company's insolvency, although this essentially duplicates the liability discussed above.

The more serious risk is that a dominant company, regardless of fault, is jointly and severally liable for obligations undertaken by its daughter company pursuant to the dominant company's binding instructions.

Liability here turns on whether a company qualifies as a dominant company, and if so whether (i) it has the right to give binding instructions, and (ii) actually exercised that right by instructing the daughter company to undertake the relevant obligation. This is a complicated issue, but some summary conclusions can be stated. First, dominant company status requires the ability to determine another company's decisions on the basis of a predominant shareholding, an agreement with that company, or "other means". This last basis is unexplored territory, however; as all reported cases addressing dominant company liability have involved either direct shareholders or agreements.

Second, according to the relevant statutes, the right to give binding instructions at a JSC must be by express agreement or must be written in its charter; whereas for an LLC it seems that this right can be implied or de facto. In any event, court cases show that the right can be proven indirectly, such as by domination of management bodies or by mandatory intra-group regulations. A decree of Russia's supreme courts states that mere "influence" over decisions of the daughter company may be sufficient for liability so long as the particular obligation was undertaken further to the dominant

“A shareholder or other person “able to give binding instructions” to a Russian company “or determine its actions” is secondarily liable for the company’s obligations if such person is at fault in causing the company’s insolvency or bankruptcy”

company's specific instructions. The risk of liability seems greatest if the relevant decision is formally made by the dominant company and the daughter company had no discretion to act otherwise. Accordingly, it is important to preserve the formal independence of the daughter company; for example, the daughter company should not be a party to any shareholders agreements. Likewise, any guidelines or directives from above should be formally reviewed and adopted by the appropriate management bodies of the daughter company.

The Chief Justice's Proposal

Returning to Chief Justice Ivanov's proposal, it is fair to ask whether the best response to the problem of "one-day companies" and other perceived abuses of limited liability is to clarify and enforce the standards for vicarious liability that already exist in Russian law, or to import concepts from the common law. The latter approach would raise both procedural and substantive questions, such as these:

- Should a civil-law jurisdiction such as Russia adapt equitable principles from common-law jurisdictions? (Chief Justice Ivanov's prior endorsement of precedential caselaw suggests that he personally is comfortable with a hybrid approach.)
- Does the reference in the Civil Code's Article 6 to filling statutory lacunae on the basis of good faith, reasonableness and fairness provide sufficient authority for Russia's judges to adapt the doctrine of piercing the corporate veil sua sponte, or is legislation required?
- Substantively, which of the variety of tests should be incorporated? In the U.K., for example, veil-piercing is rare and is allowed only where a company was established either for fraudulent purposes, or to avoid an existing obligation. But in most U.S. jurisdictions, courts may pierce the veil based on a wide variety of factors, including neglect of corporate formalities; failure to maintain arms-length relationships; commingling of assets or siphoning of funds; willful undercapitalisation; whether the company is an alter ego or mere instrumentality; and even whether "justice so requires".

These are not rhetorical questions, and reasonable people may disagree on the answers. What is incontestable, however, is that whatever the rules of vicarious liability, they must be made clear in advance, must be applied fairly and consistently, and must be balanced against the key justifications for limited liability – namely, to promote entrepreneurial risk-taking and large-scale capital investment, both of which are critical to Russia's continuing development.

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Innovations Introduced in the Joint Stock Companies Law in Ukraine

One of the most important and long expected laws adopted in Ukraine over the last decade is the Law of Ukraine “On Joint Stock Companies” adopted in 2008 (the “JSC Law”). Though the law entered into force on 30 April 2009, it only became fully effective from 30 April 2011. It is applicable to all Joint Stock Companies (“JSC”) registered in Ukraine.

Before this law came into effect, issues on establishing Joint Stock Companies and controlling their activities were regulated by the Law “On Business Entities” 1991, and by separate provisions of the Civil and Commercial Codes of Ukraine 2004. Unfortunately, these laws left many issues on Joint Stock Companies’ governance open, and did not provide enough protection for either major or minority shareholders, which led to numerous corporate conflicts. The situation improved considerably with the adoption of the JSC Law.

The JSC Law contains many innovations, connected with establishing JSCs and controlling their activities. In this article we will consider selected innovations of the new JSC Law.

Differences in Public and Private JSCs

The JSC Law supports two types of JSC:

- Public JSCs, shares in which may be placed through public (open) sale to previously unidentified persons; and,
- Private JSCs, shares in which can be placed only through sale to previously identified persons.

Other differences between a public JSC and a private one are:

- Number of public JSC shareholders

is not limited, while number of shareholders in a private one may not exceed 100 shareholders.

- A public JSC must undergo a listing procedure and stay on the stock exchange register of at least one stock exchange.
- Annual financial statements of a public JSC must be audited by independent auditors and published (along with an independent auditors’ report). A private JSC is not obliged to disclose its financial statements on the stock market.
- The list of questions that are approved by a qualified or other majority of votes may not be extended in a public JSC: such a list is established exclusively by the law. The charter of a private JSC may extend the list of questions that are approved by a qualified or other majority of votes.
- Election of members to a supervisory board or audit commission of a public JSC can be performed only by cumulative voting. In a private JSC, members of a supervisory board may be elected on the principle of proportional representation, or by cumulative voting.
- The charter of a private JSC may provide a right of first refusal to shareholders and the JSC for the acquisition of that company’s shares

“The charter of a private JSC may extend the statutory list of questions that are approved by a qualified majority of votes”

which their owners propose to sell to third parties. Such a right of first refusal is not applicable in a public JSC.

Under the JSC Law, the minimum charter capital both for a public and a private JSC remained at the same amount as previously – equivalent to 1,250 minimum wages, based on the rate of the minimum wage effective at the time a JSC was established. Currently, the amount of a minimum charter capital for a JSC amounts to UAH 1,231,250 (about Euro 113,800).

Establishing a JSC: Placement of Shares

To establish either a public or a private JSC, first a closed (private) placement of its shares must be performed among the company’s founders, who must pay up their shares in full. After the shares are paid up in full:

- A statutory meeting must be held;
- The issue of shares must be registered in the State Commission for Securities and Stock Market of Ukraine (the “SC SSM”); and,
- A state registration of a JSC as a legal entity must be carried out.

After this, the charter capital of a public JSC may be increased by closed (private)

placement of shares, or by public placement of shares. However, one should note, that public placement of shares is prohibited if the amount of a JSC's equity capital of a JSC is less than the amount of its charter capital. A private JSC has the right to increase its charter capital only by closed (private) placement of its shares.

Following the public placement of shares an offering memorandum is published, together with a report on the results of that placement. In addition, this report of the results of the placement of shares in both public and private JSCs must be submitted to the SC SSM.

Shares in a JSC must be paid up in full by shareholders (or investors) before the results of a placement of shares are approved by the JSC's authorised agency.

An important innovation of the new JSC Law, is the requirement for a JSC to place its shares at a price not less than their market value. This requirement does not apply to the initial placement of shares during the establishment of a JSC. The market value of shares that are not circulated on stock exchanges is estimated by an independent certified appraiser. The market value of shares that are circulated on stock exchanges is estimated based on their stockholder value at the point a decision regarding shares issue is taken.

Placement of Shares from Additional Share Issues

In the case of the private placement of shares from an additional issue, shareholders can exercise their right of first refusal for purchasing such shares on a proportional basis. For the public placement of shares, the shareholders do not have such a right. A JSC that performs a private placement of shares is obliged to send personal written notifications to its shareholders and certain investors on the terms of the placement and the procedure the shareholders must

follow to exercise their right of first refusal in purchasing the shares.

Shareholders of a private JSC can exercise a right of first refusal for purchasing that company's shares which shareholders propose to sell to a third party, if such a right is stipulated by the charter of a corresponding JSC. However, the situation in a public JSC is different – shareholders of a public JSC may alienate their shares without the consent of other shareholders or the JSC. This norm is imperative and may not be changed by the charter of a company. Thus, the shareholders of a public JSC do not have, and may not have, the right of first refusal for purchasing that company's shares that shareholders propose to sell to third parties.

Repurchase of Shares of Minority Shareholders

Another important innovation of the JSC Law is the right of minority shareholders in both public and private JSCs to demand the repurchase of their shares in cases where a controlling block of shares is acquired by any person (similar to the conception of "tag-along right"). A controlling block of shares is 50% or above of ordinary shares. This right of minority shareholders is exercised by an obligation of the purchaser of the controlling block of shares to send a public irrevocable offer to all shareholders of the JSC – the owners of ordinary shares – for the acquisition of their shares. This offer must be sent within 20 days of the date of acquisition of the controlling block of shares. The price for the acquisition of the shares from the minority shareholders may not be less than their market value, calculated on the basis of an independent evaluation of the JSC's shares. In addition, the purchaser of the controlling block of shares is obliged to send a notification of this acquisition to the SC SSM, and for public JSCs, to also notify the stock exchange where the company is listed.

For acquisitions of a considerable block of shares (10% or more of ordinary shares) the person intending to purchase such a block of shares is also obliged to notify the JSC and the SC SSM about such intention. In addition, the intended purchaser must also publish a notification concerning this intention in the official printed publication of the SC SSM, no later than 30 days prior to the date of acquisition.

Repurchase of Shares by JSCs

One more innovation of the JSC Law is the right of shareholders to demand the repurchase of their shares by the company itself. Such a right may be applied if a shareholder voted at a general shareholders' meeting against:

- a decision on merging, joining, separating, transforming or changing the type of the company;
- a major transaction by the company; or,
- a change in the amount of the company's authorised capital.

In the case of repurchasing shares by the company itself, the repurchase price may not be less than their market value.

Conclusion

In conclusion it is worth mentioning that the adoption of the JSC Law has considerably increased the level of protection of shareholders' rights and made it possible to solve a number of problems related to the corporate governance of a JSC. Nevertheless, the JSC Law is not perfect and needs updating; a number of drafts regarding introducing amendments to the JSC Law are currently under consideration by the Ukrainian parliament.

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Legal Aspects of Mergers and Acquisitions in Kazakhstan

Targets of Merger and Acquisition (“M&A”) Transactions

Business operations in Kazakhstan are usually conducted either through joint stock companies/corporations (“JSC”) or through limited liability partnerships/limited liability companies (“LLP”).

In both, the partners’ or shareholders’ liability is limited to their equity interest in the respective legal entity. The principal difference between a JSC and an LLP is that JSCs are subject to regulation by the competent authority. JSCs are also subject to stricter requirements for protecting minority shareholders rights and must have more transparent business, management and reporting practices, etc.

As a result, the majority of business in Kazakhstan is conducted through LLPs. In particular, the largest Kazakhstan companies, such as Kazakhmys and TengizChevrOil, are organised as LLPs. However, many different factors, including legal considerations, a company’s capital structure and its business strategy all affect the most appropriate legal form for a company.

Kazakhstan law requires that business is conducted through JSCs in certain sectors of the economy, for example:

- Commercial banks
- Professional participants in the securities market¹
- Insurance companies
- Non-governmental pension funds
- Air carriers providing regular transportation services
- Stock exchanges

In other sectors, for example, commercial microcredit activities, Kazakhstan law requires that business must be conducted through LLPs.

The most important difference between LLPs and JSCs in the context of M&As relates to the transfer of ownership of JSC shares or LLP participation interest.

According to Kazakhstan securities’ laws, transactions involving JSC shares must be registered with the JSC’s registrar. Ownership of the JSC shares vests in the new owner upon registration of the transaction. In contrast, LLP participation interest is not considered securities, and so the transfer of their ownership is governed by Kazakhstan civil laws. Under these laws, the transfer of LLP participation interest does not need to be registered with any competent authority. Ownership of LLP participation interest therefore vests upon either the conclusion or the fulfillment of a contract – depending on that contract’s terms. However, because LLPs do not, by default, use registrars, the law requires that an LLP must be re-registered with the appropriate agencies if there is any change in the LLP’s participants. This ensures that the state and/or the public are given notice if the ownership of LLP participation interest changes. Under Kazakhstan law, even though ownership of the participation

“The most important difference between LLPs and JSCs in the context of M&As relates to the transfer of ownership of JSC shares or LLP participation interest”

interest has been transferred according to the terms of the particular contract, the participant’s right to dispose of his or her participation interest actually arises when the LLP’s constituent documents are changed, and registered with the appropriate state agencies.²

Another requirement of Kazakhstan law for M&As is that an LLP may not have as its sole participant another sole-participant LLP. For example, the sole participant of an LLP may not be a foreign (e.g. offshore) company with only one participant or shareholder.

Restrictions on Foreigners in M&As

Kazakhstan law imposes some restrictions on the number of shares or participation interest that a foreign person or entity can acquire or own in a Kazakh legal entity conducting business in certain sectors of the economy. The table below gives a general summary of these restrictions for some of the key investment sectors.

¹Excluding registrars, stock transfer agents and broker-dealers who do not maintain client accounts.

²Paragraph 6. Normative Decree No.2 “On some questions of applications of law on limited and supplemental liability companies/partnerships” of the Supreme Court of the Republic of Kazakhstan dated 10 July 2008 (as amended on 25 June 2010).

Economic Sector	Restrictions on Foreign Persons/Entities
Mass media	■ Up to 20% of shares/participation interest
Air carriers providing regular transportation services	■ Up to 49% shares/participation interest
Telecommunications	■ Not allowed to manage or operate the main communication lines
Telecommunications, as an operator of long-distance lines and/or international telecommunications, which own communication landlines (that is, cable, including fibre optics, radio relay)	■ Up to 49% shares/participation interest
Commercial banks and insurance companies	■ Offshore companies registered in certain offshore areas cannot own/acquire shares/participation interest

Approval of M&As by Governmental Agencies

General information on the key approvals that are likely to be required from state agencies for M&As is given below. However, this information is only intended as a guide: individual cases will all have their own particular circumstances, which could require specific legal advice.

Under Kazakhstan law, the Republic of Kazakhstan has a priority right in certain situations to purchase any shares/participation interest in a Kazakhstan legal entity that the owners plan to sell. In addition, owners also have an obligation to obtain the government authority's permission prior to any sale. These situations cover:

- Strategic Assets
- Subsoil Use
- Financial Organisations
- Natural Monopolies
- Economic Concentration

Priority Purchase Right and Permission to Transfer Strategic Assets

Government approval must be given before transferring shares/participation interest

in a Kazakhstan entity that owns strategic assets, as determined by the government. In addition, such transfers must also satisfy the state's priority purchase right. The government compiles lists of strategic assets, which include shares or participation interest in legal entities that own strategic assets. The list also covers shares or participation interest in legal entities that are directly or indirectly able to determine or to influence decisions made by legal entities that own strategic assets. The transfer of all such shares or participation interest requires government approval and must comply with the requirements of Kazakhstan law, with respect to the priority right of the Republic of Kazakhstan to purchase.

Priority Purchase Right and Permission to Transfer Rights to Subsoil Use

As a general rule, the government also has priority rights to contracts covering subsoil use and to acquire ownership interest in legal entities that own the rights to subsoil use. This priority right also covers legal entities that directly or indirectly are able to control or influence decisions made by subsoil users, if the main activity of the legal entity exercising this control/influence is

related to subsoil use in Kazakhstan. In such cases, the government must approve the transfer of shares or participation interest. Kazakhstan law defines a procedure to satisfy the government's priority purchase rights and to enable the necessary permission for the transfer to be obtained.

Approval for Financial Organisations (Banks and Insurance Companies)

As a general rule, under Kazakhstan law, no single person acting alone or jointly with another person may, without the prior written consent of the competent authority, be:

- (i) a major participant in a bank, i.e. own, either directly or indirectly, 10% or more of the bank's outstanding shares (net of preferred shares and shares repurchased by the bank)
- (ii) a bank holding company, i.e. own, either directly or indirectly, 25% or more of the bank's outstanding shares (net of preferred shares and shares repurchased by the bank).

There is a clearly defined procedure under Kazakhstan law whereby such consent can be obtained, which includes a list of the relevant documents that must be

³Each individual case is different and so may require specific legal advice.

submitted to the competent authority in order to gain this consent.

It is worth noting that such consent might also be required where major participation or bank holding thresholds are reached with indirect ownership in a Kazakhstan bank.

Similar requirements to secure consent by the competent authority exist for M&As involving insurance companies.

Approval for Natural Monopolies

Kazakhstan law requires the competent authority to be given prior notification where individuals or legal entities (or groups thereof) acquire more than 10% of the voting shares/participation interest/in the charter capital of a natural monopoly. However, due to the nature of this legislation, in practice filing such notice does not completely exclude the risk of the competent authority opposing the transaction.

Approval for Economic Concentration

Under Kazakhstan antitrust laws, economic concentration is defined, inter alia, as acquisition by a person (or group of persons) of voting shares/participation interest in the charter capital of a market actor; in which such person (or group of persons) acquires the right to control more than 25% of the shares/participation interest. This is provided that before the acquisition, such person (or group of persons) either did not control the shares/participation interest of that market actor; or alternatively controlled 25% or less of the voting shares/participation interest in the charter capital of that market actor.

The anti-monopoly authority must approve such acquisitions, if either the aggregate book value of the assets of the acquirer

“Kazakhstan law requires that business is conducted through JSC’s in certain sectors of the economy”

and of the target market actor as of the filing date of the application, or their aggregate sales of goods for the last fiscal year, exceed approximately US\$20M. Alternatively, such approval must be given if one of the persons involved in the transaction is a dominant market actor or holds a monopoly in the relevant market.

Corporate Approvals

The following must also be given special consideration when undertaking M&As:

- Priority purchase rights of LLP participants
- Sale and purchase of 30% or more of a JSC’s shares

Priority Purchase Right of LLP Participants

As a general rule, under Kazakhstan law LLP participants have a priority right to purchase participation interest sold by any of the other participants in that LLP. Kazakhstan law determines the sales procedure that must be carried out in order to satisfy such priority purchase rights. If any sale of participation interest violates the LLP participants’ priority purchase rights, those participants may, within three months of such a sale, petition the court to transfer the rights and duties of the buyer to that participant. If the LLP participants fail to exercise their priority right to purchase

participation interests, the LLP itself may exercise its priority purchase right.

Unlike LLP participants, JSC shareholders do not have a priority right to purchase any JSC shares sold by other shareholders in that JSC.

Sale and Purchase of 30% or More of Shares in a JSC

Under Kazakhstan law, a person intending to purchase 30% or more of a JSC’s voting shares on the secondary securities market (i.e. from the existing shareholders), must first notify the JSC and the competent authority by following the appropriate procedure laid down by that authority. Within thirty days of such acquisition, the purchaser must publish an offer in the media to the remaining shareholders to buy their shares in the JSC. Kazakhstan law specifies the procedure that must be followed when publishing such an offer; together with the consequences of non-compliance with this procedure.

Unlike the laws of some other countries, Kazakhstan law does not give a majority shareholder (i.e. one who holds 95% or more of a JSC’s shares) the right to forcibly buy out the shares of the remaining shareholders (a squeeze out merger).

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Streamlining Business Formalities in Azerbaijan

In recent years Azerbaijan has made considerable progress in streamlining how business is conducted in the country. Measures taken include:

- Establishing centralised property and mortgage registries;
- Reducing the number of activities requiring licenses;
- Introducing “single window” or “one stop shop” systems for company registration, customs processing, and immigration and work-permit formalities.

Over the last six years Azerbaijan has achieved some of the highest growth rates in the world 26.4% in 2005, 34.5% in 2006, 23.4% in 2007, 10.8% in 2008, 9.3% in 2009 and 5% in 2010.

This extraordinary growth is partly due to the opening of major new hydrocarbon export routes via the Baku-Tbilisi-Ceyhan Pipeline and the South Caucasus Pipeline, but is also due to improvements in the business environment.

Ease of Doing Business

“A recent independent survey that evaluated how easy it is to do business in a country placed Azerbaijan an impressive 54th out of the 183 countries surveyed.” This survey was contained in the *Doing Business 2011* report published by the World Bank and the International Finance Corporation (IFC). This marks a slight improvement over Azerbaijan’s ranking in the previous year’s survey. (While its 2010 ranking was actually 38, a different ranking methodology was used in drawing up the 2011 survey and, if that method had been used in the 2010 survey, Azerbaijan would

have been given a ranking of 55 that year, one place lower than this year.)

The survey highlighted how recent revisions in Azerbaijan’s tax code has lowered several tax rates and simplified the process for paying corporate profits tax and value added tax. In addition, the creation of online services has improved access to credit by enabling financial institutions to access and provide data onto a public credit registry.

Company Registration

Perhaps the most far-reaching recent change assisting the start-up of new businesses in Azerbaijan has been the promulgation of Presidential Decree No. 2458 of 25 October 2007. Following this Decree, since 1 January 2008, all company registrations are handled by the Ministry of Taxes. (The only exception to this is non-commercial organisations, which continue to be registered by the Ministry of Justice.) As part of the new “single window” process, the Ministry also handles any subsequent registrations that are needed for the State Statistics Committee, the Social Protection Fund, local tax authorities and the National Employment Centre. (However, for joint stock companies, shares must still be registered separately with the State Securities Committee.)

Most dramatically, the company-registration process, which typically took 4-8 weeks prior to the change in the procedures, now takes only 5-8 days.

“Most dramatically, the company-registration process, which typically took 4-8 weeks prior to the change in the procedures, now takes only 5-8 days”

Electronic Filing Systems

Various initiatives are currently underway to increase the availability and use of electronic filing systems. This trend is highlighted in Presidential Order No. 1056 of 11 August 2010, “*On the Approval of the State Programme on the Development of Communications and Information Technologies in the Azerbaijan Republic for the Years 2010-2012 (Electronic Azerbaijan)*”. It is also highlighted in the more recent Presidential Decree No. 429 of 23 May 2011, “*On Certain Measures in the Field of the Organisation of the Provision of Electronic Services by State Bodies*”. The ability to file profits tax, value-added tax, land tax, property tax and simplified tax declarations online has been offered by the Ministry of Taxes for a number of years and is gaining in popularity. An online facility enabling taxpayers to ask tax officials questions has also been very effective, especially in an environment where written requests seeking clarification from government bodies have traditionally met with significant delays.

Since 1 July 2011, individual entrepreneurs have been able to submit their registration applications to the Ministry of Taxes

online. This has greatly reduced both the timeframe and the bureaucratic formalities that had previously hindered individuals who wanted to engage in business activities.

It has also been announced that sometime in 2012 an online system for the registration of legal entities will be implemented by the Ministry of Taxes. "Assuming that such a practice is broadly applied to company registrations and notifications, it will revolutionise the process of setting up businesses in Azerbaijan." It will also reduce the time it takes for existing companies to perform routine tasks, such as amending the company registry owing to changes in legal addresses, or revising company charters.

“Over the last six years Azerbaijan has achieved some of the highest growth rates in the world 26.4% in 2005, 34.5% in 2006, 23.4% in 2007, 10.8% in 2008, 9.3% in 2009 and 5% in 2010”

Conclusion

The legal and business climate in Azerbaijan is far from perfect, but recent changes have clearly been geared to helping new businesses start up.

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Why Rule 10b-5 Matters in International Securities Offerings

A “10b-5 letter” is a letter from the US counsel to the effect that during its involvement in preparing a prospectus or another securities offering document, nothing has come to its attention that would lead it to believe that the offering document contains material misstatements or omissions.

In most offerings into the US, the underwriter will require a 10b-5 letter from both its own counsel and from the issuer’s counsel. However, while the 10b-5 letter is arguably the best-known US legal opinion, it is actually not a legal opinion at all, but rather a negative assurance letter.

Rule 10b-5, under the US Securities Exchange Act of 1934, as amended, sets forth a fundamental principle of US securities law:

“It shall be unlawful for any person, directly or indirectly . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.”

A “material fact” has been defined by relevant US case law as one where “there is a substantial likelihood that a reasonable [investor] would consider it important in deciding” whether to purchase or sell a security.

Although 10b-5 letters are typically sought for public offerings in the US, in practice most investment banks routinely request 10b-5 letters for Rule 144A offerings, private placements and Regulation S offerings over a certain threshold amount, depending on the number and sophistication of the offerees. Thus, an initial public offering (“IPO”) that is available to US investors via a Rule 144A offering will typically

also require a 10b-5 letter, regardless of whether the issuer is listing its securities in London, Hong Kong or Moscow.

The reason for this practice is that an underwriter can avoid liability for certain claims brought by investors in connection with the underwriter’s sale of securities if the underwriter can prove it exercised due diligence in investigating the business and financial condition of the issuer in an effort to ensure that the disclosure in the offering document was adequate. The provision of a 10b-5 letter from the US counsel strongly bolsters this defense.

To provide a 10b-5 letter, the US counsel must be involved in the drafting of the offering document, after conducting extensive legal due diligence. The US counsel must work closely with the issuer’s management and auditors, as well as the underwriters, during this drafting process.

Salans New York Office regularly prepares and issues 10b-5 letters in connection with Rule 144A offerings and IPOs in various jurisdictions.

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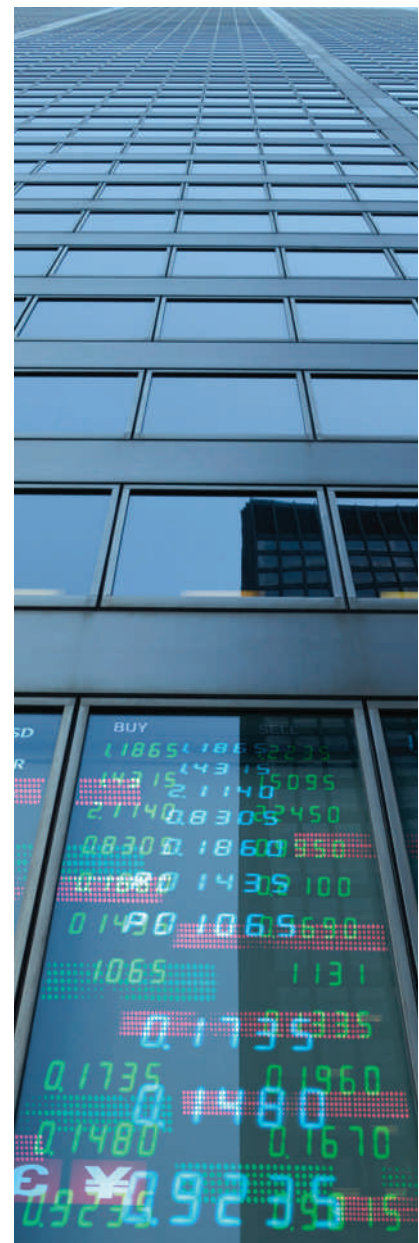
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“Rule 10b-5 sets forth a fundamental principle of US securities law”



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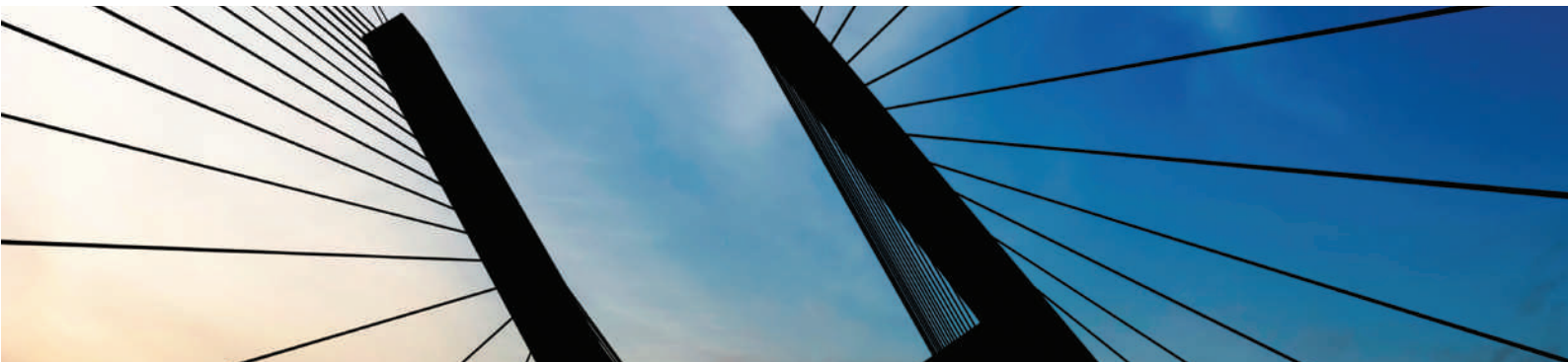
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Global Corporate Group



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Madrid
Moscow
New York
Paris
Prague
Shanghai
St Petersburg
Warsaw

Stryker Corporation
USD 161,878,000
Acquisition of Memometal Technologies SA

France



Sahaviriya Steel Group Plc
USD 680,000,000
Acquisition of Tata Steel's steelmaking plant

United Kingdom



BayernLB Capital Partner GmbH
Value Confidential
Non-sponsored management buy-out and mezzanine financing of Native Instruments Group

Germany/USA ♦ Bayern LB Capital Partner

Vivendi
EUR 1,250,000,000
Sale of Vivendi's interests in Polska Telefonía Cyfrowa (ERA) and related settlement of the shareholders' dispute

Poland



IK Investment Partners
Value Confidential
Acquisition of Agros Nova

Poland



**European Refreshments/
The Coca Cola Company**
Value Confidential
Acquisition of Nidan Juices

Russia



S-Finanzgruppe
EUR 2,300,000,000
Acquisition of a 50% stake in DekaBank

Germany



Sistema JSFC
USD 438,000,000
Sale of Sistema Telecommunications, Informatics and Communications

Russia



**Sun.King Power
Electronics Group Limited**
USD 410,000,000
Initial public offering on the Main Board of the Hong Kong Stock Exchange

Hong Kong



OMV
EUR 1,000,000,000
Acquisition of 54,17% stake in Petrol Ofisi

Turkey



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