

LT in focus

Changes in the Civil Code of RF: M&A transactions



On 8 March 2015, the President of the Russian Federation signed Federal Law No. 42-FZ “On amending the first part of the Civil Code of the Russian Federation” (hereinafter – the Law), which will come into effect on 1 June 2015 and brings in a number of significant amendments into the Civil Code of the Russian Federation (hereinafter – the Civil Code).

In this article, we analyse amendments to the provisions regulating mergers and acquisitions (hereinafter – M&A). The new law introduces a number of concepts common for foreign law into Russian legislation.

Negotiations for the conclusion of a contract (Art. 434.1 of the Civil code)

The Law develops the principle of “good faith” for negotiations of a contract. Also it sets limitations for entering into negotiations when one of the parties invariably does not have the intention to make an agreement with the other party.

The principle for “bad faith actions” are set as follows:

- providing the counterparty with incomplete or inaccurate information or non-disclosure of circumstances, which should have been brought to the attention of the counterparty;
- sudden and unjustified termination of negotiations under circumstances which the other party could not reasonably expect.

It is important to note that the Law provides for the obligation of the “unscrupulous party” to compensate the counterparty for damages equivalent to the expenses incurred in connection with conducting the negotiations, as well as in connection with the loss of the opportunity to conclude a contract with a third party.

Therefore, Russian legislation has adopted the principle of “good faith,” which is common in English law and used in M&A negotiations. At the same time, terms like, “incomplete or inaccurate information,” “justifiability,” and, “reasonability,” of the cancellation of negotiations need to be defined.

In addition, the Law prescribes that the parties bear liability for expenses connected with conducting negotiations themselves and do not bear liability for the fact that the agreement has not been reached; as well as the duty of the parties to keep the negotiations confidential (otherwise there is an obligation to compensate for damages arising).

The Law provides for a new type of contract – “the agreement for the procedure of conducting negotiations,” which specifies the requirements of good faith, allocation of costs for conducting negotiations and penalty for its breach, confidentiality etc. Thus, the Law provides an opportunity for the enforcement of similar rules in the Russian Federation. However, the difference between this type of contract and the preliminary contract remains uncertain. We assume that this is a separate contract, which regulates relations between the parties during negotiations, but not further contractual terms under the principal agreement.

In addition to the abovementioned amendments, it is worth noting the following amendments:

- silence can be considered as acceptance if it is pursuant to the agreement made earlier between the parties (item 2, Art. 438 of the Civil code);
- the party which accepted full or partial performance of the contract does not have the right to claim that the contract was not concluded (item 3, Art. 432 of the Civil code).

Representations of the circumstances (Art. 431.2 of the Civil code)

“Representations,” which are used in M&A contracts are included in the Law as representations of the circumstances, which are important for the performance, termination or conclusion of a contract.

The law indicates, but has not limited, the scope of such circumstances to the following: the subject of the contract, the power to make a contract, the adherence of the contract to the applicable law, the existence of a license, the financial condition of the parties etc.



The party, which presented inaccurate information is obliged to compensate the counterparty by way of damages which occurred due to these representations and, at the counterparty's demand, pay the penalty prescribed by the contract. The injured party has the right to cancel the contract or claim for the contract to be voided.

The consequences of the submission of inaccurate information related to corporate agreements and share purchase agreements on the equity of companies are an important nuance in the legislation. It is not important if the party is aware of the authenticity/unauthenticity of the information it is submitting. The abovementioned negative consequences can be applied in either case.

A contract for indemnification (Art. 406.1 of the Civil Code)

The next aspect which has a certain similarity to the English concept of "indemnification," regulates the issue of compensation for losses.

The parties to the indemnification, acting in the ordinary course of their business, can make a contract, which binds one of the parties to compensate the other for losses. Such losses can occur if certain events identified in the contract occur.

This loss can arise from obligations of any kind. For example, within the framework of a contract for the sale of shares, the seller can undertake to compensate the buyer for losses in respect of conditions which existed before the sale of the shares and was not identified during due diligence. Examples of this might include claims made against the company by the tax authorities.

The Law obliges the parties to define the amount of compensation for this loss or the procedure for its calculation (the latter seems to be more appropriate) in the contract. The obligation to compensate exists independently of the fact that the contract is considered as not concluded or invalid if it is not written in the contract.

The Law allows the use of this indemnity in a corporate agreement or an agreement on the sale of shares where one of the parties to which is an individual.

Therefore, the Law amends and adopts a number of foreign legal constructions common for M&A agreements into Russian legislation. In our opinion, the amendments made by the Law potentially open the opportunity to conclude contracts and ensure their enforcement within the legal framework of the Russian Federation.

We trust that you will find the information in this issue both interesting and useful. Our specialists are available to answer any questions you may have with regard to its contents.

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