

Mergers & Acquisitions in Ukraine



by Vadim V. SAMOYLENKO

1. The notions of mergers and acquisitions

From the legal perspective, mergers and acquisitions (in Russian *sliyaniya i pogloscheniya*) transactions (hereinafter “M&A”, the “Transaction”, or the “Transactions”) pursued in Ukraine may be examined within a narrow (formally legal) or wide (economic-and-legal) contexts.

From the *formal legal* point of view (Articles 104-107 of the *Civil Code of Ukraine* (hereinafter “CCU”)), M&A appears to be a form of *reorganization (termination) of legal entities* (hereinafter “LE”). At a “merger” (*sliyanie*) of two LEs, such LEs terminate as subjects of law and in their place a new LE appears. Such a new LE stands as a full (universal) legal successor of all rights and obligations of LEs merged, i.e., its legal predecessors.

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During an “acquisition” (*pogloschenie*) of a LE by another LE, the former LE terminates, and all of its assets and liabilities are transferred to the raider. The latter LE becomes a full (universal) legal successor of the LE acquired.

At the same time, Ukrainian business practice has also adopted the “mergers and acquisitions” term in a wider, primarily economic, sense as used in the West. In the *wide* sense the term purports

that corporate control (hereinafter “CC”) is established over the undertaking.

In the context of this research, the M&A is understood by the author as *acquisition by a person or a group of persons acting in concert* (hereinafter the – “Raider”) of CC over an enterprise (hereinafter – “Target”) in the form of a block of shares or an equity interest representing a part of the Target’s authorized capital, securing such control.

2. Types of corporate control over joint stock company

Obviously, the final objective of each M&A is an indirect right to manage the Target's assets for the benefit of the Raider, while an interim objective as well as an instrument for achieving the Raider's plans to manage the Target's assets is to obtain CC over the Target.

The author discerns between a few types of CC over a Target, being a joint stock company (hereinafter "JSC"), such as:

Relative CC over the Target JSC is usually achieved through a transfer to the Raider of a block of shares constituting less than 50% + 1 share of the total number of shares (hereinafter "TNS") in the Target JSC, which vote at the general shareholders' meeting (hereinafter "GSM") of the Target. However, therewith exist certain circumstances, which allow the Raider to soundly consider that:

- 1) It will be able to convene a valid GSM; and
- 2) Such a GSM will, by a simple majority vote (hereinafter "SMV") of the participating shareholders (owning at least 50% + 1 voting shares), elect the management board of the Target JSC (hereinafter the "Management Board") nominated by the Raider.

Generally, such a result can be achieved through:

- 1) An agreement between the Raider and a number of independent shareholders to tender a consolidated vote on a given item of the GSM agenda (hereinafter the "Agenda");
- 2) Acquisition by the Raider of appropriate proxies for participating and voting at the GSM, issued by a number of independent shareholders;

- 3) Inertness of independent shareholders (particularly, the State Property Fund of Ukraine (hereinafter – "SPF") or other governmental authority authorized to manage a government-owned block of shares in the Target JSC, if any) revealing itself in a regularly low attendance of GSM (however, securing a quorum) and/or their passivity in voting at GSM (however, allowing a SMV to be achieved during voting at a GMS).

Operating CC over the Target JSC is achieved through a transfer to the Raider of a block of the Target JSC's shares equal to, or exceeding 50% + 1 share of TNS, though less than a 60% + 1 share of TNS. Provided it can convene a valid GSM, the Raider is guaranteed to achieve a SMV in the election of the Management Board nominated by the Raider.

Strategic CC (hereinafter – "SCC") over the Target JSC may be conventionally divided into:

Relative SCC is, as a rule, achieved when a block of the Target JSC's shares equal to, or exceeding 60% + 1 share, though less than 75% of TNS, is transferred to the Raider. Therewith, the Raider can implement the following scenarios of corporate management of the Target JSC:

- 1) Despite the will of the other shareholders, convene a valid GSM and adopt any decisions that require a SMV;
- 2) Block any GSM for an indefinite period of time and thus "freeze" such Target JSC management structure which evolved or was created by the Raider at previous GSMs.

Full SCC is established when a block of the Target JSC's shares equal to, or exceeding 75%, though less than 90% + 1 share of TNS, is transferred to the Raider. Such equity interest in the Target provides the Raider with an infallible opportunity, despite the will of the other shareholders, to convene a valid GSM and adopt any decisions that require a SMV or a qualified majority vote, i.e., not less than 75% of the votes present at the valid GSM (hereinafter – "QMV").

Please note that pursuant to Part 4 of Article 159 of CCU, a QMV is required for the GSM to resolve the following matters:

- 1) Amendment of the company charter;
- 2) Liquidation of the company.

Absolute SCC is achieved when a block of the Target JSC's shares equal to, or exceeding 90% of the TNS, is transferred to the Raider. In such case:

- 1) Nobody except the Raider (which, naturally, controls the Management Board as well as the Target JSC's supervisory council and the auditing commission, and also benefits from the Target's charter convenient for it) can convene the GSM. (Please note that Part 4 of Article 45 of the *Business Associations Act of Ukraine* No.1576-XII of 19 September 1991 as further amended (hereinafter – "Business Associations Law") vests such right, particularly, with the shareholders that own in aggregate over 10% of the votes);

- 2) Shareholders cannot request a mandatory audit of the Target JSC's operations (pursuant to Part 2 of Article 162 of the CCU), such right is vested with the shareholders, which own in aggregate at least 10% of JSC shares);

- 3) Shareholders cannot request from the auditing commission of the Target JSC an audit of financial and business operations of the Management Board (Part 4 of Article 49 of the Business Associations Law vests such right with the shareholders, which own in aggregate over 10% of the votes).

3. Types of corporate control over a limited liability company

The other most common legal form of organization of large and medium-sized businesses in Ukraine, which usually stands as an M&A target, is a *limited liability company* (hereinafter – "LLC").

The author discerns between the following types of CC over a Target LLC:

Relative CC over the Target LLC is usually achieved through a transfer to the Raider of an equity interest representing a part of the authorized capital (hereinafter – "AC") and securing less than 50% + 1 vote of the total number of votes (hereinafter – "TNV") at the general participants' meeting (hereinafter – "GPM") of the Target LLC. However, therewith there exist certain circumstances that allow the Raider to soundly consider that:

- 1) It will be able to convene a valid GPM; and
- 2) Such a GPM will, by a simple majority vote (hereinafter – "SMV") of the participants in attendance (owning at least 50% + 1 voting shares), elect the director or a directorate of the Target LLC (hereinafter – "Directorate") nominated by the Raider.



Generally, such a result can be achieved through:

1) An agreement between the Raider and a number of independent participants to tender a consolidated vote on a given item of the GPM Agenda;

2) Obtaining by the Raider appropriate proxies for participating and voting at the GPM, issued by a number of independent participants;

3) Inertness of independent participants (particularly, the SPF or other governmental authority authorized to manage a government-owned equity interest in the Target LLC, if any) revealing itself in a regularly low attendance of the GPM (however, securing a quorum) and/or their passivity in voting at the GPM (however, allowing to achieve a SMV).

Operating CC over the Target LLC is achieved through transfer to the Raider of an equity interest representing a part of AC of the Target LLC and securing 50% + 1 vote of TNV or more. Provided it can convene a valid GPM, the Raider is guaranteed to achieve SMV in the election of the Directorate nominated by the Raider.

SCC over the Target LLC may be conventionally divided into:

A *relative SCC* is, as a rule, achieved when an equity interest representing a part of AC securing 50% + 1 vote of the *total number of the votes set out in the Target LLC's charter* (hereinafter – “TNVC”) (please note that this is not TNCL) or more, though at least 60% + 1 vote of TNVC, is transferred to the Raider. Provided it can convene a valid GPM, the Raider is guaranteed to achieve a SMV (which pursuant to Article 59 of the Business Associations Law constitutes 50% + 1 vote of TNVC or more, but not of the total number of votes of the participants attending the validly convened GPM (as in the case with a JSC!)), when resolving the following issues (Part 4 of Article 145 of the CCU; Part 2 of Article 59 of the Business Associations Law):

1) Determining the company major areas of activities; approving its plans and status/completion reports;

2) Amending the company charter; changing the amount of its capital fund;

3) Excluding a participant from the company.

A *full SCC* is established when an equity interest representing a part of

AC that secures 60% + 1 vote of TNVC or more, but not less than 80% votes of TNVC, is transferred to the Raider.

Therewith, the Raider can implement the following scenarios of corporate management of the Target LLC:

1) Despite the will of other participants, convene a valid GPM and adopt any decisions that require a SMV or QMV;

2) Block any GPM for an indefinite period of time and thus “freeze” such Target LLC management structure which evolved or was created by the Raider at previous GPMs.

Absolute SCC is achieved when an equity interest representing a part of AC that secures 80% of TNVC or more, is transferred to the Raider. In this case no-one

The LLC is one of the relevant legal forms which stands as an M&A target

except the Raider (which, naturally, controls the Directorate as well as the Target LLC's auditing commission (auditor), and also benefits from the Target LLC's charter convenient for it) can convene GPM (Part 4 of Article 61 of the Business Associations Law vests such right, particularly, with the shareholders, which own in aggregate over 20% of votes). However, even having an absolute SCC the Raider should consider that, pursuant to Part 4 of Article 146 of CCU, any participant in the Target LLC can request a mandatory audit of the Target JSC's annual financial statements.

4. Legal representation with respect to mergers and acquisitions

As practiced in Ukraine, the M&A representation goes, as a rule, through the following major phases:

4.1. Legal due diligence of the Target

Usually, the legal due diligence phase (hereinafter “LDD”) is aimed at:

1) Supplying the Raider's top manager with impartial information on the economic and legal status of the Target, facilitating the decision on continuing, modifying, or even terminating the Transaction;

2) Supplying the top manager of the Raider and, perhaps, of the Target, with information and, possibly, recommendations on correcting legal defects in the documents and/or the business of the Target prior to, in the course of the Transaction, and thereupon;

3) Obtaining information and documents, necessary for subsequent phases of the Transaction, particularly, structuring of the Transaction.

4.2. Transaction structuring

This phase includes, as a rule, the following major efforts:

1) Identifying ways and timeframes for correcting material legal defects in the establishing and operations of the Target, which bar implementation of the Transaction;

2) Identifying ways and timeframes for removing encumbrances over the Target's assets, its corporate rights, with liabilities;

3) Identifying quantities, type, material terms and conditions of the contracts, under which the Raider is acquiring the Target, and the contracts securing due performance by the Target sellers and/or (which is less common) by the Raider of the obligations under the acquisition contracts;

5) An opinion on the necessity to obtain prior permission from the AMCU about a Transaction treated as ‘economic concentration’;

6) Developing a model general Transaction implementation schedule;

7) Assigning duties with respect to the development of the Transaction documents and performance of other acts required for its implementation to the parties and their counsels.

4.3. Drafting and executing transaction documents

Normally, this Transaction phase includes the following major efforts:

1) Developing first draft contracts, minutes of meetings and resolutions issued by the Raider's and Target's govern-

ing bodies, amendments to the Target's constituent documents, and other documents mediating the agreements between the parties to the Transaction and legal requirements;

2) First comments and coordination of the draft documents with the parties to the Transaction and their counsels;

3) First negotiations between the parties to the Transaction, coordination and adjustment of financial terms and conditions of the Transaction;

4) Finalizing the drafts of the Transaction documents by the counsels to its parties;

5) Final negotiations between the parties to the Transaction, non-financial adjustment of the terms and conditions of the Transaction and the draft documents;

6) Preparing execution copies of the Transaction documents;

7) Official execution of the Transaction documents by authorized representatives of the parties, and where necessary, certification and/or registration of such documents.

4.4. Transaction implementation

At this phase, the parties to the Transaction and their counsels undertake efforts and follow procedures, the mandatory nature of which is established by law and the Transaction documents executed. Below, the author provides a description of the most common and important efforts and procedures.

4.4.1. Filing with the AMCU for transaction authorization

According to Part 2 of Article 22 of the *On Protection of Economic Competition Act of Ukraine of 11 January 2001, No.2210-III*, as further amended (hereinafter – “Competition Act”), the economic concentration the implementation of which may require prior authorization from the AMCU (hereinafter – “Authorization”) is, in particular, as follows:

“1) merger of undertakings or accession of one undertaking to another;

...3) direct or indirect purchase or other acquisition of a title to, or management of, equity interests (stocks, shares), which secures 25 or 50% of the votes or more in the governing body of a respective undertaking.”

In reality, these are the most typical M&As, though other kinds of M&A, which according to the provisions of the Competition require Authorization, are also possible.

According to Part 1 of Article 24 of the Competition Act, the foregoing requires Authorization where the aggregate value of the assets or the aggregate revenues from sales of the participants in the concentration, also considering control relationship, for the most recent financial year, including abroad, exceeds an equivalent of EUR 12,000,000 as calculated using the National Bank of Ukraine

Legal Due Diligence is aimed at supplying the top manager of the Raider with recommendations on correcting legal defects...

(hereinafter – “NBU”) exchange rate effective on the last day of that financial year, and therewith:

1) the value (aggregate value) of the assets or the revenues (aggregate revenues) from the sale of goods, including abroad, of at least two participants in the concentration, also considering control relationship, exceeds an equivalent of EUR 1,000,000 as calculated using the NBU exchange rate effective on the last day of that financial year; and

2) the value (aggregate value) of the assets or the revenues (aggregate revenues) from the sales of the goods in Ukraine of at least one participant in the concentration, also considering control relationship, exceeds an equivalent of EUR 1,000,000 as calculated using the NBU exchange rate effective on the last day of that financial year.

4.4.2. Transfer of Target's corporate rights to the Raider

When implementing the given phase of the Transaction, it is important to con-

sider that, according to the law, the Raider acquires:

a) Title to the following Target's shares:

– Bearer shares, from the moment of their endorsement by the seller;

– Immobilized bearer shares, from the moment when the shares are credited to the Raider's account with the custodian;

– Registered shares issued in documentary form, from the moment when their seller issues respective written transfer instructions to the registrar of the holders of the Target's securities to the effect of registration of those securities in the Target's shareholders' register in the Raider's name;

– Immobilized registered shares issued in documentary form, from the moment when they are credited to the Raider's account with the custodian;

– Registered shares issued in non-documentary form, from the moment when they are credited to the Raider's account with the custodian;

b) An equity interest that represents a part of the LLC's AC (corporate rights), from the moment of state registration of the LLC's restated charter naming the Raider as a participant in the LLC, holding the equity interest that represents such part of AC.

4.4.3. Delivery of shares and payment under the transaction

The established practice of executing agreements that provide for the blocking of shares in the Target seller's securities account with the seller's custodian (hereinafter – “Blocking Agreement”) provides a useful mechanism for minimizing the risk of failure by the parties of the Transaction to perform their obligations to deliver the JSC Target's shares and pay for them. In order to follow this pattern:

1) The shares should be issued in non-documentary form, or the shares already issued in documentary form should be immobilized in advance;

2) Both the Raider and the seller of shares should have securities accounts opened with one and the same custodian;

3) The shares purchase agreement ought to provide for the delivery of the shares to the Raider, using a separate Blocking Agreement. ■