

B2B: Specifics of Legal Due Diligence in Russian Asset Deals

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Undoubtedly, for a variety of reasons, share deals remain highly favored in Russia. That said, we do see the occasional acquisition structured as an asset deal. This includes not only real estate transactions (where the single-asset structure makes the transfer easier), but even in manufacturing, sales and service industries. It will be recalled that in a share deal the buyer directly or indirectly acquires the title to the shares of a company holding the target asset business (either directly or via a subsidiary). Consequently, it becomes that business's owner. Asset deals involve acquisition of the specific standalone asset or assets, or acquisition of the entire business (if done in Russia this may be structured as a so-called "enterprise complex" under the Civil Code).

Regardless of whether the acquisition is structured as an asset deal or a share deal, it is essential that a buyer conduct proper legal due diligence over the key assets of the target business. A typical due diligence report, prepared after counsel's careful review and analysis of relevant documents and information, identifies major problematic issues affecting the target business and advises on the options for curing defects or mitigating risks.

In an asset deal, counsel performing due diligence typically must take an even more in-depth look at the history of the acquisition of each specific asset and the current legal standing of each relevant asset. In addition, it is essential that counsel and principals in the deal work together to identify and analyze the best ways to transfer the assets. This work must start as early as possible in the process to avoid delays in completing the acquisition due to unpredicted bureaucratic formalities. There could be plenty of these, such as the need to obtain the landlord's prior consent to the assignment of rights under a lease agreement, a requirement to register alterations to real property, or even the need to analyze whether a particular target asset constitutes a real property and thus must be registered in the seller's name prior to the buyer's acquisition. Such matters do not directly arise when the deal is structured as an asset deal.

While asset deals are possible in Russia, they require very careful planning in advance and thorough and appropriate due diligence.

Another area requiring close study is the area of material contracts. An asset deal will require the transfer of each and every material contract into the buyer's name. It is critical that counsel for the principals agree on the list of contracts to be assigned and the approach for treating the relevant cash flow after completion or, where applicable, in the interval between signing and completion. This becomes particularly important for complex contracts envisaging supply, installation and post-sales technical maintenance, distribution arrangements, and the like.

Similarly, the parties must agree on the relevant procedure for the assignment of such contract or contracts in the buyer's name. In Russia, such assignment may be formalized either as a tripartite document between the assignor, the assignee and the counterparty to the underlying contract or as a bipartite document between the assignor and the assignee, subject to obtaining the prior consent of the counterparty. The latter option may be quite problematic to implement in practice where the client's sales, legal, accounting and management teams must coordinate these issues.

It is typical that the client would request meeting the buyer's operational team who will manage the performance after the assignment, reviewing the buyer's constitutional documents, and analyzing the buyer's technical, commercial, economic and labor capabilities to perform under the contract intended to be assigned. Such negotiations may take weeks, if not months, and not necessarily lead to receiving the counterparty's consent to the assignment.

A potentially workable solution here may be to subcontract performance under the underlying contract to the buyer, provided, of course, that the underlying contract allows this or, in the event it envisages that consent is required for this, obtaining such consent. In such scenario, the seller and the buyer may need to enter into a technical assistance agreement, and the buyer would invoice the seller for performance thereunder.

In some instances, it may be easier for all parties involved to terminate the existing contract with the seller and to enter into a new contract with the buyer altogether or only with respect to new orders. The parties must, however, consider the risk that the client may attempt to renegotiate certain commercial terms of the new contract.

In all respects where the acquisition involves assignment of certain material contracts, the transaction documentation must provide for clear guidance regarding client maintenance, contract performance standards, cash flow and, no less important, communication standards

and confidentiality undertakings. Where technical conditions so require, the buyer's staff might need to undergo special health and safety or other types of training specifically requested by the client or arising out of applicable legal requirements. In preparing for negotiations on commercial contract assignments, the principals and their counsel must agree well in advance on the precise moment when local teams should approach clients with the request to approve the assignment and ensure clients are given all required comfort to make sure performance under the contracts will be of the expected standard.

Where contracts involve financing structures these can also complicate the asset deal transfer, as creditors are generally unwilling to transfer such arrangements without a thorough consideration of the impact on their credit risk and whether further credit coverage may be required.

Another issue requiring consideration is the issue of employee transfers. In a sale deal the employees will (unless otherwise agreed upon) remain with the target business (and the role of employer remains in place), whereas in an asset deal the employees of the business must be transferred under the Russian Labor Code either by virtue of a "transfer" or by virtue of termination and re-employment. This particular exercise can raise delicate issues with employees and must be carefully structured. Where employees are not willing to transfer this can also raise the transaction costs as non-transferring employees would ordinarily need to be made involuntarily redundant, which can raise a major cost for the seller in the deal.

Finally, the issue of licenses must not be forgotten. Licenses are generally non-transferable in Russia, meaning that the buyer of the business (if it does not already have the requisite licenses) would be required to re-apply for the licenses. This, too, can create substantial lead time and potential obstacles.

In short, while asset deals have proven to be possible in Russia, they will require very careful planning in advance and thorough and appropriate due diligence by counsel, tailored for the intended deal structure.

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