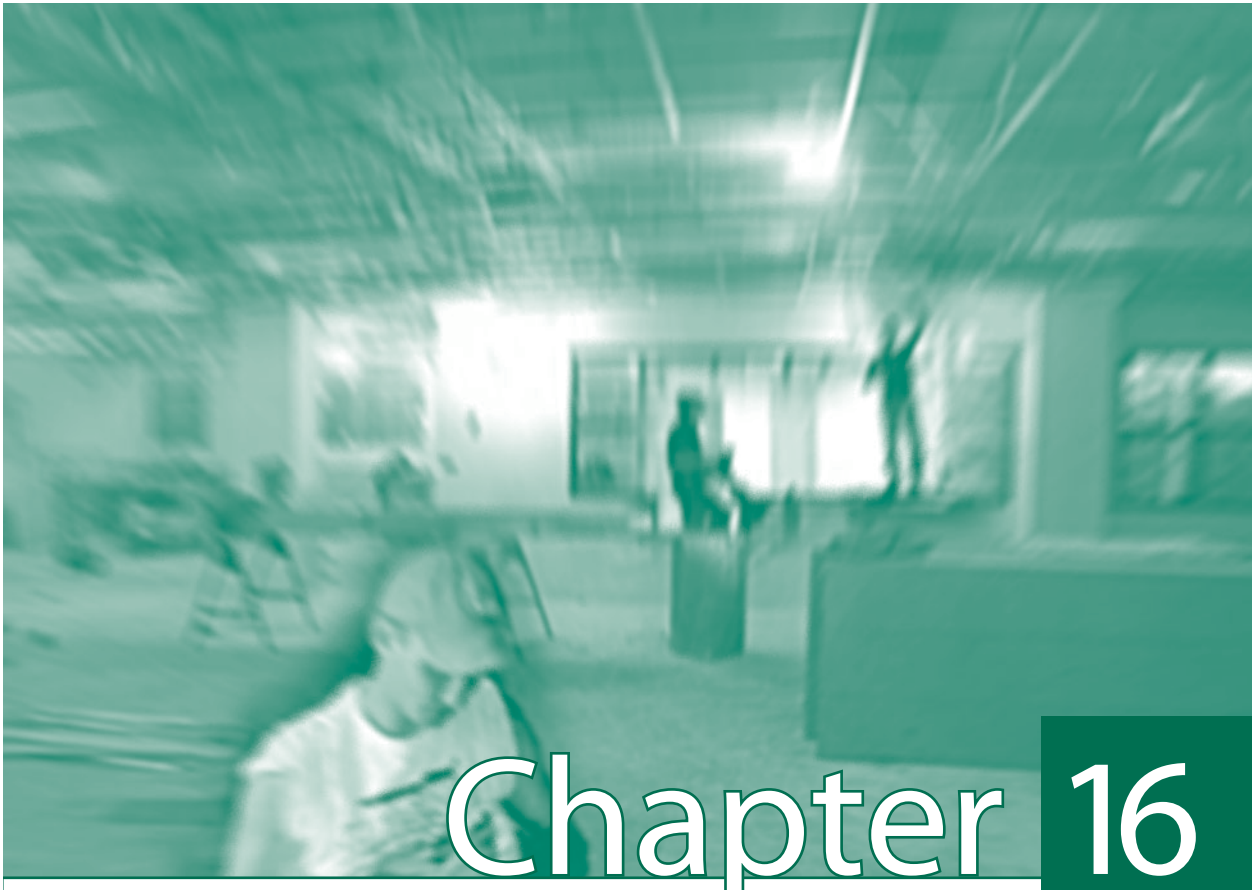
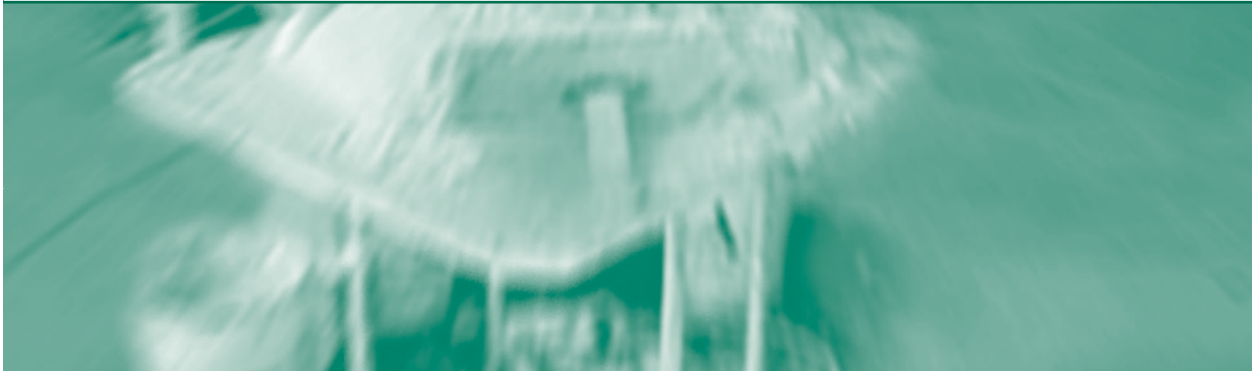


Chapter 16

Corporate Governance **Implications** of **Reorganizations**



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The Chairman's Checklist

- ✓ Is management's reorganization proposal economically justifiable and legally feasible? Have negotiations with other companies participating in the reorganization been conducted with due diligence and in good faith?
- ✓ Has the Supervisory Board considered the company's reorganization as part of the company's long-term development strategy? If so, has the Supervisory Board carefully deliberated financial, legal, and social implications?
- ✓ Have all documents needed for the approval of the reorganization by the General Meeting of Shareholders been prepared and submitted to shareholders on a timely basis? Are these documents sufficient for shareholders to make an informed decision?
- ✓ Have creditors been duly notified of the planned reorganization? Has the legal succession of all debt been ensured? Has the potential cost of early repayment of debts been properly estimated?
- ✓ Have all the requirements of state registration (including of charter amendments) been met? Have the appropriate state bodies been notified of the reorganization or, if applicable, has their preliminary approval been obtained? Are there any aspects of the proposed reorganization that involve international or foreign rules and regulations?

Companies often respond to a dynamic and changing business environment by reorganizing their operations, for example by recasting their legal structure. They may decide to restructure on a relatively small scale by streamlining, for example, a division or function, or by changing reporting structures.

There are other times when companies will restructure or reorganize themselves on a larger scale. They may acquire or merge with other companies in order to take better advantage of markets or assets, or to achieve greater economies of scope or scale. The joining of existing businesses is generally referred to as a "consolidation" or a "merger". There are other situations when the isolation of business operations, assets, or liabilities is needed. These are generally

referred to as "spin-offs, sales, or divestitures". A change to another legal form of company such as, for example, a limited liability company, is referred to as a "transformation".

Whatever the justification may be for a corporate reorganization, it is typically a complex process that involves the interaction of the company's governing bodies; it will also typically have corporate governance implications for the rights of shareholders and creditors, as well as other stakeholders, such as employees.

A. General Overview

1. Types of Reorganization

Russian law envisages five different types of company reorganization.[43] Figure 1 describes the simplest cases of each type.

2. Voluntary and Mandatory Reorganization

A reorganization is generally voluntary. In specific circumstances, however, legislation may require a company to reorganize.[44] Such reorganization can take the form of a split-up or divestiture, and is carried out pursuant to the decision of an authorized state body or court ruling.[45] For example, the Ministry of Antimonopoly Policy and Entrepreneurship Support (MAP) can force the split-up or divestiture of companies if they:[46]

- Have a dominant market position; or
- Have committed two or more violations of antimonopoly legislation.

Companies may also be forced to restructure themselves in the context of bankruptcy proceedings. This chapter refers to reorganizations in the

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[43] Civil Code (CC), Article 57, Clause 1; Law on Joint Stock Companies (LJSC), Article 15, Clause 2.

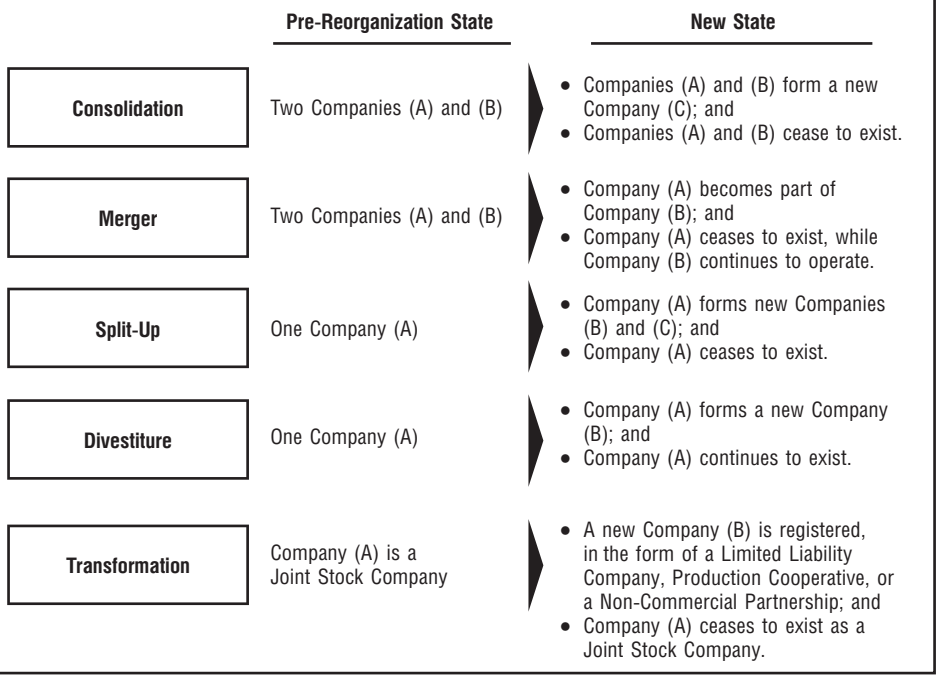
[44] CC, Article 57, Clause 2; LJSC, Article 15, Clause 1.

[45] CC, Article 57, Clause 2.

[46] Law on Competition and Restricting the Monopoly Activities on the Commodities Markets (Antimonopoly Law), Article 19.

broader sense and focuses only on large-scale voluntary reorganization of companies.

Figure 1: Types of Reorganization According to Russian Legislation



Source: IFC, March 2004

B. Shareholder Protection During a Reorganization

Reorganization is a significant event in the life of a company with potentially far-ranging implications for shareholders. Legislation provides rules that guarantee shareholders access to information about the reorganization, participation in the decision-making process and, in certain circumstances, the right to exit from the company. Some requirements in case of reorganisation include:

- **Longer notification periods for the General Meeting of Shareholders (GMS):** Notice of the GMS must be given no later than 30 days in advance of the GMS, if the decision to reorganize is placed on the agenda.[47]
- **Longer access periods for information:** Information must be made available 30 days before the GMS.[48]
- **Additional information must be made available to shareholders.**[49]
- **Preferred shareholders have the right to vote on agenda items related to the reorganization.**[50]
- **A supermajority (3/4-majority) of votes is required for the approval of the reorganization.**[51]
- **Redemption rights:** Holders of voting shares can demand the redemption of all or part of their shares if they voted against the reorganization or did not participate in the voting during the GMS.[52]
- **The right to receive the same type of shares in cases of split-up or divestiture:** Shareholders of a company being reorganized either through split-up or divestiture who did not vote on the decision or voted against it are entitled to receive a proportional number of shares in the newly established company(ies) granting them the same rights as before.[53]

C. Creditor Protection During a Reorganization

Reorganizations may also have important implications for creditors. Changes may be made to the company's assets and/or liabilities that could have an impact on the degree of risk affecting the repayment of debt, or on the terms of the debt agreements themselves. Thus, legislation guarantees the following rights to creditors during a reorganization:[54]

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47 LJSC, Article 52, Clause 1.

48 LJSC, Article 52, Clause 3.

49 Federal Commission for the Securities Market (FCSM) Regulation No. 17/ps on Additional Requirements to the Procedure of Preparing, Calling, and Conducting the General Meeting of Shareholders (FCSM Regulation No. 17/ps), 31 May 2002, Section 3.5.

50 LJSC, Article 32, Clause 4.

51 LJSC, Article 49, Clause 4.

52 LJSC, Article 75, Clause 1.

53 LJSC, Article 18, Clause 3; Article 19, Clause 3.

54 It is also important to keep in mind that contractual agreements with creditors may provide additional guarantees that benefit lenders in the event of the company's reorganization.

a) Notification Requirement

The governing body of the company must notify creditors about the reorganization.[55] This must be done within 30 days of the day of:

- The decision on the reorganization if this involves a split-up or divestiture; or
- The decision on the reorganization adopted by the last company involved in the reorganization if it involves a consolidation or merger.

Further, the company must notify creditors by:

- Written notification; and
- Publication of the decision in the print media where information on the state registration of companies is published.

b) Options of Creditor Actions

Creditors have the right to request the termination or early performance of the company's obligations, as well as compensation for losses.[56] Creditors are granted 30 days from the notification day to file a written claim against the debtor.[57]

c) Rules on the Succession of Company Liabilities

Legislation guarantees that liabilities are assumed by the new entities resulting from reorganization. Thus:

- The transfer act and the divided balance sheet required for the reorganization must allocate the rights and obligations of the reorganized entity(ies) to the new entity(ies), thus ensuring legal succession.[58] If no such provision is made, the state registration authority must refuse the registration of the reorganization.[59]
- If the transfer act or the divided balance sheet makes it impossible to determine the precise legal successor of the reorganized company, all newly established companies will be jointly and severally liable for the debts of the defunct entity(ies).[60]

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[55] CC, Article 60, Clause 1; LJSC, Article 15, Clause 6.

[56] CC, Article 60, Clause 2.

[57] LJSC, Article 15, Clause 6.

[58] CC, Article 59, Clause 1.

[59] CC, Article 59, Clause 2.

[60] CC, Article 60, Clause 3; LJSC, Article 15, Clause 6.

D. Reorganization Procedures[61]

1. The Proposal for a Reorganization

The executive bodies of a company typically decide how to reorganize, based on the company's goals, and act to initiate and implement the reorganization. The initiation of the reorganization should be consistent with the company's overall strategy as developed and approved by the Supervisory Board and shareholders.

Best Practices: A corporate reorganization is a complex and resource intensive undertaking. Most reorganizations in fact destroy rather than create shareholders value. Some of the preparatory steps that management will thus want to carefully consider include:

- Conducting a full analysis of the commercial and legal (as well as social and political) implications of the reorganization. The analysis should include an assessment of the role of, and the impact upon, shareholders and other stakeholders during and after the reorganization;
- Negotiating the (preliminary) terms and conditions of the reorganization with the executive bodies of other companies participating in the reorganization;
- Preparing documents that will enable the Supervisory Board and the shareholders to make an informed decision on the reorganization; and
- Preparing drafts of the main documents required by the Company Law for the reorganization. These documents are then submitted to the Supervisory Board and the GMS for approval (as well as regulatory bodies where applicable).

2. The Preliminary Approval

A preliminary approval of the Supervisory Board is usually required for a reorganization. The Supervisory Board should consider whether the proposed reorganization is in the best interests of the company and its shareholders. It will

[61] This section summarizes procedural steps common to all types of reorganization. The specific aspects of different types of reorganizations are discussed in this Chapter's Sections E through I.

also need to consider other issues, such as the fate of the reorganizing company's employees. The Supervisory Board must then submit a proposal on reorganizing the company to the GMS for shareholder approval.[62]

Best Practices: The decision to submit a reorganization for approval to the GMS should only be made after the Supervisory Board has concluded that the reorganization is necessary, and after determining that the negotiated terms are acceptable to the company. The Supervisory Board must be provided with all information necessary to make an informed decision. In addition to the draft documents required for the reorganization, the Supervisory Board should be provided with:[63]

- Annual reports and balance sheets for the last three reporting years of all companies participating in the reorganization in the case of a consolidation or merger;
- Quarterly reports compiled no later than six months prior to the date of the GMS which will consider the issue of reorganization, if more than six months have passed since the end of the reporting year; and
- The rationale for the reorganization.

In addition, the Supervisory Board should participate actively in finalizing the terms of the company's reorganization.[64] The Supervisory Board may be involved in the reorganization in a number of ways:

- Individual directors may participate in negotiations conducted by executive bodies; and
- A special, or *ad hoc* Supervisory Board committee, task force, or working group can work with the executive bodies before, during, and/or after the negotiations regarding the reorganization.

Reorganization is of such importance to a company that close oversight by the Supervisory Board during the final stages of the negotiation process is indispensable.

The Supervisory Board should approve the final drafts of the documents by a simple majority vote, unless the charter or by-laws require a supermajority.[65]

[62] LJSC, Article 16, Clause 2; Article 49, Clause 3.

[63] FCSM's Code of Corporate Conduct (FCSM Code), Chapter 6, Section 3.1.2.

[64] FCSM Code, Chapter 6, Section 3.1.

[65] LJSC, Article 68, Clause 3.

Best Practices: Supervisory Board members should be physically present at the Board meeting to recommend the approval of the reorganization by the GMS.[66] In addition, a higher quorum of $^2/_3$ of all directors is recommended.[67]

The Supervisory Board should express its position (with minority dissenting views clearly appended to any Board opinion that is not unanimous) regarding the merits and disadvantages of the reorganization along with the other documents that are submitted to the GMS.[68]

3. Approval

a) Preparing for the General Meeting of Shareholders

The preparation for the GMS, which will either approve or reject the corporate reorganization, should not be a last-minute exercise. First, there is a longer legally stipulated notification period (30 instead of 20 days); furthermore, there are also legally-mandated additional disclosure requirements.[69]

A detailed list of information that must be made available to shareholders is set out in the Company Law and securities legislation; additional disclosure requirements may be mandated by the company's charter.[70]

Best Practices: The company's charter should define the materials to be provided to shareholders, including the:[71]

- Rationale for the reorganization;
- Annual reports and annual balance sheets for the last three reporting years of all organizations participating in the reorganization;
- Conclusion of a professional securities markets expert;

[66] FCSM Code, Chapter 3, Section 4.4.

[67] FCSM Code, Chapter 3, Section 4.15.

[68] FCSM Code, Chapter 6, Section 3.1.1.

[69] LJSC, Article 52, Clause 1 and 3.

[70] LJSC, Article 52.

[71] FCSM Code, Chapter 2, Section 1.3.1; Chapter 7, Section 3.2.1; FCSM Regulation No. 17/ps, Section 3.5.

- Quarterly reports if more than six months have passed since the end of the last reporting year; and
- Any additional information that might be relevant in influencing the decision to approve a reorganization.

Another aspect of GMS preparation relates to the agenda. Voting on the reorganization may involve adopting a number of separate but related resolutions (e.g., on the terms and conditions of the reorganization, on the conversion of shares, or on the election of new governing bodies).

Best Practices: For this reason it is recommended that companies group together, or combine, resolutions on related issues.[72]

b) Conducting the GMS

The resolution on reorganization must be approved by a 3/4-majority vote of shareholders participating in the GMS.[73] Both common and preferred shares are allowed to vote on the reorganization of a company.[74]

4. Transactions with Shares During a Reorganization

Different transactions with shares, namely retiring, placing, converting, distributing, or acquiring shares during the reorganization process are regulated by the Company Law, securities legislation, and the terms of the reorganization agreement.[75] The processes and methods of placing new shares are specified by the Company Law and securities legislation for each type of reorganization.

Best Practices: It is good practice for an Independent Appraiser to determine the conversion ratio of shares in order to ensure a fair transaction.[76]

[72] FCSM Code, Chapter 2, Section 1.4.3.

[73] LJSC, Article 49, Clause 4.

[74] LJSC, Article 32, Clause 4.

[75] LJSC, Article 37, Clause 2.

[76] FCSM Code, Chapter 6, Section 3.2.

This appraisal should be communicated to the executive bodies, Supervisory Board and shareholders on a timely basis. Confidentiality restrictions should be limited in number and scope to only those that are strictly necessary in the legitimate business interests of the parties involved.

5. State Registration

The state registration of a reorganization is mandatory. Table 1 depicts the different registrations mandated, depending on the type of reorganization.

Table 1: Reorganization Registration

	Charter Amendments	Striking the Company Off the Register	Registration of Each New Company
Consolidation		✓	✓
Merger	✓	✓	
Split-up		✓	✓
Divestiture	✓		✓
Transformation		✓	✓

➜ *For more information on how to amend the charter of the reorganizing company, see Part I, Chapter 3, Section A.*

a) Registering a New Legal Entity

When reorganization results in a new legal entity, it will need to be registered by the state registration authority at its location. When the new legal entity is located at a place different from that of the reorganized company, the registration requires the cooperation of different regional divisions of the state registration authority.[77]

The following documents need to be submitted to the registration authorities:[78]

[77] The procedure for this is provided by Regulation No. 440, the Government of the RF, 19 June 2002.

[78] Law on State Registration of Legal Entities, Article 14; LJSC, Article 15, Clause 6. Some of the documents are specifically mentioned in the CC, Article 59, Clause 2.

- A statement regarding each newly created company confirming that:
  - The founding documents of the newly created legal entity comply with legal requirements,
  - The information included in the founding documents and the statement is true,
  - The transfer act or the divided balance sheet includes provisions regarding the legal succession of all obligations with respect to all creditors,
  - All creditors of the reorganized company have been notified in writing about the reorganization, and
  - The reorganization has been approved by the appropriate state and/or municipal authorities if legally required;
- The founding documents of the newly established entity;
- The reorganization agreement and decision to reorganize;
- The transfer act or the divided balance sheet; and
- Proof of payment of the registration fee.

b) Striking the Reorganized Companies from the Register

The state registration authority makes a record that the reorganized companies cease to exist. It then strikes the reorganized companies from the register of commercial legal entities after receiving information from the registration division registering the newly established legal entities.[79]

E. Consolidations

A consolidation is the combination of separate companies into a single one. It differs from a merger in that a new entity is created.[80] The newly created company assumes all rights and obligations of the companies participating in the consolidation according to the transfer act.[81] Consolidations allow companies to:

- Achieve economies of scale or scope and operate more efficiently;
- Realize strategic benefits, such as entry into new markets in the case of cross-border consolidations;

[79] Law on State Registration of Legal Entities, Article 15, Clause 2.

[80] CC, Article 58, Clause 1; LJSC, Article 16, Clause 1.

[81] LJSC, Article 16, Clause 5.

- Increase the company's charter capital;
- Improve its capacity to borrow; and
- Raise revenues by the aggregation of sales, through increased market power and more efficient marketing efforts.

1. Documents and Decisions Required for a Consolidation

Each of the companies participating in a consolidation must adopt the documents and decisions as presented in Table 2.

Table 2: Documents Required for Consolidation

Document	Information Contained in the Document
Consolidation agreement	The consolidation agreement should include the terms and procedures necessary for implementing the consolidation, including:[82] • The procedure for converting the shares of each of the consolidating companies into the shares of the new company; • The conditions for conducting the joint GMS of the new company (e.g. voting procedures); and • Other terms and conditions, such as the date of the consolidation, allocation of costs, management (executive) functions, and the liability for breach of agreement.
Transfer act	The transfer act is the main document that deals with the succession of the company's obligations, including any contested obligations.[83] Certain documents should be attached to the transfer act.[84]

[82] LJSC, Article 16, Clauses 2 and 3; FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses, 18 June 2003, Section 8.4 also provides for other methods of converting shares of the reorganized companies into the shares of the new company which, however, do not apply to the consolidation of Joint Stock Companies (it applies to Limited Liability Companies, Production Cooperatives, or Non-commercial Partnerships).

[83] CC, Article 59, Clause 1; LJSC, Article 16, Clause 5.

[84] Ministry of Finance Order No. 44n, on the Approval of Methodological Instructions on Formation of Accounting Statements in the Process of Reorganization of Organizations, 20 May 2003, Annex, Section 4.

Table 2: Documents Required for Consolidation	
Document	**Information Contained in the Document**
Charter of the newly created company	➜ *For more on charter requirements, see Part I, Chapter 3, Section A, as well as the model company charter in Part VI, Annex 2.*
Decision on the reorganization	The decision adopted by the GMS of each consolidating company.[85]

2. Specific Aspects of the Decision-Making Procedure

a) Exemption from Provisions on Related Party Transactions

When one of the consolidating companies holds more than $^3/_4$ of voting shares of the other, then the legal provisions on related party transactions do not apply.[86]

➜ *For more information on related party transactions, see Part III, Chapter 12, Section C.*

b) Conducting a GMS of the New Company

A joint GMS of all consolidating companies shall be held after the decision of the companies to consolidate.[87]

Best Practices: The notice of the joint GMS should be given by each consolidating company in accordance with the procedures established for that company by legislation and its charter.[88]

The joint GMS adopts decisions on:

- Electing the governing bodies of the new company;[89] and
- Other issues related to the founding of the new company, such as adopting a new charter and by-laws.

[85] LJSC, Article 48, Clause 1, Section 2.

[86] LJSC, Article 81, Clause 2.

[87] LJSC, Article 16, Clause 3.

[88] FCSM Code, Chapter 6, Section 3.3.

[89] LJSC, Article 16, Clause 3. The Company Law does not describe the procedures for conducting the joint Supervisory Board meeting or joint GMS. It does, however, provide the possibility of specifying voting procedures in the consolidation agreement.

Best Practices: The GMS of the newly created entity should follow all of the regular voting procedures established by law, and its charter and by-laws.[90] In addition, the consolidation agreement should specify who will perform certain functions at the GMS, including its chairmanship. It is recommended to select individuals who perform these functions from the companies that are a party to the consolidation or from among outside persons who possess relevant special skills or experience. Finally, the agreement should specify individuals who will count the voting results.

3. Retiring Shares

Any shares that a consolidating company holds in another consolidating company, as well as any treasury shares, must be retired.[91]

➜ *For more on retiring treasury shares, see Part III, Chapter 9, Section C.1.*

4. Approval by the Competition Authorities

The MAP exercises two forms of control over consolidations: 1) notification; and 2) preliminary approval.[92]

a) Notification Requirement

Consolidating companies are obliged to notify the MAP within 45 days of state registration, if its assets exceed 100 thousand times the minimum monthly wage.[93]

If the resulting entity potentially restricts competition, the MAP may prescribe corrective actions.[94]

b) Preliminary Approval

For the consolidation of companies with assets of more than 200 thousand times the minimum monthly wage, preliminary approval of the MAP is required.[95]

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[90] FCSM Code, Chapter 6, Clause 3.4.

[91] LJSC, Article 16, Clause 4.

[92] This control is based on the general provisions of the CC, Article 57, Clause 3.

[93] Antimonopoly Law, Article 17, Clause 5.

[94] Antimonopoly Law, Article 17, Clause 6.

[95] Antimonopoly Law, Article 17, Clause 1.

To obtain the MAP's preliminary approval, consolidating companies must submit:[96]

- An application;
- The same documents that need to be submitted to the state registration authority;
- Information on the economic activities and production (or service) volumes of the company; and
- Other information as may be required by the MAP.[97]

The MAP must respond within 30 days of the written application (50 days with an extension).[98] The MAP may reject the application if:[99]

- The information submitted in the application is untrue; or
- The approval of the consolidation would restrict competition.

Even if competition could be restricted as a result of consolidation, the MAP may grant the approval if:[100]

- The applicant proves that negative effects will be offset by the positive effect of the consolidation; or
- The consolidating companies agree to carry out actions to safeguard competition.

The preliminary approval of the MAP is a pre-condition for state registration.[101]

5. State Registration

Companies are consolidated as of the date when state registration of the newly established company is completed,[102] and the reorganizing companies are stricken from the register.[103]

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[96] Antimonopoly Law, Article 17, Clause 2.

[97] This list of possible additional information was introduced by the MAP Order No. 276, 13 August 1999.

[98] Antimonopoly Law, Article 17, Clause 2.

[99] Antimonopoly Law, Article 17, Clause 3.

[100] Antimonopoly Law, Article 17, Clause 4.

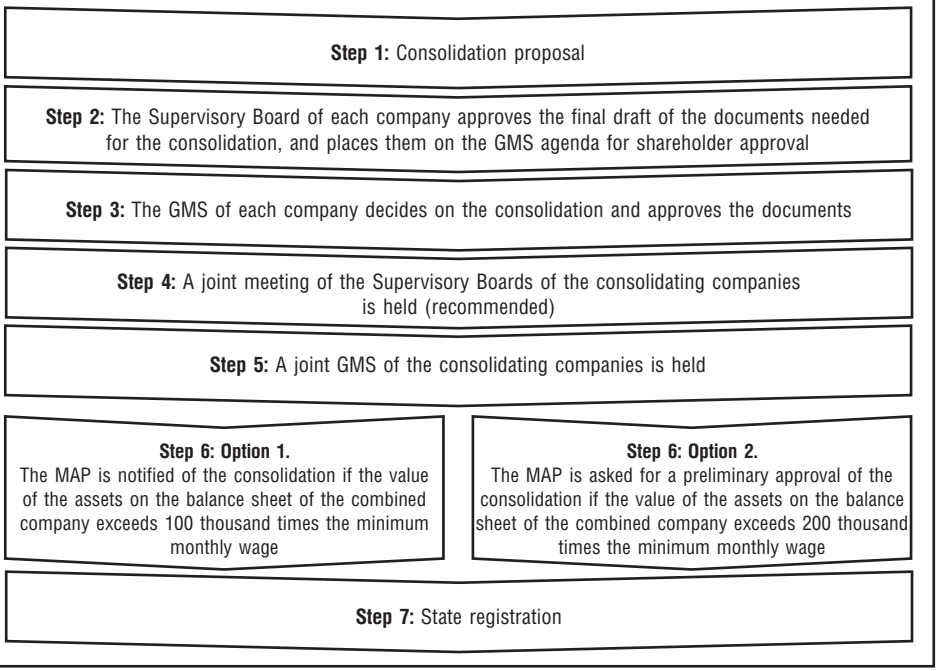
[101] Antimonopoly Law, Article 17, Clause 8.

[102] CC, Article 57, Clause 4.

[103] Law on State Registration of Legal Entities, Article 16, Clause 2.

Figure 2 summarizes the steps involved in a consolidation.

Figure 2: Steps for Consolidation



Source: IFC, March 2004

F. Mergers

A merger is the combination of two or more entities into one, through a purchase or a pooling of interests. A merger differs from a consolidation in that no new entity is created from a merger. Mergers involve the transfer of rights and obligations of one or more companies to another company. One company survives and the other(s) is (are) stricken from the register.[104] The surviving company assumes all of the rights and liabilities of the merging company(ies) according to the transfer act.[105]

[104] CC, Article 58, Clause 2; LJSC, Article 17, Clause 1.

[105] LJSC, Article 17, Clause 5.

The advantages of a merger are generally the same as for consolidations.

The steps required to carry out a merger closely resemble those of a consolidation. This section focuses on the differences.

1. Documents and Decisions Required for a Merger

In a merger, the following documents need to be submitted to the GMS for shareholder approval by each of the merging companies:[106]

- The merger agreement, which sets forth merger terms and conditions, the procedure for converting the shares of the merging companies into surviving company shares, the voting procedure for conducting the joint GMS of the surviving company, and other conditions;
- The transfer act; and
- The decision on reorganization through merger.

2. Specific Aspects of the Decision-Making Procedure

The joint GMS of the merging companies must make decisions on:[107]

- Amendments and additions to the charter of the surviving company; and
- Other issues related to the merger, e.g. the adoption of new by-laws.

The decision-making procedure for the joint GMS is specified in the merger agreement.

3. Retiring Shares

Any shares in the merging company that are owned by the surviving company, as well as any treasury shares, must be retired.[108]

[106] LJSC, Article 17, Clause 2.

[107] LJSC, Article 17, Clause 3.

[108] LJSC, Article 17, Clause 4.

4. State Registration

The merger is concluded with the registration of the merging company(ies) termination in the state register.[109]

Figure 2 above also refers to the steps involved in a merger.

G. Split-Ups

A split-up of companies is the transfer of all rights and obligations of one company to a number of newly created companies, and the termination of the original company.[110] The newly created companies assume all the rights and liabilities of the original company according to the divided balance sheet.[111] A split-up typically allows a company to:

- Rid itself of units (divisions) that are either underperforming, no longer important to the achievement of its strategic goals, or potentially worth more as separate units than as part of a whole;
- Grant legal personality to previously existing sub-divisions (e.g. in order for these to benefit from an Initial Public Offering (IPO);
- Comply with specific legal requirements in different jurisdictions in which the company now (or in the future) operates;
- Comply with the requirements of competition authorities or to reorganize in the context of bankruptcy proceedings; and
- Better resolve corporate conflicts with shareholders.

1. Documents and Decisions Required for a Split-Up

Figure 3 illustrates the decisions and documents needed to split a company:[112]

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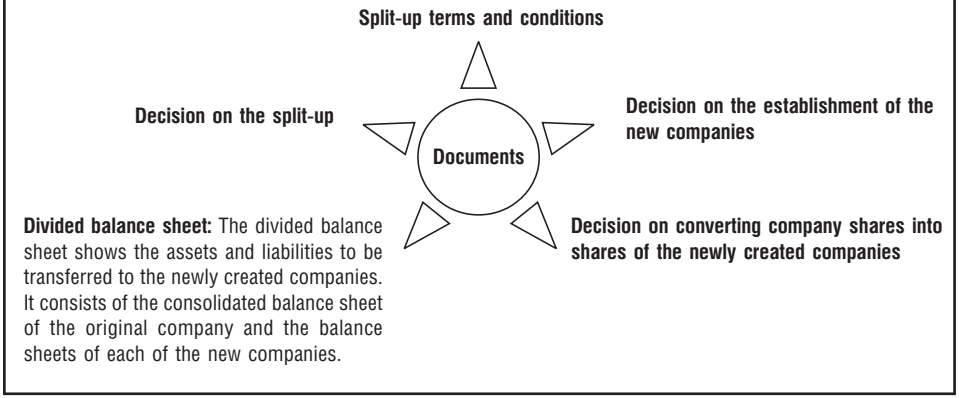
[109] Law on State Registration of Legal Entities, Article 16, Clause 5.

[110] CC, Article 58, Clause 3; LJSC, Article 18, Clause 1.

[111] LJSC, Article 18, Clause 4.

[112] LJSC, Article 18, Clauses 2 — 4; Ministry of Finance Order No. 44n on the Approval of Methodological Instructions on Formation of Accounting Statements in the Process of Reorganization of Organizations, 20 May 2003, Annex, Section 4.

Figure 3: Documents Required for a Split-Up



Source: IFC, March 2004

2. Specific Aspects of the Decision-Making Procedure

The GMS of the original company is followed by separate GMS of the new companies created by split-up, each of which must:[113]

- Adopt a new company charter;
- Form governing bodies; and
- Decide on other issues related to the governance of the new company, such as adopting new by-laws.

3. State Registration

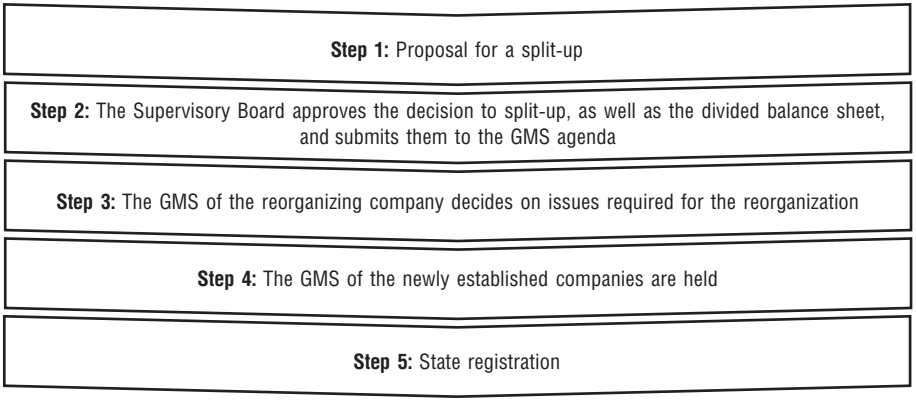
The split-up is legally recognized as of the state registration of the last of the newly established companies.[114]

Figure 4 summarizes steps involved in carrying out a split-up.

[113] LJSC, Article 18, Clause 3.

[114] Civil Code, Article 57, Clause 4; Law on State Registration of Legal Entities, Article 16, Clause 3.

Figure 4: Split-Up Procedures



Source: IFC, March 2004

H. Spin-Offs or Divestitures

Spin-offs or divestitures are the establishment of one (or more) new company(ies) with the transfer thereto of a portion of the rights and obligations of the company being reorganized without its termination.[115] Companies often choose to divest assets that are:

- Underperforming;
- Not part of the company's core business; or
- Worth more as separate entities than as part of the company.

A spin-off or divestiture may also be used to remedy mismatches between acquired companies and parent companies or to comply with the requirements of competition authorities. The newly created company(ies) assume(s) part of the assets and liabilities of the original company according to a divided balance sheet.[116] Unlike in a split-up, the original company continues to exist.[117]

The steps for carrying out a divestiture closely resemble those of a split-up, and, therefore, the following text focuses only on differences.

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[115] LJSC, Article 19, Clause 1.

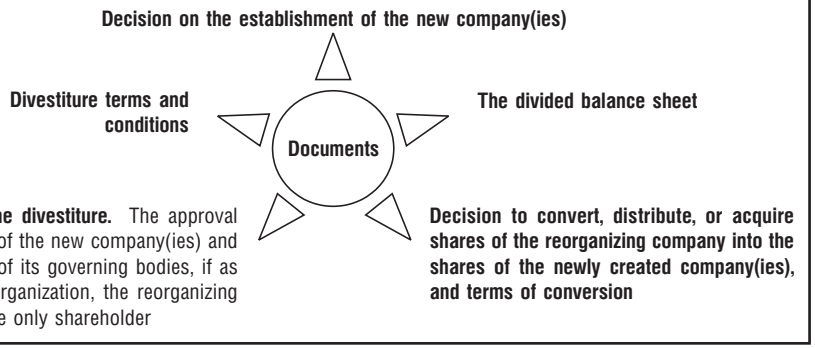
[116] LJSC, Article 19, Clause 4.

[117] CC, Article 58, Clause 4; LJSC, Article 19, Clause 1.

1. Documents and Decisions Required for a Divestiture

Figure 5 shows the documents and decisions required to implement a divestiture.[118]

Figure 5: Documents Required for a Divestiture



Source: IFC, March 2004

2. Specific Aspects of the Decision-Making Procedure

If the divesting company is not the sole shareholder in the spin-off, the GMS of each newly created company must:[119]

- Approve a new charter;
- Form governing bodies; and
- Decide on other issues, such as the adoption of new by-laws.

3. Converting, Distributing, or Acquiring Shares

The shares of the divesting company must be exchanged for the shares of the newly established company(ies). This can be done by:[120]

- Conversion;
- Distribution of the new company's shares to the shareholders of the divesting company without consideration; or
- Acquisition of these shares by the divesting company.

[118] LJSC, Article 19, Clause 2 and 3.

[119] LJSC, Article 19, Clause 3.

[120] LJSC, Article 19, Clause 2.

4. State Registration

The divestiture is completed when the state registration of the last of the divested companies is completed.[121]

Figure 4 above also refers to the steps involved in carrying out a spin-off or divestiture.

I. Transformations

A joint stock company may transform itself into another type of legal entity. Transformation of a company involves the transfer of all rights and obligations to a newly formed legal entity based on a transfer act, whereby the joint stock company is terminated.[122] The legal forms of entities include a:

- Limited liability Company (LLC);
- Production Co-operative; or
- Non-commercial Partnership.[123]

Company Practices in Russia: Transformations frequently occur when minority shareholders are bought out by the company's controlling shareholder(s) who wish(es) to take the company private. Indeed, many companies involuntarily became joint stock companies through privatization, regardless of their size and ability to carry the costs of this legal form. A transformation, thus, continues to be a useful tool to make a company's economic identity consistent with its legal identity.

There are important differences between joint stock companies on the one hand, and LLCs, production cooperatives, and non-commercial partnerships, on the other. Mostly, these relate to the rights of shareholders (members), relationships between the governing and other internal bodies, and disclosure requirements.

➜ *For a general discussion on the advantages (and disadvantages) of joint stock companies relative to LLCs, see Part I, Chapter 2, Section A.*

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[121] Law on State Registration of Legal Entities, Article 16, Clause 4.

[122] CC, Article 58, Clause 5; LJSC, Article 20, Clause 4.

[123] Law on Non-Commercial Organizations, Article 8.

1. Documents and Decisions Required for a Transformation

The GMS must adopt the following decisions for the company transformation:[124]

- Decision on the transformation;
- Decision on the terms and conditions of the transformation; and
- Decision on the conversion of shares into the stakes of members of a limited liability company or the contributions of the members of a production co-operative.

2. Decisions of Participants in the New Legal Entity

The participants in the new legal entity must decide on:[125]

- The founding documents of the new legal entity; and
- The formation of the governing bodies of the new legal entity.

These decisions need to conform with applicable legislation for the particular legal form to be adopted.

3. State Registration

The company transformation is completed as of the moment of the state registration of the newly established legal entity, whereupon the original company ceases to exist.[126]

[124] LJSC, Article 20, Clause 2.

[125] LJSC, Article 20, Clause 3.

[126] Law on the State Registration of Legal Persons, Article 16, Clause 1.