

RUSSIA LAW UPDATE

Revision to Russian Competition Law

MOSCOW
OCTOBER 20, 2006

I. OVERVIEW

On July 26, 2006, President Putin signed into law Federal Law No. 135-FZ On Protection of Competition (the “New Competition Law”). The New Competition Law supersedes the Law of RSFSR No. 948-I On Competition and Limitation of Monopolistic Activity on the Commodities Markets, dated March 22, 1991 (the “Old Competition Law”), and Federal Law No. 117-FZ On Protection of Competition on the Financial Services Market, dated June 23, 1999 (the “Old Financial Market Competition Law”), which applied to banks. The New Competition Law will become effective on October 26, 2006 so that any application filed with the Russian antimonopoly authorities (“FAS”) after that date will be considered under the new regime.¹

The New Competition Law regulates any agreement between persons (whether corporate or individual, foreign or domestic) if two conditions are met: (i) the agreement relates to assets located on the territory of the Russian Federation, to shares (or participation interests) of Russian legal entities or to rights with respect to Russian commercial legal entities; and (ii) the agreement results or may result in the limitation of competition in the Russian Federation.

The law sets forth specific provisions applicable to the banking sector, which are to be supplemented by regulations to be issued by the Russian government. This memorandum does not review the provisions particularly applicable to the banking sector.

In short, the New Competition Law: (a) expands the criteria for when filings are required; (b) in a significant practical development, creates an exemption for intra-group transactions; (c) in the context of share acquisitions, specifies that filings should be made

¹ FAS has informally advised that applications outstanding on October 26, 2006 will be considered under the Old Competition Law. Although the New Competition Law is silent on the issue, we would expect that approvals issued by FAS before October 26, 2006 would remain valid, even for transactions that closed after that date.

upon acquisition of more than 25%, 50% and 75% of voting shares in a joint stock company and of more than 33.33%, 50% and 66.67% of the equity (i.e., “participation interests”) in a limited liability company (as opposed to more than 20% and the need for FAS approval for a further acquisition of a single share above the FAS-approved level under the Old Competition Law); and (d) extends the timeframe for review of applications by FAS. The New Competition Law also establishes a definition for “concerted actions,” expands the definition of “dominant position,” and revises the definition of “group of persons.”

II. KEY DEVELOPMENTS

A. PRE-CLOSING APPROVAL OF MERGERS AND ACQUISITIONS

The New Competition Law requires **approval prior to closing** by FAS of the following actions:

- (i) Subject to the monetary thresholds stated below, the initial acquisition by a person and its group² of more than 25% of the voting shares of a joint stock

² A group of persons is defined under the New Competition Law as any of the following: (i) a legal entity and an individual or legal entity, if such individual or such legal entity has, by virtue of its ownership in that legal entity or by virtue of powers received from other persons, over 50% of the total number of votes/equity of that legal entity; (ii) all legal entities over which the same individual or legal entity has, by virtue of its ownership in such legal entities or by virtue of powers received from other persons, over 50% of the total number of votes/equity of those legal entities; (iii) a legal entity and an individual or legal entity, where such individual or legal entity discharges the powers of the sole executive body of that legal entity; (iv) all legal entities over which the same individual or legal entity discharges the powers of the sole executive body; (v) a legal entity and individual or legal entity, where such individual or such legal entity on the basis of the constitutive documents of that legal entity or an agreement executed with that legal entity has the right to give that legal entity mandatory orders; (vi) all legal entities in which the same individual or legal entity on the basis of the constitutive documents of those legal entities or agreements executed with those legal entities has the right to give those legal entities mandatory orders; (vii) a legal entity and individual or legal entity, if upon the nomination of such individual or such legal entity, the sole executive body of that legal entity was appointed or elected; (viii) all legal entities in which the sole executive body was appointed or elected upon the proposal of the same individual or legal entity; (ix) a legal entity and individual or legal entity, if upon the nomination of such individual or such legal entity, over 50% of the composition of the collective executive body or of the board of directors of that legal entity has been elected; (x) all legal entities in which over 50% of the composition of the collective executive body and/or of the board of directors has been elected upon the proposal of the same individual or legal entity; (xi) all legal entities in which over 50% of the composition of the collective executive body and/or of the board of directors comprise one and the same individuals; (xii) all persons who are part of the same “financial and

company (or more than 33.33% of participation interests in a limited liability company) and any subsequent increases of ownership past thresholds of more than 50% and more than 75% of the voting shares of a joint stock company (or more than 50% and 66.67% participation interests in a limited liability company); or

the acquisition by a person and its group of the fixed production and/or intangible assets of such entity if the balance-sheet value of such assets exceeds 20% of the total assets of such entity (as measured by the company's most recent balance sheet prepared under Russian accounting regulations, which, generally, is prepared on a non-consolidated basis); or

the acquisition by a person and its group of rights to determine the conditions of business activity of an entity or to exercise the powers of its executive body,

provided that, in each case, at least one of the following thresholds is met: (a) the aggregate asset value of the acquirer together with its group and target together with its group exceeds RUR3 billion (approximately US\$112 million³) – since this threshold applies to the acquirer and its group, this threshold will be crossed by any large multinational or financial investor; (b) the total annual revenues of the acquirer together with its group and the target together with its group for the preceding calendar year exceed RUR6 billion (approximately US\$223 million) and at the same time either the total assets of the target together with its group exceed RUR150 million (approximately US\$5.6 million) or the acquirer, target or any entity within the acquirer's group or target's group is included in FAS's Register of Entities Having a Market Share in Excess of 35% on a Particular Commodity Market (the "FAS Register").⁴

industrial group" (being a set of companies registered as such under Russian law); (xiii) an individual, his/her spouse, parents, children, brothers and sisters; and (xiv) where a person is a member of a group, then any person in another group that includes a person in the first group.

³ Currency conversions in this memorandum are based on the October 19, 2006 exchange rate (RUR 26.93 to US\$1).

⁴ A post-closing notification to FAS (within 45 days of closing) is required where the above thresholds are not met but where (a) the aggregate asset value or total annual revenues of the acquirer together with its group and target together with its group for the preceding calendar year exceeds RUR200 million (approximately US\$7.5 million) and

- (ii) The merger and consolidation of entities, *provided* at least one of the following conditions is met: (a) the aggregate asset value of such entities and their groups exceeds RUR3 billion (approximately US\$112 million); (b) the total annual revenues of such entities and their groups for the preceding calendar year exceed RUR6 billion (approximately US\$223 million); or (c) one of the entities (or any entity within its group) is included in the FAS Register;⁵
- (iii) The foundation of an entity, *provided* at least one of the following conditions is met: (a) the charter capital of the entity is paid with the shares (or participation interests) and/or assets with the result that the newly-founded entity acquires rights in respect of such shares (or participation interests) or assets as specified in item (i) above, *provided further* that the aggregate value of assets held by the founders (and their respective groups) and by the entities (and their respective groups) whose shares (or participation interests) and/or assets are contributed to the charter capital of the newly-founded entity exceeds RUR3 billion (approximately US\$112 million); (b) total annual revenues of the founders (and their respective group) and the entities (and their respective groups) whose shares (or participation interests) and/or assets are contributed to the charter capital of the newly-founded entity for the preceding calendar year exceed RUR6 billion (approximately US\$223 million); or (c) the entity whose shares (or participation interests) and/or assets are contributed to the charter capital of the newly-founded entity is included in the FAS Register.

B. APPLICATION REVIEW TERMS

The New Competition Law establishes a 30-day review period for pre-closing approval of transactions. The review period may be extended for a further two months if FAS believes the prospective transaction might restrict competition with respect to a particular commodity market. FAS has significant discretion in deciding what comprises a particular commodity market, both in terms of the geographical boundaries of the

either (i) the total assets of the target together with its group exceed RUR30 million (approximately U.S.\$1.1 million) or (ii) the acquirer, target or any entity within the acquirer's group or target's group is included in the FAS Register.

⁵ A post-closing notification to FAS (within 45 days of closing) is required where the above thresholds are not met but where the aggregate asset value or total annual revenues of the relevant entities for the preceding calendar year exceed RUR200 million (approximately US\$7.5 million).

relevant market and what products/services define a particular market. Where there is such an extended review, information about the transaction is to be posted on FAS's official web site. Any interested party may then provide FAS with information regarding the effect of the proposed transaction on a particular commodity market.

In connection with the establishment of a new entity or the merger or consolidation of entities, the review period may be further extended, if FAS believes the prospective transaction might restrict competition, and FAS considers that certain conditions should be satisfied before approving the application.⁶ FAS is to prescribe the time period for the fulfillment of such conditions, which, however, may not be more than nine months. FAS is to issue its approval within 30 days after it is provided with documents confirming the fulfillment of the prescribed conditions during the period prescribed by FAS. If the conditions are not satisfied by the deadline established by FAS, FAS may refuse approval.

Separately, FAS may make any approval subject to ongoing "behavioral conditions" – e.g., that a particular enterprise continues to supply certain customers.

As is the case under current practice, the approval of a prospective transaction by FAS remains in effect for one year after its date of issuance. If closing of the approved transaction does not occur by such time, new approval would be required.

C. INTRA-GROUP TRANSACTIONS

Under the Old Competition Law, intra-group transactions are not distinguished from third-party transactions with the result that for many corporate reorganizations FAS pre-closing approval is required, even through the ultimate parent company stays the same.

Under the New Competition Law, an intra-group merger or acquisition can be carried out without pre-closing approval from FAS, *provided* the following conditions are met: (a) at least one month prior to the transaction completion date, the list of persons comprising the corporate group is submitted to FAS⁷ – this information is to be posted by FAS on its official web site; (b) the composition of the group does not change

⁶ Such conditions may include: (i) a requirement to supply certain products or information (including intellectual property) to certain customers/third parties; (ii) a requirement to sell certain assets or property to an independent party; and (iii) a requirement regarding the composition of the relevant group of persons.

⁷ The disclosure of the corporate group has to be prepared in accordance with a form promulgated by FAS. As of October 19, such form has not been promulgated.

prior to the closing of the inter-group transaction; and (c) subsequent notification is made to FAS of the transaction (within 45 days of the transaction completion date).

D. DOMINANT POSITION

The New Competition Law sets forth a combination of qualitative and quantitative criteria to determine whether an entity together with its group or several unrelated entities (together with their respective groups) have a “dominant position” on a particular commodity market. Under the qualitative criteria, a “dominant position” arises if such entity(ies)/group(s), as the case may be, are able to (a) have a dominant influence on the general conditions of the circulation of goods on a particular commodity market; (b) remove other entities from such commodity market; or (c) impede another entity’s access to such commodity market. This broad qualitative criteria is combined with the following quantitative criteria to determine whether an entity has a “dominant position.”

- (i) An entity (together with its group) has a dominant position on a particular commodity market if: (a) the entity (together with its group) has a market share on a particular commodity market in excess of 50%, unless it is specifically established that the entity (together with its group) does not have a dominant position; or (b) the entity has a market share on a particular commodity market in excess of 35% (but less than 50%), and it is specifically established by FAS that the entity (together with its group) has a dominant position based on the following factors: (i) the share of the entity on the relevant commodity market is permanent or is subject to insignificant changes as compared to competitors’ shares on the same commodity market; (ii) there is a low likelihood for new competitors to enter the relevant commodity market; or (iii) other criteria characterizing the commodity market that FAS deems relevant.
- (ii) Several unrelated entities (always considered together with their respective groups) have a dominant position if each of the following three criteria are satisfied: (a) the aggregate share of not more than the leading three entities exceeds 50% or of not more than the leading five entities exceeds 70% of a particular commodity market, but this provision does not apply if the share of one of the entities is less than 8%; and (b) during a significant period of time (not less than one year or, if shorter, the life of the particular commodity market), the respective shares of such entities remain constant or are subject to insignificant changes, and entry into the particular commodity market is difficult; and (c) the relevant commodity goods cannot be easily substituted and demand for the commodity is price-inelastic.

- (iii) Any “natural monopoly” of a particular commodity has a dominant position on the relevant commodity market (“natural monopolies” are created by specific legislation and include the gas and electricity markets).

Under the New Competition Law, an entity with a dominant position on a particular commodity market shall not engage the following array of activities: (a) price fixing; (b) the withdrawal of goods from circulation resulting in price increases; (c) dictating terms unfavorable to a counterparty or irrelevant to the subject-matter of the agreement; (d) the reduction or termination of production of goods, for reasons not economic or technological in nature, where demand for the goods exists, so long as the goods can be produced at a profit; (e) the refusal to enter into an agreement with particular buyers or customers, where the goods can be produced or supplied; (f) the fixing of disparate prices (tariffs) for the same goods, for reasons not economic or technological in nature; (g) the creation of discriminatory conditions; (h) the creation of barriers to enter or exit a particular commodity market; and (i) the carrying out of any other activities that result or may result in the prevention, limitation or elimination of competition and/or the infringement of interests of other persons.

E. CONCERTED ACTIONS AND AGREEMENTS LIMITING COMPETITION

The New Competition Law newly defines “concerted actions” to be actions taken by more than one entity with the prior knowledge of the other entity(-ies), the result of which promotes the interests of such entities, where such action has been instigated by one of the entities.

The New Competition Law generally prohibits⁸ any concerted action or agreement of entities on a commodity market that results or may in the future result in any of the following: (a) the fixing or maintaining of prices (tariffs), discounts, extra charges or margins; (b) the coordination of bids for auctions or tenders; (c) the division of a commodity market by territory, volume of sales or purchases, types of goods or range of customers or suppliers; (d) the refusal to enter into an agreement with certain buyers (customers) for reasons not economic or technological in nature; (e) the dictating of terms unfavorable to a counterparty or irrelevant to the subject-matter of the agreement; (f) the fixing of disparate prices (tariffs) for the same goods, for reasons not economic or technological in nature; (g) the reduction or termination of production of certain goods, where demand for the goods exists so long as the goods can be produced at a profit; (h) the creation of barriers to enter or exit a particular commodity market; (i)

⁸ Under Article 13 of the New Competition Law, the government may permit concerted action if such would have social or market benefits.

the establishment by market participants of requirements for participation in any professional or other union if such requirements adversely affect competition; and (j) the restriction of competition through other means.

The New Competition Law also prohibits “coordination” by a third party, i.e., the coordination of entities’ actions by an unrelated third party of business activity if such “coordination” results or may result in consequences specified in items (a)-(i) above (we note that item (j) above was not cross-referenced in the New Competition Law).

The New Competition Law does expressly permit a “vertical agreement” – an agreement between a customer/potential customer and a producer/potential producer that do not compete with each other – if it relates to a commercial concession or as long as each party does not control more than 20% of any commodity market.

F. LIABILITY FOR THE VIOLATION OF ANTIMONOPOLY LEGISLATION

The New Competition Law does not address the liability for the violation of antimonopoly legislation. Currently, such liability is generally governed by the Code on Administrative Offenses of Russia (the “Code”). However, FAS has recently proposed amendments to the Code that, if adopted, will significantly change the existing system of liability for violations of antimonopoly legislation so that fines could be expressed as a percentage of revenues.

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Any questions regarding the application of the New Competition Law may be discussed with Scott Senecal, Vladimir Frolov or Olga Jourek in the Moscow Office (tel. +7 495 258 5006).

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