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CREATION OF HOLDING STRUCTURES AT MERGE: THE PERMISSION OF „IMPASSES“

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Abstract:
Legal designing of corporate structure of any merge is extremely volume and multiplane work at which realization it is necessary to take into consideration a huge layer commercial, legal, tax and money matters. To cover all these questions or even their big part within the limits of one article it is simply impossible, and consequently the author would like to concentrate on some problem aspects of the permission of impasses at creation of holdings.

Key words:
Holding structure; impasses; merge designing; escrow agent.

Merge designing

First of all it is necessary to consider approaches used in modern business practice to creation of corporate structure of merge which in most cases are based on three basic concepts:

1. Creation of a holding company on the basis of one of the merge companies-participants

The given concept can be realised two ways:

Reorganization by joining to one of the companies of other companies – participants of association. As a result of such reorganization there is a headquarters plant, and the attached companies become its branches. In turn, shareholders of the attached companies become shareholders of headquarters plant;

The conversion of shares, manufactured by one of the companies – participants of merge, on the share of other companies – participants of merge in which result the issuing company of these additional shares becomes a holding company, and other companies become its branches. Shareholders of these companies become shareholders of a holding company.

2. Reorganization of the companies-participants by their merge (in sense of item 57 of the civil code of the Russian Federation)

As a result of such reorganization there are the new company shareholders of the companies – participants of this process become which shareholders.

3. Holding company Creation

The holding company forms, as a rule, by entering into its authorized capital stock of shares of the companies – participants of merge therefore shareholders of these companies become shareholders of a holding company, and the companies – participants of merge – by its branches.

It is almost impossible to characterise any of the above-named variants of creation of holding structure as most or the least comprehensible to the purposes of realisation of friendly merge in Russia.

Each of these variants has the defects, no less than dignities.

For example, by reorganization of the companies by their merge and creation on their basis of one company (the Variant 2), obviously, there are following questions: (i) absence of independent responsibility before creditors of each enterprise which are the constituent of one company (unlike the Variant 1б and the Variant 3 when branches bear independent responsibility under the obligations); (ii) necessity of the decision of uneasy questions where to register a merged company, in what volumes to pay taxes in the location of head office and in what volumes to pay taxes in places of realisation of activity by its industrial branches; (iii) necessity of renewal of all licenses and certificates on the property right to the real estate etc.

However, on the other hand, we see that the similar structure gives the chance not to muse more of methods of formation of the centre of profit with the help of dividend stream which is interfaced to payment 9 %-s' taxes, it is not necessary "to puzzle" more, will the problem arise or not, from item 40 of the Tax code as a result of transfer pricing application, accordingly does not arise also a problem of the "intragroup" VAT.

Thus, for decision-making concerning legal architecture of merge it is necessary to conduct a careful and comprehensive estimation of branch and other risks and negative sides of each of variants with allowance for specificity of concrete industrial production or other commercial activity, in view of all aspects of activity of the companies – participants of merge, including and creation of a new control system by incorporated business.

So, in telecommunication branch the tendency of creation of the uniform companies which are carrying out the local activity through regional branches, i.e., in essence, a Variant use 1a is observed. It is possible to assume that shareholders and managers of such companies had been carried out the detailed analysis and an estimation of risks, and also economic and others business-benefits which they expect to receive from such structurization of their companies. Apparently, these reasons prevailed over loss risks of separate responsibility since for this branch the risk of recovery of claims from outside users a telecommunication service is not critical.

Whether it is possible to start with the same reasons if it is a question of merge structurization in oil and gas sector or in metallurgical branch? In this case at least it is necessary to take into consideration ecological and industrial hazards (failures), administrative risks (fulfillment of conditions of licenses), number taken on the enterprises (labor disputes, compensation of a damage to health as a result of industrial failures) etc. Also it is not excluded that results of the analysis of all aspects of activity of the concrete enterprises working in given branch with allowance for of its specificity, will lead to a conclusion that a question independent (or limited for shareholders) responsibility of a production company will prevail over economic reasons.

In some cases, when there is a merge of two groups which enterprises are taken in various areas of commercial activity, the combined approaches to creation of a legal design of association are applied, i.e. some enterprises merge and-or join, but concerning top of this

design, i.e. in a point where legal interests are fixed and advanced, the rights and obligations of holders – participants of association, creation of a new holding company is applied.

Nevertheless, despite impossibility to give absolutely correct recommendations concerning legal architecture of merge, the author would like to notice that, by present experience, the design based on creation of a holding company in the top point of corporate structure to which possesses shares industrial or commercial enterprises, is more universal and statistically more often applied by businessmen.

The author believes that it is connected first of all by that in the order a holding company much easier to adjust such questions of mutual relations of proprietors as a share of sharing of each partner in the capital of group and its profits, questions of a business management and the decision-making regulations, and also to establish "divorce" conditions if that takes place.

That fact is important also that at use of the concept of an independent holding company slightly easier from the legal standpoint to structure bargains of sale of a part of assets and acquisition of new assets.

Besides, for lawyers this concept is the most attractive also because it does not infringe upon one of "golden rules" of our trade: securities (first of all shares), the real estate and intellectual property should not be subject to any commercial risks. Unique external function of a holding company is to keep, operate and dispose of shares of affiliated companies. She should not conclude any commercial contracts not to infringe upon the given rule.

From each deadlock there are only four exits.

Besides mentioned above external function, the holding company executes as well internal function which, as a rule, is realised in the agreement of shareholders and in company founding documents. In these documents the developed regulation of relations of holders of incorporated business contains. Thereupon, I believe, it is necessary to stay on one of most complicated questions arising in a legal practice of creation of such regulation, – the permission so-called« Impasses ». This problem arises when holders of the merging enterprises as one their main rules of the further activity advance a principle of unanimous decision-making on all vital issues of management of incorporated business or when shareholders participate in the holding company capital on an equal footing and each of them votes 50 % of shares of this company. Accordingly, if one of shareholders votes for any decision, and other – against, the decision is not accepted, and in many cases it can lead to stay of work of the enterprise and drawing of a serious damage to business. As consequence, it frequently leads to the long and destructive conflict between shareholders in which result, as a rule, does not happen won since both parties sustain heavy material losses.

To avoid similar negative consequences of occurrence of an impasse, it is necessary already at the very beginning of work on the agreement of shareholders and other corporate documents of a holding company to create detailed regulation concerning rules of the permission of impasses which as it is represented, should consist of following mainframes.

First of all, the detailed, pragmatically verified and real regulations should be registered in these documents for performance so-called« Treatments of impasses », i.e. should be provided the mechanisms allowing the parties in reasonable term to agree, without leading up a disagreement to a situation of the real and insuperable conflict. These procedures should be

obligatory for the parties, and infringement of one of the parties of such rules should be advanced as default to it of the obligations with corresponding consequences in the form of sanctions. So, in particular, such regulations can provide realisation of several meetings of the partners devoted to consideration of a matter in dispute, during the certain period of time which results should be protocoled; attraction for an estimation of arguments of the parties of external neutral advisers; entering into the agreement of partners of positions about additional responsibility of one of them for consequences of acceptance of its offer against which other partner etc. acts.

In the mentioned documents the positions interfering artificial creation of impasses when one of the parties for those or other reasons at a given time considers it for itself favorable should contain also, but the damage causes similar actions to the partner and business.

In corporate documents of a holding company positions or regulations of a crisis business management according to which management of incorporated structure could act on the authority should contain necessarily, but is strict within the limits of corresponding instructions of regulations during time necessary for shareholders for the permission of an impasse. These instructions should contain the detailed description of the competence of management concerning an operative daily management of activity of incorporated structure (it is not excluded that it can be slightly wider, than in regular courses of business) and responsibility for their inadequate performance. The similar regulations are actual for those structures in which co-owners participate not only in acceptance of strategic decisions, but also in approval of certain operative questions and when disagreements have arisen concerning strategic questions. The main purpose of regulations of crisis management – to ensure normal functioning of the company in the impasse permission.

Further, holding company documents should contain rules which will be applied in that case when attempts to find the mutually acceptable decision have not given positive results. In this situation partners really have only two scenarios of the further succession of events:

1) An exchange of offers on the repayment/sale of shares in which result one of partners leaves the company, having received for the shares real market (or even above) cost. It a most often maintained method of the permission of an impasse;

2) Division of business and return to each of partners of originally made installment in the form of shares of the companies – participants of association. Such method is used extremely seldom.

The first method, in essence, is reduced to an exchange of offers on buying shares/sale, and, as a rule, for performance by the parties that offer which has the greatest term of money is obligatory. Such method of the permission of impasses on a professional legal slang is called «the Texas shooting» and is applied there and then, where and when one of partners is voted for by decision-making and other partner categorically against such decision. In it its main difference from so-called on the same legal slang of "Russian roulette» which, as a rule, is contractual position of the agreement of shareholders/participants according to which one of partners can direct at any time to other partner (a) the offer on the repayment/sale of shares. To transfer all possible variants of regulation which exist in world legal practice, it is simply impossible (some of them can take to 15 pages of the text). The main task which faces to lawyers by preparation of these rules, – to exclude possibility of occurrence of the obligation to purchase or sell the share for nothing or on an overcharge. It is reached as follows:

i. Introduction of the bottom restriction for an ask price. Thus is better to do it not in absolute figures, and in the form of the formula, for example: the price formula is based on indicator EBITDA or other criteria. This recommendation is based that it is impossible to assume at the moment of signing of documents of a holding company that will be with currencies and their rates in the future;

ii. The rule according to which the party which is proposing marriage with instructions of the price, can receive the counter offer with the same price is provided and will be obliged it to accept. Usually such regulation discourages to underestimate or overestimate the price of the first offer. The combination of these two rules is possible also.

As it was already marked, the second method of the permission of impasses meets in business practice very seldom. As a rule, partners in association muse of application of this method in the event that financial possibilities of one of them are non-comparable more than at another. The partner with smaller financial possibilities understands that at application of the first method of its share will be redeemed by other partner. However its priority is preservation in the property of originally introduced asset and consequently he insists on business division as a method of the permission of an impasse. The problem consists as well that for application of this method the availability at least following conditions is necessary:

- Consolidated assets should save the isolation as independent legal bodies, and their shares should belong to a holding company which does not attend to any other activity and has no other assets, except these shares and money resources;

- Daily commercial activity of these enterprises after association should not change towards dependence from each other;

- In case during association reorientation of the enterprises to the various markets, possibility of their return exit is planned for the markets on which they worked before association.

If these conditions are realistic, the engineering of the realisation of return of initially introduced assets is rather simple: the holding company is liquidated and distributes the property in the form of shares of the enterprises belonging to it between shareholders – the former partners in association or pays them dividends in the natural form, i.e. shares of these enterprises.

Having advanced with method of the permission of impasses, the lawyers preparing documents on merge, should deal with the following question: in what legal environment this or that method will work most effectively? Before analyzing this question, it is necessary to make one introduction remark. Impasse occurrence is in most cases result of the conflict between partners to which the usual scale of feelings and actions, and, first of all, the increased level of mistrust accompanies. With allowance for it one of the major problems of lawyers is creation of the mechanisms allowing in the greatest possible automatic mode at the minimum dependence on acts or omissions of partners to carry out procedure of the permission of an impasse.

Let's consider possibilities of the Russian right at application of the first method of the permission of an impasse. As it is represented, the unique legal tool which could be used for this purpose, the contract of purchase of shares under a condition where as a condition of the introduction of the agreement in force the fact of occurrence of an impasse serves is.

I believe that thereupon it is necessary to notice first of all that in Russia there is no judiciary practice of consideration of the disputes following from similar contracts of purchase of shares which are used for the repayment of shares as a method of the permission of an impasse. Besides, it is difficult to imagine consideration in our court of the similar agreement in which the status of the seller and the buyer, and also a price of transaction should be advanced according to the procedures established by the agreement of shareholders.

But the most important thing consists that the contract of purchase of shares under a condition does not create the mechanism of automatic performance by the parties of the obligations on it without dependence from their acts or omissions. Differently, after realisation of procedure of an exchange by offers and definition of the buyer, the seller and the price of the sold block of shares the buyer acquires a right requests of delivery to it of shares, and it has an obligation to pay this acquisition, in turn, the seller is obliged to transfer stock to the buyer and to accept money in their payment, i.e. each of the parties should make certain actions in pursuance the contractual obligations. It is obvious that in the conditions of the potential conflict between shareholders such design is not stably guaranteeing observance of their interests.

The analysis of possibilities of application of the second method of the permission of impasses by liquidation of a holding company and property distribution between shareholders or dividend payouts also leads to a conclusion that a main purpose of this regulation – to carry out procedure of division of business without material effect on it of conflicting parties – is not reached, as both in case of liquidation, and in case of dividend payout from shareholders acceptance of corresponding corporate decisions is required. Besides, liquidation is connected, as a rule, with enough long procedure of complex tax check, and dividend payout – with necessity of payment of corresponding taxes.

Escrow agent

Result of the stated analysis is the conclusion that for automatism achievement at realization of the actions directed on the permission of an impasse, it is necessary for shareholders to have contract relations with a certain third person whom, operating from their name and according to regulations in advance adjusted by shareholders, will have authorities to dispose of corresponding blocks of shares, to receive money resources for sale of one of packages and accordingly to lend stock to the buyer, and money – to the seller, thereby creating both parties of a performance bond of mutual obligations.

Unfortunately, the Russian legislation does not allow neither to nominee holders, nor confidential managing directors, attorneys to act in such role and to the full to ensure necessary automatism in realisation stated above procedures of the permission of impasses.

It, apparently, the steady tendency of the Russian business practice on creation of holding companies in the countries of the Anglo-Saxon legal system where the institute escrow agent has a stable legislative basis and long-term practice of application for the permission of similar situations also speaks. If to carry out the comparative analysis of legislations of such countries as Great Britain, the British Virgin Islands, Cyprus, Panama and the Bahamas, that,

in the author's opinion, Cyprus is the most preferable jurisdiction for creation of holding companies. Such conclusion is based first of all on the following:

1.Cyprus is a member of the European community, and the legislation of this

The countries it is completely adapted for requests of community and corresponds most to high standards;

2. Recent changes of the legislation of this country have created the best (in features from the point of view of the taxation) a mode for holding companies;

3. Cyprus practically has in full apprehended substantive provisions

Legislations of England, and English court cases are applied in to judiciary practice of this country;

4. Cyprus has old and stable relationships with Russia. The Cyprian banks, attorneys and auditors have a wide experience of work with the Russian business community and well understand our realities, and also the problems facing to the Russian business.

The legislation of Cyprus allows attorneys, the various structures rendering trust services, and to financial institutions to act in a role escrow agent which as the nominee holder of shares of a holding company can receive authorities from beneficiary holders of these shares to apply corresponding positions of corporate documents and the agreement of shareholders concerning the permission of impasses, namely – to transfer stock to the buyer under condition of receipt on it (escrow agent) the account of corresponding payment which will be readdressed to the seller of shares.

As a rule, escrow agent fixes the moment of occurrence of an impasse and begins realisation of the procedures of their permission ordered by corporate documents. For these purposes escrow agent it is nominated also as the director (or the secretary) a holding company, responsible for convocation of shareholder meeting and conducting corresponding protocols in which various items of the parties are fixed at voting by this or that question. It also is the person who is carrying out transfer to shareholders of offers directed by them one another concerning the repayment or stock trading. For guarantee of fulfillment by the buyer of the obligations on paying up of shares shareholders of a holding company transfer the stock as a deposit escrow agent. In case in law days payment for shares does not arrive to account escrow agent, it has the right to pay provided by corporate documents and the agreement of shareholders collection on the share of the buyer. The now in force legislation (including the Law on an exchange control and currency exchange regulation) does not contain any essential obstacles in Russia that the Russian residents, holding shares the Russian enterprises, have carried out an exchange of these shares for the shares manufactured newly founded for conducted them of merge of the Cyprian holding company.

I believe that in absence in Russia the developed special legislation regulating activity of holding companies, use of advantages of the Cyprian legislation presumes to decide to participants of merge not only those questions which were considered in the given article, but also many other questions of their mutual relations and management of incorporated business.

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