

# EFFECTIVE DEFENSE METHODS AGAINST HOSTILE TAKEOVERS AND RAIDERS IN RUSSIA

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## **1. Introduction**

The introduction part of the paper is organized as follows. First I will discuss background and motivation aspects of related area. Second, I will state main research questions that will be addressed in the paper. Third part of the introduction will be devoted to definitions used in the thesis. And last, fourth subsection of the introduction part will be devoted a structure of the thesis as a whole. Now, let us start with background and motivation aspects of the paper.

### **1.1. Background and Motivation**

There has been a great wave of M&A transactions taken place in Russia. The country is now becoming an important and noticeable international player in M&A field. The Russian M&A market has been growing rapidly, with a compound annual growth rate of 56% from 2002 to 2007. According to ReDeal Group and its “Mergers & Acquisitions in Russia, 2007” report the total value of the market reached \$120.7 billion in 2007, which is almost twice the figure for 2006. M&A transactions with Russian targets accounted for \$108.1 billion, while Russian acquisitions abroad were more than \$22.3 billion. Part of abovementioned trend was there due to economic attractiveness of Russian market for foreign investors. Therefore, many foreign companies were eager to enter the market in spite of still existing loopholes in corporate governance legislation and private property right. The latter ones compromise a set of potential challenges that every entity has to deal with in Russia on a daily basis.

The problem of corporate governance has become notably burning in Russia since the late '90s. In Russia, initially the interest in corporate governance objectively emerged only upon the completion of the mass privatization of 1992-94, even though some economic and legal experts had yet before recognized the significance of the long-term nature of the problem. The law “On joint-stock companies” (December 1995) formed an important legal landmark in this respect. However, it can be argued that the nature of the discussion on corporate governance, more precisely, on discrimination of outsiders' rights, became applied against the background and following the outcomes of the boom on the securities market of 1996-97.

The discussion on corporate governance was generated mostly by foreign portfolio investors, who found themselves yet unaccustomed to the standards of the Russian corporate culture.

The 1998 financial crisis has just contributed to the intensity of the discussion about a rise of a new wave of M&A transactions and new instruments for property redistribution. That happened primarily due to the strengthening of managers' property positions and emergence of new shareholders in the national companies who had acquired stock packages during the cheap over the post-crisis period. Above mentioned problems and weaknesses of corporate governance legislation seemed to encourage "creative" ways of using loopholes in corporate governance legislation to take over someone's property. Loopholes in corporate governance legislation and increasing trend of hostile takeovers stimulated initiatives in establishing legislation on mergers and acquisitions.

Further development of legislation on mergers and acquisitions reflects real processes on the corporate restructuring market. The Thirteenth Directive of the European Union (EU) on Takeover Bids<sup>1</sup> (henceforth—the Directive) came into force on May 20, 2006. Then on July 1, 2006, amendments were adopted to the Russian law "On Joint-Stock Companies" aimed primarily at regulating hostile takeovers. Both documents contain provisions concerning "equitable prices" and "squeeze-out and sellout procedures" pertaining to minority shareholders, "the right to an obligatory buyout offer," and so on. The Russian directive had been prepared in 2004, when a boom in hostile takeovers was beginning in Russia, forcing the government to work on amending the law "On Joint-Stock Companies."

The changes in EU corporate law turned out to be very relevant for Russian legislators. The paradox, however, is that the two laws adopted for the regulation of acquisitions pursued opposite goals. In Russia, according to Demidova (2007), the changes in legislation were designed to reduce the number of hostile takeovers to a minimum. Referring to "Hostile takeovers and Defenses Against them in Russia" a proposal was even tabled to incorporate liability for the hostile takeover of firms into the RF Criminal Code. In the EU, by contrast, the new Directive did everything possible to encourage the growth in hostile takeovers: restrictions are imposed on defensive measures and rules are introduced to ensure the neutrality of the board of directors with regard to the bidder company's acquisition of a controlling share. The observed difference in attitude towards the same phenomenon in Russia and in The EU might be explained by nature of a hostile takeovers and rational behind one.

In addition to still developing legislation on mergers and acquisitions, corruption, flourishing in over the past decades in Russia, tends to be another reason for poor corporate governance in Russia. Loktinov (2004) argues that corruption has become a Russia reality and fallen into the ordinary routine of Russian citizens. The 2008 survey conducted by the German group “Transparency International” proves that Russia ranks among the most corrupt countries in the world. In 2008, the “Transparency International” Corruption Perceptions Index (CPI) ranked 180 countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. It placed Russia 147<sup>th</sup> out of 180 in the category of “highly corrupt” countries, in the same group with such countries as Bangladesh, Kenya.

Despite all recent developments that have been introduced in corporate governance legislation, there is still huge amount of hostile takeovers taking place in Russia (Kireev, 2007). The presence of evident loopholes combined with abundant corruption enables raiders to take over entities and strip off most valuable entities’ assets while an entity is under their control. Therefore, ability to protect an entity or prevent hostile takeover at its initial stage seems to be a relevant subject currently for most small, medium and large size enterprises with valuable assets in possession in Russia. Additionally, current financial crisis seemed to increase an exposure to hostile takeovers and tends to make the subject even more vital due to the tendency of raiders to use entities’ debts as one instrument in hostile takeover scheme.

## **1.2. Research Question**

The research problem of the thesis is as follows: How enterprise can protect itself from hostile takeover and raiders on Russian market? The research problem can be further divided into three sub-problems. The first sub-problem is to examine most common schemes of hostile takeovers in Russia. Having most common hostile takeovers’ scheme established it is possible to pursue the second sub-problem which is identifying already well-known anti-hostile takeover defense methods used in Russia. Last, third sub-problem is to describe which of above mentioned defense methods or their combination are most effective against takeover schemes mentioned in the study. The main purpose of the thesis is to create some sort of instructions that would be valuable to both SME, with their limited resources, and large entities for protecting an entity from potential hostile takeover or preventing an attack on its initial stage applying the instructions as a result of this thesis.

### **1.3. Definitions and key terms**

The following section of introduction part is intended to present key terms and definitions that will be applied in the paper. Some of the key terms will be borrowed from previous research literature.

#### ***The Market for Corporate Control***

There are a few concepts of the market for corporate control which I was considering to apply in this paper. First, Manne (1965) understands corporate control as the power to use and distribute the assets of a company. A somewhat different interpretation of the concept was given by Jensen (1983). He is convinced that it is the right to influence the formation of the managerial team that administers the assets of a corporation. In case of abovementioned authors, a market for corporate control is the arena in which a competitive struggle is waged for control of company's assets. Kireev (2007) on the other hand, decided to use a broader meaning. He understands the market for corporate control as a system of economic relations that take shape in the course of the competitive struggle for the power to use and distribute (control) assets. Kireev definition will be used in this paper.

#### ***Hostile takeover***

According to Leonov (2000), a “business term”, a “hostile takeover” is understood to be an attempt to obtain control over the financial and business activity or assets of a target company against the resistance of management or key participants in the company. Whether a deal is regarded as “hostile” depends rather on the reaction of the managers and (or) shareholders / participants (as in Russian practice) of the target company, provided that the attacking company has fulfilled all requirements of the regulatory bodies concerning announcement of its actions. Furthermore, analysis of publications in the business press suggests that the most widespread types of raiding, in terms of the strategies used to carry out the scheme, are:

- the hostile takeover of companies that possess rights to attractive assets;
- acquiring control over assets by means of bankruptcy proceedings;
- disputing rights to assets in the courts;
- compelling the victim to conclude a deal concerning certain assets, using instruments of corporate blackmail or other means;

- acquiring control over an asset by secretly stealing it or by means of fraud;
- concluding deals concerning assets by conspiring with officials of the target company; lobbying various state bodies by conspiring with state employees; and
- other types of raiding

At present, the dominant type of raiding is the hostile takeover. However, it should be noted that in the majority of cases the types indicated above are observed as a combination rather than in their one pure form. Therefore, all above mentioned types of raiding action will be considered as raiding and hostile takeover activity.

### ***Raiders***

According to Kireev (2007), raiding is systematic activity by stable formal or informal groups, aimed at obtaining the ability to use and distribute (control) assets belonging to other economic actors. Specialists engaged in such activity will be called raiders in this paper. In addition, alongside the term “raider,” there are also generally accepted formulations that designate specialists in raiding and groups of such specialists. For instance, a raider might be called as a predator, an aggressor, a raider-structure, a raider-company, and so on.

### ***Target***

A physical or legal person, whose assets have become the core reason of a conflict I will be calling a target, a victim, and the like.

### ***Assets***

The term “asset” refers to a broad range of economic goods, including rights on real estate, securities, financial flows, nonmaterial assets, a business as such, and so on.

### ***Takeover***

Takeover is a corporate action where an acquiring company makes a bid for an acquiree.

### ***FSB***

The Federal Security Service of the Russian Federation (FSB) is the main domestic security service of the Russian Federation and the main successor agency of the Soviet-era Cheka, NKVD, and KGB.

## ***MVD***

The Ministerstvo Vnutrennikh Del (MVD) was the Ministry of Internal Affairs in Imperial Russia, later USSR, and still bears the same name in Russia.

### **1.4. Structure of the Thesis**

The structure of this paper is organized as follows. The second part of the thesis presents a literature review on various aspects of hostile takeovers in Russia. Precisely, the chapter analyzes previous research available on hostile takeovers, rational behind takeovers and Russian raiders' characteristics. Especially it explores main characteristics of sophisticated takeover schemes in Russia and their features. It also highlights common well-known defense methods that might be applied to prevent hostile takeovers or protect an entity from one in Europe. Further, it explores whether above mentioned defense methods could be applied on Russian market.

Third part of the thesis is dedicated to methodology aspects of the research. This part discusses analyses that were presented in previous research. It also briefly deals with cases and their main characteristics that influenced the choice of the cases for the thesis.

The fourth part of the thesis is devoted to two takeover cases that are analyzed and dismantled to investigate takeover events and raiding on practice. To be precise, this part analyses Togliattiazot and Russneft takeover event.

Fifth part of the thesis considers lessons learned from the research conducted. These lessons are explained in combination with cases presented earlier and results analysis conducted. The main focus of the part is to state accurately which defense method is most suitable for each particular type of hostile takeover attack. In particular this part will create some sort of instruction for enterprises that is intended to increase an entities' soundness on the market for corporate control.

And the last, sixth part of the thesis will summarize main practical lessons enterprises and their owners can learn from this paper.



## **2. Literature review**

In this literature part I am covering main aspects that might help me to understand hostile takeover activity and process initiators in Russia. Therefore, the intentions behind literature review part are to become familiar with aspects mentioned in previous research that might explain methods used in hostile takeover activities and possible defense mechanisms. The structure of the literature review part is organized as follows. First, it will examine (1) three general aspects related to hostile takeovers such as history of a market for corporate control, effects of takeover on stakeholders, and general perceptions and attitudes towards hostile takeovers and its main actors. Second, it will analyze (2) main common types of raiders mentioned in previous research. Keeping in mind common types of raiders in Russia we can move on to third section of the literature review which is devoted to (3) common incentives behind hostile takeovers. Fourth section will describe most important (4) hostile takeover schemes mentioned in previous research. And next section will highlight main (5) hostile takeover defense methods. Now, let us first become familiar with little bit of background of hostile takeovers and general attitudes towards that activity.

### **2.1. Environment around takeovers and parties involved**

Almost daily we can see such headlines in news as “A Culture of lawlessness” (Joson Bush, 2008), “Out of Siberia, A Russian way to wealth” and “Russian mobsters redefine the hostile takeover” (Andrew Kramer, 2006), “Russia’s Robber Baron” (Paul Klebnikov, 2006), “An Offer you can refuse” (Uwe Klussmann, 2007) and many others. All above mentioned articles are concerned with hostile takeovers in Russia. From headlines above and their tones we can sense that hostile takeovers tend to be presented or viewed rather as quite negative market phenomena than a positive one in Russia. Hostile takeovers in Europe or US, on the other hand, is viewed as natural step of replacing inefficient owners with efficient ones and being just another part of M&A activities. Therefore, in following part of the literature review I will take a closer look at raiding and history of hostile takeovers in Russia. The main purpose of the first literature review section is to understand perception of hostile takeover and raiders in Russia. To understand nature of hostile takeovers and parties involved I will first (1) become familiar with a history of hostile takeovers and a market for corporate control in Russia. Second, I will take a look at (2) welfare consequences of takeovers for stakeholders. In

addition, I will (3) highlight different attitudes towards hostile takeovers, parties involved, and hostile takeovers perceptions among different social groups in Russia.

### **2.1.1. The Market for corporate control**

Let us first take a look at how a market for corporate control emerged and has developed over the years in Russia. According to Kireev (2007) a market for corporate control began to emerge in Russia at the end of the 1980s. For the last twenty years the market for corporate control has been highly dynamic, contradictory, and conflict-ridden. The civilized institutionalization of this market has been blocked by such negative factors as corruption, legal shortcomings, political instability, and the presence of a large shadow economy. In addition, such aspects as lack of respect for the law among members of the business community, and the fact that many economic actors ignore the courts and law enforcement systems tended to worsen the market conditions. Combination of above mentioned factors seem to be a perfect environment for hostile, unethical, or even illegal behavior on a market for corporate control.

Many researchers, e.g. Borisov (2009) and Kireev (2007) believe that Russia and its market for corporate control came up against a phenomenon of hostile takeovers and raiding at the beginning of 90s. According to Borisov (2009), individuals, involved in hostile takeovers in Russia, have been on the market for a long time. At the beginning of 90s they worked for private entities owned by industrial-financial groups owned by oligarchs. Oligarchs used services offered by these individuals, first, to build financial-industrial groups through hostile takeovers, privatization and loans-for-shares auction. Second, built financial-industrial groups used services offered by these individuals to prevent potential hostile takeovers towards oligarchs' groups and defend entities. At the beginning of the twenty-first century abilities to grow further became rather limited. In other words, most of available and valuable assets in the economy were already shared among oligarchs' industrial-financial groups. Furthermore, services related to hostile takeovers became less needed and demand for extremely high security services diminished as well. As a result, a huge number of highly qualified people were forced to leave groups after a long period of well compensated era. Kireev also seems to be on the same page with Borisov. He believes that somewhere around late 90s the market for corporate control has come across of phenomenon that was new to Russia: appearance of

stable formal and informal groups on the market. These groups systematically were striving to establish control over the assets of other economic actors.

The number of takeover activities has been increasing quite rapidly since the beginning of the twenty-first century in Russia. A combination of very high rates of return reaching 1000 % margin earned within a relatively short period of time and the absence of mechanisms for counteracting this practice attracted many actors on the market. As a result, within a few years dozens of formal and informal groups appeared on the market for corporate control whose main purpose was to seize businesses. According to Kireev (2007), by 2004 the rapid proliferation of conflicts in above mentioned market had practically paralyzed the operations of many firms in various parts of the country. The situation became so serious that the top country leaders believed that there is a need for state interventions in this field. However, many of researchers (e.g. Demidova, 2007; Borisov, 2009; Chernykh, 2008) are convinced that, in spite of the new introduction of various laws concerning corporate governance in Russia, predators find a way around the barriers, which have been built, often remaining within the boundaries of the law. As a result, government seems to be not really efficient at preventing raiders' from unethical and even illegal behavior. Therefore, substantial improvements have not been reached yet.

### **2.1.2. Takeover's welfare consequences for stakeholders**

Previous research tends to identify both negative and positive effects of takeovers. On the one hand, hostile takeovers, mergers, LBOs and MBOs are viewed as wealth increasing due to the tendency of the total market value of the target firms and the raiders to go up. Many economists, e.g. Jensen (1984), argue that large returns received by the shareholders result from an improved management and an increased efficiency due to restructuring. These economists argue for a positive role of mergers and acquisitions from the social viewpoint. On the other hand, such representatives of business world and academics as Drucker (1986), Lowenstein (1985), or Law (1986), are of completely opposite opinion. They question any social gains resulting from takeovers by arguing that anyone's profit results from a pure redistribution at the expense of someone else. Researchers argue that the shareholders' gains result from an inappropriate valuation of companies by the financial markets, a use of tax breaks, an interception of the part of employees' paychecks and profits of the suppliers or other stakeholders. Moreover, the critics say that the battles over the control of companies

constitute a loss of productive energy that could be used much more efficiently in other applications. For these reasons, at least in the case of some takeovers, the costs substantially exceed any social gains.

In addition, Shleifer and Summers (1988) make an attempt to prove that takeovers facilitate opportunistic behavior of shareholders at the expense of other stakeholders. Especially hostile takeovers allow the shareholders to capture the wealth of other stakeholders (redistribution), and create much less of any new wealth. According to Shleifer and Summers, the existing evidence shows that the size of the redistribution may be quite large, even resulting in net losses. Thus it would be a mistake to judge the effects of takeovers exclusively on the basis of the shareholders' returns. A result of negative effects around takeovers activity might justify general perception of hostile takeovers and their initiators. Next, I will highlight different attitudes towards hostile takeover as an activity, parties involved, and perceptions of hostile takeovers among different social groups in Russia, which in a way tends to be a history related aspect.

### **2.1.3. Perception of hostile takeovers and raiders in society**

General perception of a hostile takeovers and raiders as main actors in process tends to be rather negative than positive one in Russian society. According to public inquiry "Raiders, who are they?" which was conducted by the Institution of Public Opinion in August 2007, there were only 10% of the sample who knew the meaning of the word raider. The group familiar with the term raider and their activities was divided in two subgroups by their definition of a raider. First group (8%) defined a raider as "an individual or group of individuals that arbitrarily seize stable business or assets of that business by using loopholes in corporate governance legislation". The second group (2%) confined themselves by defining raiders only in one of following words: "crook", "con", "thieves", "rogue", "criminals". Clearly perception of raiders and their actions seemed to be very negative. Let us next take a look at possible explanations of obtained negative tone result.

There seems to be two main explanations that might justify such negative attitude towards hostile takeovers and their initiators. First, background of some individuals involved in the field might influence public opinion through generalization. According to many researchers e.g. Demidova (2007), V. Volkov (2004), or Kireev (2007), there are several types of raiders

which are classed in three groups in accordance with degree of legitimacy of methods used in overtaking a target. Therefore, there is one particular group that tends to use illegal methods the most. Kireev (2007) argues that some of the representatives of just mentioned particular group are “strong-arm entrepreneurs” or, in other word, an individual with criminal background. Therefore, a combination of such factors as controversial background, the business press and its tendency of utilizing every opportunity to create hot selling headline might create a negative stereotype concerning raiders and hostile takeover activity in general.

Second factor that might be partly associated with general negative perception of raiders and an occupation of hostile takeovers is an incentive behind takeover actions. According to public inquiry “Raiders, who are they?” and magazine “Dengi” (Money, # 31,p. 18-21, 2004), there is a general opinion that hostile takeovers are usually undertaken just to use an arbitrage opportunity by taking over an entity and selling it further ignoring any interest concerning such close stakeholders as employees and partners. According to Kireev incentives behind hostile takeover activities usually depend on the type of raider and its background. Typically incentives are likely to be either short-term or long-term. To understand aggressors’ incentives let me turn to most common types of raiders that were mentioned in previous research.

## **2.2. Types of raiders**

According to many researchers, e.g. Demidova (2007), V. Volkov (2004) and Kireev (2007), raiders can be classed into a few particular groups. Kireev (2007) for instance, has categorized raiders into two main types such as professional raiders and strong-arm entrepreneurs. Lucy Chernykh (2008) seems to be in agreement with Kireev. However Chernykh also added third type which also was mentioned by other authors such as J.Bush (2005), and Kramer (2006). This type of raider is an official who holds a position with any government agency. Next, I will describe main traits of each type. Let me start with strong-arm entrepreneurs.

### **2.2.1. Strong Arm entrepreneurs**

Strong-arm entrepreneurship tends to have many similar and dissimilar features in common with raiding. According to Kireev (2007) strong-arm entrepreneurship is “an activity to convert organized force into marketable goods (money, securities, real estate, property, and so on)”. Kireev is convinced that despite many aspects in common between raiding and strong-

arm entrepreneurs there are still significant differences between two groups. The author believes that “raiding is a result of the evolution of strong-arm entrepreneurship”. Let us first discuss some of the main strong-arm entrepreneurship’s features developed over time.

According to Kireev (2007), up to the end of the 1980s, strong-arm entrepreneurship remained on the periphery of the economy. The first half of the 1990 can be associated with very wide spreading phenomena of organized crime. Organized crime structures quickly appeared across the country and asserted their influence in most spheres of economic activity. Initially, criminal groups engaged mainly in such activities as physical protection, conveying of export–import operations, and fraud prevention. However, the combination of market relations development and increasing numbers of transactions pushed or encouraged strong-arm partners to become more diverse and offer greater selection of complex functions. These functions ranged from collecting information about a firm’s contractors to resolving corporate disputes, and representing the interests of a business in dealings with state agencies.

The evolution period is also supported by V. Volkov (2004). He believes that during the 90s there was a shift from simple to more complex forms of strong-arm entrepreneurship. Furthermore, Volkov (2004) distinguishes three main forms of the phenomenon: protection, strong-arm partnership, and strong-arm intermediation. Moreover, both authors are convinced that strong-arm entrepreneurs were able to perform these business functions through the skillful use of organized criminal structures and information. Strong-arm intermediation involved cooperation between commercial and criminal structures on an irregular basis. In the majority of cases, entrepreneurs turned to criminal structures to recover a debt, convert funds into cash, or resolve a business dispute. As a result, strong-arm entrepreneurs took outsider positions and influence the conflict by sending instructions to the parties representing their interests. For instance, strong-arm entrepreneurs tended to use the tax police, the fire inspection, the sanitary-epidemiological inspection, and other services to serve the bandits’ interests.

There are also dissimilarities amongst resources used by strong-arm entrepreneurs and raiders. According to Kireev (2007) strong-arm groups tend to be made up mainly of veterans of the war in Afghanistan, former athletes, and former (and, not infrequently, also current) members of various state quasi-military special units. As a result, strong-arm entrepreneurs’ tend to use very often threats and violence in efforts to determine or constrain the behavior of other

actors. Both Kireev (2007) and V. Volkov (2004) believe that strong-arm entrepreneurs tend to have critical advantage of an ability to determine or constrain the actions of other economic actors, both through direct pressure and by influencing their expectations. However, authors also pointed out that a significant decline of direct force action involved in hostile takeover was noticed. They are convinced that above said decline occurred due to law enforcement is becoming stricter and the risk associated with the use of violence increases.

Strong-arm entrepreneurs usually tend to attack only one target type. Strong-arm entrepreneurship is likely to be directed predominantly at small businesses. To be precise, typical targets are particularly firms with low investment requirements, large and frequent cash turnover, and simple patterns of technical-economic activity. For instance, firms in the service sphere, wholesale and retail trade, have been most likely to fall under the influence of strong-arm entrepreneurship. Strong-arm groups are more interested in controlling monetary flows and seizing valuable assets of a target rather than seeking to become owners of industrial firms. Despite many common traits between strong-arm entrepreneurs and raiders we can see that there are significant differences as well. In the next subsection let us turn to other type of raiders which is professional raiders.

### **2.2.2. Professional raiders**

Professional raiders and raiding have many similarities in common with strong-arm entrepreneurship. Authors Kireev (2007) and V. Volkov (2004) found two similarities between raiding and its initiators and strong-arm entrepreneurship. First, Kireev (2007) compared the speed of a raiding appearance across the country with organized crime spreading. The author is convinced that raiding spread with equal rapidity. It has arisen at the turn of the new century and by 2003–2004 it had already acquired national dimensions. Therefore, the evolution of raiding in many respects parallels the history of strong-arm entrepreneurship in the 1990s.

Second aspect that was pointed out by both authors (Kireev, 2007; Volkov, 2004) is changing relations between raiders and businesses. Kireev and Volkov believe that prior to 2003–2004 relations between raiders and businesses likewise reflected the “aggressor–victim” model. As a rule relations were in the context of bilateral conflicts between top management and the raiders. Authors are convinced that in most cases, control over the target firm and its assets

was established by buying up shares held by minority shareholders. The predator rarely encountered serious resistance given the highly dispersed structure of ownership and the weak position of top management. However, gradually raiding acquired new, more complex forms. The range of participants in conflicts expanded substantially as the mass media, representatives of state bodies, contractors of target firms, and other interested groups were drawn into disputes. Predatory strategies also underwent changes in a way that raiders no longer assumed the role of initiators of conflict. This function was now performed by former partners or shareholders of the target company, by creditors, by regulatory state agencies, or by other persons. Raiders took outsider positions, influencing the conflict by sending instructions to the parties representing their interests. Similar changes occurred in the practice of strong-arm entrepreneurship. For instance, a shift was observed from basic “roofing” towards using the tax police, the fire inspection, the sanitary-epidemiological inspection, and other services to serve the bandits’ interests.

Furthermore, as strong-arm entrepreneurs were becoming more diverse by providing more complex functions, raiders seem to follow a similar scenario. Volkov (2004) believes that partnership relations between a business and raiders more often tended to have defending nature. The firms are buying protection services from external aggressors. For instance, at the end of 2005, the Tsentrodorstoi (Central Road Construction) Company came under attack from raiders. The defense of the firm against the hostile takeover attempt was taken on by the Agency of Anti-crisis Technologies and Investment, known to market participants as a raider company.

Despite quite a few similarities between raiders and strong-arm entrepreneurs both, Volkov and Kireev also highlighted three dissimilar aspects. First aspect is staff employed by raiders. Authors are convinced that professional raider structures rarely keep strong-arm entrepreneurs on staff. Kireev believes that professional raiders tend to avoid the use of strong-arm entrepreneurs even in cases when raiders were playing roles in providing “muscle” in carrying out raiding schemes, maintaining physical control of seized assets. Most often, raiders use corrupt connections to hand over the execution of strong-arm functions to employees of state power structures or to specialized security firms.

Second aspect that distinguishes raiders and strong-arm entrepreneurs that was pointed out in previous research (Kireev, 2007) is target type. The author believes that raiders tend to attack



medium and large size firms rather than small one as strong-arm entrepreneurs. Kireev is convinced that raiders seek to establish control over companies and their assets. Furthermore, the higher the value of the assets to be seized, the more attractive the target is to the raider. Additionally, relative political and economic stability created high market liquidity on the market for corporate control, which enables raiders to sell off seized assets quickly, freeing up resources for new schemes. Otherwise, raiding would not have become so widespread.

Third aspect that tends to differentiate raiders from strong-arm entrepreneurs is instruments used by both actors. While strong-arm entrepreneurs often tend to resort to threats and violence, raiders try to use less risky, lawful or, at least, ostensibly lawful instruments. For instance, raiders might resort to using such instruments as lawsuits, conspiring with companies that are contractors of the targeted firm, and initiating controls by tax inspectors, police, and other official agencies. Kireev (2007) believes that the instruments used by raiders allow them to carry out the same schemes as strong-arm entrepreneurs usually carry, with the same rate of return, but with lower levels of risk. It seems that raiders understand that in order to obtain control over a factory it suffices to obtain shares from minority shareholders, initiate bankruptcy proceedings, or use other supposedly legitimate tools rather than eliminate the managing director and/or the principle owners physically. By using such tools raiders are taking only financial risks of not achieving the set goal, while the risk for the strong-arm entrepreneur is the risk of receiving criminal charges and losing freedom, health, or even life. Another group of raiders that tends to be exposed to really low level of the financial risk, risk of losing freedom, health, or even life is government raiders. Next, let us take a closer look at some of the main characteristics that government raider likely to have.

### **2.2.3. State/Government official aggressors**

Third raider's type that I thought would be reasonable to mention in this paper is state or government officials. According to Chernykh (2008) the first actual case of state takeover of the large privately-controlled business is associated with the Yukos assets expropriation. The tax authorities bankrupted this major oil company to settle tax debt for tax evasion. In December 2004, the Yukos' main production unit, Yuganskneftegaz, was sold to the state-owned company Rosneft through the shell company Baikalfinansgroup. Furthermore, according to the OECD report on Russian economic developments, there were 24 companies that were taken over by the state during the period of 2004-2006.

Although, it is easily noticeable that state has become more active on the market for corporate control, it is still questionable whether recently done takeovers by state directly or indirectly controlled entities can be categorized in hostile takeover group. The key aspect that prevents us from defining recent state's behavior on the market for corporate control is the lack of available information concerning terms of takeovers done by state or entities controlled by it.

Despite the lack of research on such phenomena as state raiding in Russia and lack of direct evidence of it, there is a reasonable amount of discussion going on in media about recent trends in raiding related to state officials. For instance, according to Alexander Volkov (2007) and his article "Reasoning about raiding using Baron Cuvier's method" there are administrative officials that support and assist raiders in takeover process. The author stated that without administrative resources that are supposedly used by aggressors they, raiders, would not have been able to avoid criminal charges. Additionally, A.Volkov (2007) is convinced that among administrative officials there might be a few well structured groups specializing in hostile takeovers. Furthermore, the deputy of Russian Federation Duma, and chairman of Duma's economic policy and entrepreneurship committee, Aleksand Kovalev seems to be in agreement with Volkov's theory about well structured groups. According to a newspaper *Vechernia Moskva* (Evening Moscow), article "Raiders without mask" Kovalev believes that short era of rough hostile takeovers begot formation of unofficial groups inside of defense and law enforcement agencies which tend to use administrative resources implementing hostile takeovers on behalf of directly and indirectly state-owned entities, close to the president and other high level officials and high-wealth business individuals.

Similar idea associated with raiding by state officials was mentioned in *The New York Times* as well. According to C. Levy (Dec. 8, 2008) and Olga Kryshstanovskaya (2008), a prominent Kremlin expert at the Center for the Study of Elites in Moscow, Igor Sechin, a deputy prime minister is "the state's main raider". Olga believes that "he (Igor Sechin) organizes these raider seizures, sometimes to the benefits of the state, or sometimes to the benefits of companies that are friendly to him." Arkady Ostrovsky (Dec. 30, 2004) seemed to find parallel ideas with above mentioned statements. According to Ostrovsky, Igor Sechin, a key member of the siloviki clan, a group including members of police and security services, is widely considered to be the ideologue of the attack on Yukos.

In spite of great possibility of abovementioned statements being accurate we cannot blindly be persuaded by them. First, there are still such arising questions as where is the justice, why power abusing officials do not face any criminal charges, etc. Second, even if some incentives were created for or provided to theoretically power abusing state officials, the question is where are these evidence of obvious economical incentives. Speaking about incentives, let us turn to most obvious incentive behind hostile takeovers in Russia mentioned in previous literature.

### **2.3. Incentives behind hostile takeovers**

It must be obvious that the chief incentive in raiding and strong-arm entrepreneurship is a high rate of return. Authors Kireev (2007), Volkov (2004) and Chernykh (2008) identify three major groups of incentives behind hostile takeovers. First group includes short term nature incentives such as monetary cash flows, highly liquid valuable assets. According to Kireev (2007) strong-arm groups do not generally seek to become owners of industrial firms. It seems that they are more interested in controlling monetary flows. By contrast, raiders seek to establish control over companies and their assets. The higher the value of the assets to be seized, the more attractive a scheme is to the raider. High market liquidity on the market for corporate control, resulting from relative political and economic stability, enables raiders to sell off seized assets quickly, freeing up resources for new schemes. In the absence of demand for assets, raiding would not have become so widespread.

Despite short-term nature of raiders' activities, there is also a group of incentives which relate to long-term rather than short-term incentives. The second group of incentives concerns long-term benefits and strategic investments. According to Volkov (2004) and Kireev (2007) such financial-industrial groups as Alfa-Capital (via Alfa-Eko), Bazovyi element (via Rosbuilding), Yukos (via bank Menatep and Russian Investors) and other managed to build their financial-industrial groups partly through hostile takeover activities. Therefore, behavior aspects of such professional players as Alfa-Eko, Rosbuilding and Russian Investors on the market for corporate control support long-term aims as well as short-term ones.

Third group of incentives consists of takeovers which were done by state agencies and companies or indirectly state controlled entities. To be precise, Chernykh (2008) is arguing that state takeovers are primarily driven by the political considerations. She finds that the state

seeks control over strategically important companies and sectors and tends to not pay attention to industry and firm performance. As a result, the main force behind state takeovers is likely to be protectionism rather than an arbitrage opportunity. Keeping in mind main incentives behind hostile takeover we can turn to most common hostile takeover schemes used in Russia.

## **2.4. Common hostile takeover schemes**

This section of the literature review part will be devoted to most common takeover schemes used on Russian market for corporate control. The section is organized as follows. First, I will mention most obvious signals of a coming takeover operation. Second, I will analyze most common takeovers schemes applied in Russia. Now, let us first take brief look at some of the signals of a possible hostile takeover threat.

### **2.4.1. The signals of being targeted**

There are many signals that might imply business owners that their entity is being targeted by unfriendly acquirer. First preparation phase of hostile takeover tends to be information obtaining stage. Furthermore, unfriendly acquirer or raiders tend to obtain information related to three main areas such as management, corporate and financial information. Therefore, business owners should be alert to an entity-related data being searched.

Furthermore, The Public Chamber of Russian Federation against Corruption recommended following eight signals that are advisable to pay attention to. First, it is always practical to monitor (1) trends in your industry. For instance, cases of hostile takeovers being noticed in your industrial area should warn you. Second, any (2) unusual interest towards company's equity on market might be suspicion. Therefore, information on an entity's shares being bought up from minor shareholders for overvalued price should ring a bell. Third, since debt is really actively used in hostile takeovers, any extraordinary (3) interest towards entity's debt position should warn business owners about potential of being targeted. Fourth signal is related to entity's corporate data. Thus, if it appears to business owner that some individuals received data on management, owners, and other important entity-related (4) areas from the Unified State Register of Legal Entities (USRLE) it should give a warning to owners. Fifth signal is concerned with an entity's tangible and intangible assets. An owner should be alert if

he/she becomes aware of unknown individuals receiving (5) data on his/her company real estate and hard assets from the Unified State Register of Rights to Immovable Property and Transactions therewith (USRRIPT).

Next, we move to signals that obviously indicate interest of unfriendly acquirers or raiders towards an entity. Sixth signal for instance, is related to becoming aware of (6) data on entity's shares and shareholders from company registrar being approached by somebody. This kind of information enables raiders to contact minor shareholders or even forge entity's shareholders' register. Seventh signal is related to regulatory agencies and more active aggressor's action. For instance, raiders might use regulatory agencies to obtain access to firm's stamps, important signatures. Therefore, owners should be immediately alerted if abrupt (7) unscheduled inspections from any regulatory agency with seizing of stamps' copies, copies of handwriting, entity's important signatures' copies and information storage media took place. Eighth signal is most well known as an (8) "empty envelope" signal. The signal refers to a receiving an envelope sent by unknown sender with requirement of signing a confirmation of handing over. Usually an envelope is empty or contains some odd enclosure. This might be a signal that aggressors are preparing to hold a shareholders' meeting to reelect new board of directors and new CEO, of which receiver of the envelope was informed by that empty envelope with confirmation of handing over. Despite all above mentioned signals an entity owners might leave signals unnoticed or come across different ones. As a result, if a potential target presents an easy and profitable aim, an entity might be facing hostile takeover in the nearest future. Therefore, let us turn our attention to most common takeover schemes.

#### **2.4.2. Common takeover schemes**

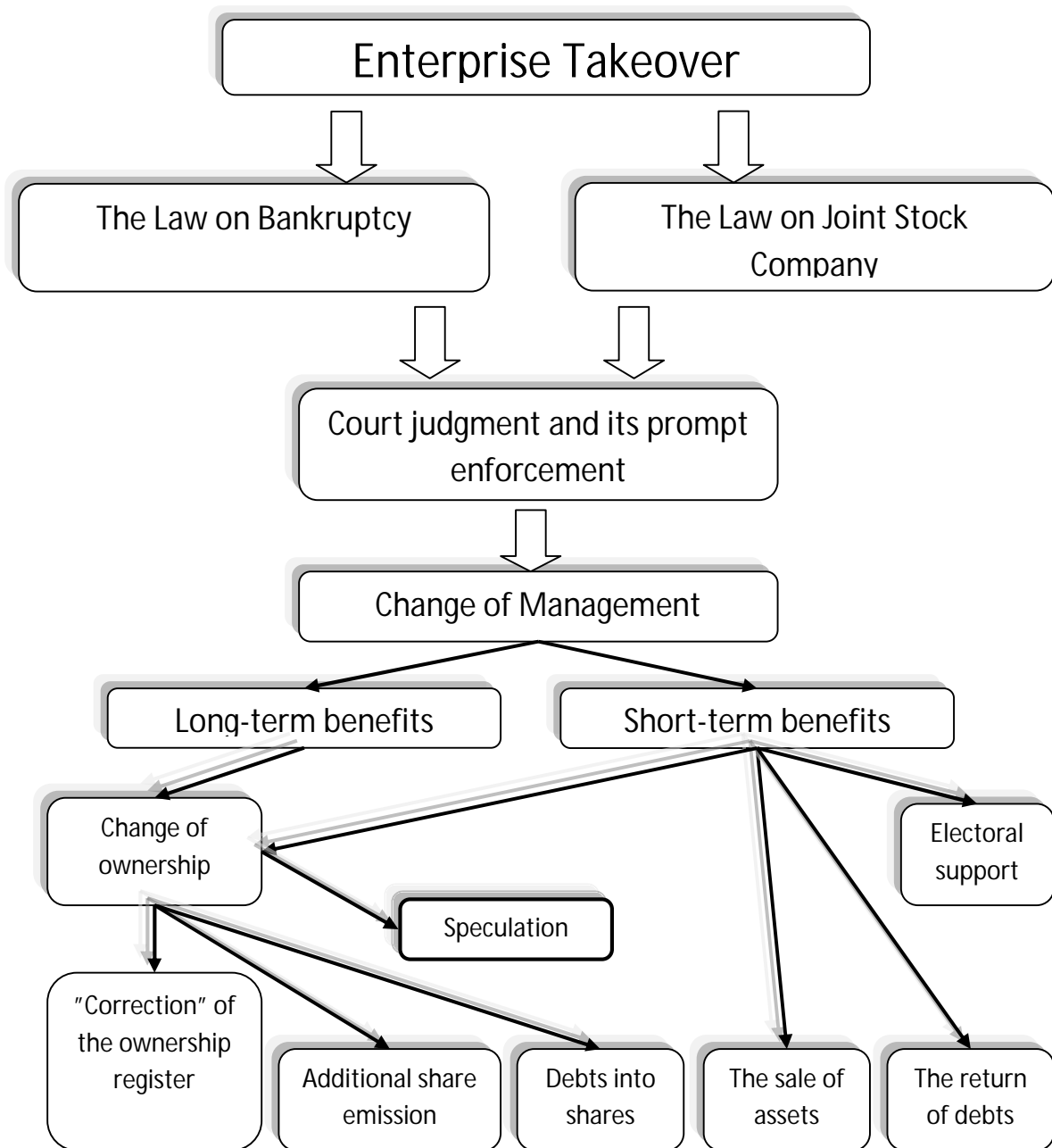
In this subsection of literature review I will first compare common features of enterprise takeovers in Russia and the EU countries. In addition, I will take a brief look at logic behind enterprise takeover in Russia. Second, I will discuss most common takeover schemes individually. Now, let us turn to key distinguishing feature of enterprise takeovers in Russia.

The Russian market for corporate control is hardly a dozen years old, however, it can brag about impressive numbers of hostile takeovers. Comparing to the EU countries a key special feature of the Russian market is the predominance of rough hostile takeovers using so-called administrative resources, or as it was stated by Demidova (2007) an access to the assistance of

state officials. Researchers, e.g. Demidova (2007), Radygin (2002), and V.Volkov (2004) have identified many takeover scheme types used in Russia. For instance, Radygin (2002) divides acquisition methods in Russia into main six groups. First is buying up various shareholdings on the secondary market. Second is lobbying for privatization transactions involving state-owned shareholdings. Third is the incorporation of the target company into a holding company or into other groupings with the aid of administrative means. Fourth is the buying up of debts and their transformation into equity in the target company. Fifth is the seizure of control through bankruptcy procedures. And sixth is the initiation of judicial rulings, including their falsification (e.g. rulings purportedly issued by nonexistent courts, not properly registered, or bearing a forged judge's signature). The classification presented by Radygin (2002) includes both lawful and unlawful acquisition methods. And obviously, in the EU countries, with their clearly defined rules in the area of acquisitions and high level of compliance with law, the misuse of administrative resources or of the judicial system for these purposes is doubtful. Furthermore, the seizure of control via bankruptcy procedures and debt-equity swaps mentioned above are also not generally accepted takeover methods in the EU.

Despite of variety takeovers schemes, almost all researchers, e.g. Demidova (2007), Radygin (2002), V.Volkov (2004) argue that obtaining a controlling interest in target through aforesaid schemes tends to be based either on the Law of Bankruptcy or on the Law of Joint Stock Company (Figure.1). According to V. Volkov (2004), most often aggressors can either use the Law on Bankruptcy by initiating bankruptcy procedure. Or frame its assault as a defense of minority shareholders' rights and refer to the Law on Joint Stock Companies. Furthermore, the establishment of managerial control is a necessary precondition for reaching the main objective which can be either a long-term or short-term business interest. Therefore, procedures implemented through above stated laws are applied in order to give the change of management an appearance of legality. Consequently, to obtain a controlling interest (ownership), the aggressor can further use an array of methods, such as amending the register of shareholders, issuance of additional shares, conversion of debts into shares, etc.

# The Logic of Enterprise Takeover



**Figure 1: The logic of Enterprise takeover.**

Vadim Volkov (2004)

However, above mentioned array of methods usually is supported by cooperation of numbers of actors and agencies. Kireev (2007) argues that whatever the strategy is chosen, a prearranged and, therefore, quick court judgment and the availability of a powerful

enforcement agency are vital. Therefore, it is not surprising that both, Volkov and Kireev are convinced that each takeover relies on a particular combination of all or some of the such actors or agencies as private security agencies, external (crisis) managers, state arbitration courts or courts of general jurisdiction, the regional governor or head of the local administration, regional representative of the Federal Agency for Financial Normalization and Bankruptcies, law enforcement (Public Prosecution Office, *MVD*, or Ministry of Justice) and their paramilitary units, as well as media outlets.

Now, being familiar with common logic behind an enterprise takeover allows us to take a closer look at most common schemes of hostile takeover individually. Let us first take a look at fraud scheme.

#### *Equity buyout*

Equity buyout refers to a situation where an aggressor acquires target's equity on open market, from minorities or/and controlling stakeholders. The main feature of the hostile equity buyouts is that the company being acquired does not approve the buyout and fights against the acquisition.

#### *Fraud*

According to Kireev (2007) and Volkov (2004), scope of fraud employment tends to be quite wide in Russia. For instance, most common fraud schemes are related to falsification of shareholders' meeting protocol, fabrication of formal written decision from the court, bribing state arbitration courts or courts of general jurisdiction to receive needed documentations. Furthermore, Kireev and Volkov are convinced that great part of all hostile takeovers is associated with fraud and documentation falsification.

#### *Administrative method*

Many researchers, e.g. Kireev (2007), A. Volkov (2008), and V. Volkov (2004) argue that administrative resources are used almost in every hostile takeover in Russia. However, there might be cases that are built around only administrative method. For instance stakes seizure as a penalty for tax evasion might be one of those. According to Chernykh (2008), this is another expropriatory method which is currently debated in the Russian courts. Consistent with the Civil Code article 169, in the case of detected tax evasion, the shares of an offending



company may be nationalized by transferring them into the federal government hands. The Article 169 is not a new one. But until recently it was very seldom used for the seizure of stakes in the private companies. A Moscow court, for example, has ruled to seize stakes in several fuel companies in Bashkortostan as penalty for tax evasion. A similar claim was filed against Russneft oil company in 2007. In April 2008, however, the Chair of the Supreme Arbitration Court has signed a regulation that prohibits courts from using article 169 for nationalization as a penalty for the tax evasion. The legality of this Supreme Arbitration Court regulation is currently questioned by the Federal Tax Service authorities.

### *Bankruptcy*

Bankruptcy used to be the most used method of hostile takeovers in Russia. However, according to a deputy of Moscow City Duma of Russian Federation V. S. Pleskachevskij attractiveness of the bankruptcy as a hostile takeover procedure decreased after the new Law of Bankruptcy's was enacted in 2002.

Usually, (Bloom, Ratnikov, Osipov, and Areshev, 2003) first step is acquiring information on debts, register of shareholders, sales, distribution, and procurement partners as well as other strategic or compromising data on potential target. Typically this assignment is done by aggressor's business group security service which is likely to be headed by former top officer of FSB or MVD. Second, the group, planning the takeover, can either forge an alliance with a company, to which a potential target is indebted, or covertly buy off target's debt through related front entity. Further, a situation is created whereby the company becomes unable to pay the debt. In particular, the corporate raider may artificially increase amounts owed, for example by using schemes involving fictitious promissory notes. Third, at the same time the corporate raider uses its administrative leverage to ensure that the court appoints a loyal administrator in bankruptcy who will authorize the transfer of the company's most valuable assets to the corporate raider. Having received a formal written decision from the court, the aggressor hastens to take the step to enforce the judgment. The quicker this is done, the greater the chance of success, since at this stage the real intention of the bankruptcy case becomes apparent to the enterprise management. However, following the adoption of the new Bankruptcy Law, this method has become less efficient and today is used less often than before.

### *Forceful seizure*

According to a deputy of Moscow City Duma of Russian Federation V. S. Pleskachevskij, forceful seizure is obviously illegal method and tends to root into the beginning of the 90s. Although the scheme is rarely used nowadays and gradually declining due to law enforcement becoming stricter, it is still vital to be aware of its threat. The main characteristic feature of the forceful seizure is the falsification of documentation such as formal written decision from the court, corporate decision accepted by the majority of shareholders etc. Following step according to V.Volkov (2004) is the use of coercive resources to propel the new management into the head office of the target enterprise and to chuck out the old management based on falsified documentation. By establishing provisional control over the company the aggressor has two options of either selling currently controlled assets to bona fide purchaser through a layer of typically few front companies or ruining target's assets and destroying or amending important documentation (e.g. shareholders' registry) and company vital operational aspects to worsen target's financial position and mitigate ability to resist future more justifiable takeover.

### *Formation of governing bodies*

This method is based on improper creation of governing bodies and structures. The method is often used when the corporate raider already owns 30 per cent or more of the target company's stock. The scheme has three steps. First, a corporate raider files a request to hold an extraordinary shareholders' meeting. Next, to ensure that the corporate raider will be able to achieve needed decisions made by shareholders' meeting, the request to hold an extraordinary meeting is not delivered to the board of directors, or only empty envelope is delivered. Additionally, the aggressor might use such a provisional measure as a court injunction in order to prevent major controlling shareholders from participating in the meeting.

Second, the shareholders are convened for the extraordinary meeting. However, since part of shareholders are not informed about the meeting or prevented from participating, the meeting lacks a quorum. As a result, the extraordinary meeting is cancelled due to the absence of quorum. However, according to the Law on Joint Stock Companies, where an extraordinary meeting is cancelled due to the absence of a quorum, the adjourned meeting may have a quorum of 30 per cent. Subsequently, an adjourned meeting takes place with a reduced

quorum of 30 per cent. At this point the adjourned meeting might decide on following issues. First, it might decide on the election of the board of directors, which then elects a new general director. Second, the meeting may decide on the amendment of the company charter. And third, the meeting might decide on the transfer of the company register to a new registrar controlled by the corporate raider.

Third, having all essential decisions made the aggressor grabs the control over the target. The corporate raider, supported by an issued court injunction ordering the company not to impede the operations of the new management, enters the company premises and replaces the management with a new board and general director. Following step for the corporate raider is to secure control over the register, cash flow and day-to-day operations of the company.

#### *Challenging entity's privatization*

This method is expropriatory. It is based on the court decision to return companies that were privatized with legal violations from private to state hands. This method, however, has legal limitations as the current law imposes only a three year statutory time period for questioning privatization deals. All major privatization deals in Russia took place in 90s and, therefore, cannot be revised under this method.

According to Bloom, Ratnikov, Osipov, and Areshev (2003), the scheme starts, when a minority shareholder in a distant region files a claim to challenge the privatization of the target, based on the alleged failure of the controlling shareholder to satisfy investment conditions or some other spurious grounds. Next, as a result of the claim, the controlling shareholder's stake in the target is seized, transferred to the Federal Property Fund, and sold by the fund to either the corporate raider itself or an affiliate. The raider alleges to be a bona fide purchaser buying shares from the Federal Property Fund or from another legal entity on the open market. The shares are usually sold along a chain of allegedly bona fide purchasers and ultimately end up in the hands of the corporate raider. Typically, the defendant receives no notice of the proceedings. Proceedings are conducted in a closed session and without the examination of evidence. Further, the target's shares are sold by bailiffs hastily, without giving the defendant the opportunity to comply with the judgment. Next, the raider obtains control over the company register by, for instance, using administrative leverage, installs its own management. As a result, aggressor obtains control over corporate documentation,

management and bank accounts. Usually aggressors use provisional measures to support abovementioned actions.

Consistent with all researchers, in practice, certain elements of abovementioned different schemes are usually combined together. The combination is often flavored with initiation of criminal prosecution against the target's director and senior managers through 'consultants' or third parties, and smear campaign to pile further pressure on the target. The abuse of provisional measures is a characteristic feature of all illegal takeovers. Unscrupulous plaintiffs often initiate lawsuits which aim merely to establish provisional remedies. Once the remedy has served its purpose, the plaintiff withdraws its claim, thus making itself immune from liability for the respondent's losses. Since the Arbitration Procedure Code does not provide an exhaustive list of provisional remedies, the court may grant any remedy it finds reasonable. For example, shares belonging to the owner of the company may be seized and later sold through the Federal Property Fund. In addition, movable and immovable property may be attached to shares. Also the company registry may be seized and removed by the bailiff, supply agreements may be frozen, the implementation of decisions of the executive bodies may be suspended, and the executive bodies may be ordered to cease activities indefinitely.

However, despite an impressive array of hostile takeover schemes available, researchers are convinced that certain defense methods can be applied to decline company's attractiveness as target and defend an entity during the attack. Therefore, let us turn to defense methods suggested by previous literature.

## **2.5. Common defense methods against hostile takeovers**

The main idea behind almost all defense methods is to complicate taking over or make it much more costly for an aggressor to takeover. As a result, cost might be increased up to such level where any economical rational behind takeover disappears and aimed company's attractiveness as a potential profitable target becomes smaller or even negative. Takeover defense method might be applied at different point in time. According to many researchers (e.g. Kolleeny, Zhavoronko, 2008) defensive measures are usually subdivided into two groups: preventive and operational. Preventive methods are applied before the threat of a takeover arises. A preventive strategy entails devising and implementing a complex of measures to create legal and economic barriers to prevent a hostile takeover or impede an

aggressor's acquisition of control over the company. Operational measures of defense, on the other hand, are effective when a takeover bid has already been made. Additionally, Demidova (2007) proposed a classification that includes an additional group of universal methods of defense that could be assigned either to preventive or to the operational group. Therefore, Demidova is convinced that universal defensive measures can be applied either before or after a takeover bid. A preventive group of defensive measures includes such methods as asset protection, "golden parachute", creation of strategic alliance, and supermajority. An operational group of defensive measures, on the other hand, includes such methods as "White Knight", counterattack, "scorched earth" tactic, litigation, share buybacks, and asymmetric decisions. A universal group, according to Demidova (2007) consists of "Poison pill" and strategic acquisition. The rest of the section will be divided into two subsections. The first subsection is devoted to preventive measures. The second one will explain above mentioned operational defensive measures. Additionally measures classified as universals will be mentioned in both subsections.

### **2.5.1. Preventive methods**

#### *Asset protection*

This method is based on transferring assets to a third party. According to Demidova (2007), the transfer of assets to a third party is a widespread means of defense in Russia. Other authors also pointed out that method. For instance, Kolleeny, Zhavoronko, and Pentsov (2008) called assets transferring the crown jewels defense method. According to authors the crown jewels defense consists of selling the target's most valuable assets to another company to make the acquisition less attractive. The same idea was mentioned by Weston, Mitchell and Mulherin as well (2006).

There are few advantages and disadvantages of the asset protection method. Kolleeny, Zhavoronko, and Pentsov (2008) and Demidova (2007) pointed out three main disadvantages. First, under Article 79.3 of the JSC Law, deals involving the sale of assets with a value of more than 50% of the balance value of the assets of the company are subject to approval by a shareholders' general meeting taken by a qualified majority of 75% of those participating (the major transaction approval rule). Therefore, if the aggressor has already purchased more than 25% of the voting shares, it could block the sale. Second, if such key assets were to be sold,

the company would probably become less attractive not only for the acquirer, but also for the remaining shareholders, unless the assets were sold to an affiliated company. Third, deals of assets transferring tend to have rather dubious and sometimes sham nature, which might violate minority shareholder right. Therefore, if a deal is not sufficiently lawful and assets are lost, minority shareholders may go to court to obtain compensation for their losses, which managers may have to pay from their personal funds if their actions are deemed unlawful. As a result, the transfer of assets tends to be expensive and risky.

Despite of above mentioned disadvantages the method is widely used. For instance, according to the newspaper Kommersant, 44 per cent of oil company Yukos shares belonged to eight trusts. The funds were managed by two trust companies registered in the British Channel Islands. The assets were transferred from the physical persons who owned them to the trust companies only in February 2004. Demidova is convinced that the trust structure enabled Yukos reliably to conceal the source of the funds used to pay off its debts and to offer possible investors a very rapid return of loaned funds through a simple change of beneficiary.

In addition, Demidova (2007) offered two alternatives instead. First, she is convinced that a cross-collateralization, which involve companies to exchange assets of equal value, would be more equitable alternative. In this case companies' balance sheets do not show a loss. Second, she believes that restructuring liabilities by building up indebtedness might protect assets as well. The restructuring of liabilities by building up indebtedness means the transfer of all assets and liabilities to the firm that is carrying on business activity. This method was used successfully by the management of TogliattiAzot.

### *Executive rewards*

The most well-know executive rewards method, which is routinely used in the modern corporate world, is “golden parachute” provision. Golden parachutes are provisions in employment contracts or separate agreements with top management of a joint stock company that provide for lump-sum payments if their employment is terminated after a change in control (Weston, Mitchell and Mulherin, 2006). The method's deterrent effect tends to be minimal unless the golden parachute composes a truly large payment.

Under Russian law it is possible to use this measure. According to Article 279 of the Labour Code of the Russian Federation (December 30 2001), heads of the organization are entitled to compensation in the amount stipulated in the employment contract if the employment contract is terminated. In addition, compensation should not be less than three times their average monthly wage, provided that they did not commit culpable acts (or failed to act). Furthermore, under Article 281 of the Labour Code, the charter of a joint stock company may extend the application of these provisions to other members of the collective management body of the company such as the administration, the directorate (Article 103.3 GK RF). As a result, a Russian joint stock company may legally state in its charter that the chairman of its board of directors and the members of its administration or directorate are entitled to compensation. The details may or may not be prescribed in the employment contracts. In addition, under Articles 279 and 281 of the Labour Code the general director and other management are entitled to compensation on termination of their employment only if they did not commit any culpable acts (or failed to act). Therefore, if a Russian court finds that any such actions (or omissions) have occurred, it would not compensate those who perpetrated such acts. According to Kolleeny, Zhavoronko, and Pentsov (2008) it is advisable to replace the general director (relations with whom are governed by the Labor Code) with an administrator, and to establish between this administrator and the company a contract governed by the Civil Code. This contract may include a golden parachute. However, unlike the labour contract with the general director it would not be subject to the Labor Code.

The method has both, disadvantages and advantages. The most obvious disadvantage that was pointed out by Demidova (2007) is the risk that management might engage in an opportunistic behavior. For instance, management may present a disadvantageous acquisition bid as an advantageous one in order to obtain large money payments. An acquisition increasing cost, on the other hand, seemed to be the most obvious advantage. According to Demidova, a “golden parachute” agreement has a positive influence on profit per share, which increase the cost of takeover and tends to reduce its likelihood.

Many researchers, e.g. Demidova (2007), Kolleeny, Zhavoronko, and Pentsov, (2008) argue that the method is actively applied in Russia. For instance, this method was used by the confectionery plant Krasny Oktyabr (Red October) when it was defending itself in 1995 against takeover by the Menatep bank. In the event of an acquisition, all employees would have had to be paid enormous sums. As a result, the attractiveness of investment in the

takeover fell by two-thirds. Additionally the “golden parachute” was backed up by an operational defense—share buybacks.

### *Creation of strategic alliance*

This kind of defense is reminiscent of the “White Knight” method, yet unlike the latter, it is applied before the threat of takeover arises. Demidova (2007) and Weston, Mitchell and Mulherin (2006) are convinced that a strategic alliance between two or more firms is capable of defending all parties against an undesirable takeover. However, there is a risk that a strategic partner will turn into a “Gray Knight” and himself try to take over his partner company, using the insider information available to it. Moreover, the creation of an effective alliance is a very difficult task. Demidova (2007) argues that there are examples of successful strategic alliances in Russian practice. For instance, at the end of 2002 the Verysell Group created an entire technology for taking over attractive businesses; while Vest (potential Verysell Group’s target) and Metatekhnologia, have formed a single and fully effective organism to be able protect themselves against Verysell Group.

### *Supermajority*

Supermajority amendment requires shareholder approval by at least two-thirds votes and sometimes as much as 90 per cent of the voting power of outstanding capital stock for all transactions involving change of control (Weston, Mitchell and Mulherin, 2006). This measure limits the ability of the bidder to take possession of the target company even if he has managed to bring the board of directors under his control. It also helps to balance the interests of management with the interests of the target company’s shareholders.

The use of the supermajority provisions defense in Russia is possible. Article 49.4 of the JSC Law prescribes such decisions as amending the charter, approving a new version of the charter, reorganizing or liquidating the company, appointing the liquidation commission, or approving intermediary, final liquidation balances and others must be taken by a qualified majority of 75 per cent of the votes. Additionally, the Law also includes such aspects as determination of the number, nominal value, and types of authorized shares and the rights these shares accord their holders. Furthermore, Kolleeny, Zhavoronko, and Pentsov (2008) pointed out that considering that under Article 57.1 of the Civil Code of the Russian Federation (GK RF) reorganization includes merger, the decision to merge with another



company must be taken by a qualified majority (75%) of the shareholders participating in the general shareholders' meeting. Therefore, if the board of directors and shareholders sympathetic to the management hold more than 25 per cent of the voting shares, they would be able to block any attempt at a merger.

The supermajority requirement in deciding the most important questions pertaining to a company's activity is contained in the charters of many Russian firms. For example, in the company VimpelCom the required supermajority is 80 per cent. This fact came to light through the unsuccessful attempt of a raider in 2005 to annul this provision with the aid of a minority shareholder, who sued the company to force a change its charter so that a simple majority on the board of directors would suffice to decide the most important questions. The Norwegian company Telenor, whose interests as a shareholder in VimpelCom were at stake, had to go to the Russian Federation Supreme Court to uphold the 80 per cent rule.

### *Poison pill*

Poison pills are detachable rights issued to the shareholders of a company in addition to their shares. These rights become exercisable upon a certain triggering event such as a third person acquiring a certain number of the company's shares. Two most common poison pills are flip-in rights and flip-over rights. Flip-in rights enable shareholders to purchase additional shares in their company, which will dilute the share of the acquirer and make the acquisition less attractive. Flip-over rights on the other hand allow buying equity in the acquiring company (Weston, Mitchell and Mulherin, 2006). In addition to abovementioned types, Ryngaert (1988) identifies three extra kinds of "poison pills" such as the true "poison pill", the voting plan, and the feedback plan.

According to Kolleeny, Zhavoronko, and Pentsov (2008), implementing poison pills in Russia may be difficult. Article 27.1 of the JSC Law has provisions that allow the authorized shares of a company to be included into the company's charter. Moreover, under Article 65.1.5 of the JSC Law, the board of directors of a joint stock company may be authorized to issue additional shares within the limits set out by the company's charter. However, once the company receives a voluntary or a mandatory offer for the purchase of more than 30% of its ordinary shares and preferred shares with voting rights (Article 32.5 of the JSC Law), only the general shareholders' meeting can decide on the issuance of additional shares (Article 84.6.1).

Therefore, a board may use poison pills to deter third parties from making a bid, once an offer is made for more than 30% of voting shares the defense is undermined.

The first “poison pill” in Russia was introduced by the American automobile company General Motors (GM) in 2001 (Demidova, 2007). GM included in the charter of its joint venture with AvtoVAZ a reservation concerning its right to full control over the joint venture in the event of a change in the ownership structure of AvtoVAZ. This “pill” dampened the interest of competitors in taking over AvtoVAZ and prevented potential owners from using the GM or Chevrolet trademark. Moreover, Demidova (2007) agreed with Schwert (1995) that smaller companies tend to more often choose “poison pills” as a means of defense since large companies are less likely to face takeovers. Therefore, Demidova is convinced that the creation of a joint venture, in which the foreign partner has the option to buy out the share of the Russian partner if a hostile takeover begins, may also be regarded as a guaranteed source of funds.

#### *Strategic acquisition*

According to Demidova (2007) and Weston, Mitchell and Mulherin (2006), strategic acquisition also might be applied as a corporate restructuring and reorganization type of defensive measure. Weston, Mitchell and Mulherin (2006) are arguing that assets acquisition might be used as a tool to dilute the ownership position, or create antitrust problem for a bidder. Demidova (2007) argues that these measures enable a company to complicate the process of hostile takeover. However, one of their defects as a preventive measure is the unpredictability of a potential aggressor before he makes an official takeover bid.

Despite the usefulness of the measure the defects related to the strategic acquisition strategy seems to be great. Therefore, according to Demidova, strategic acquisitions have only rarely been used as a means of defense in Russia. One of the few examples of this method is the acquisition by Norilsk Nickel in April 2005 of a controlling share in the closed joint-stock register-holding company Ediny Registrator. Having “one’s own” registrar facilitates defense against hostile takeovers.

### *Staggered boards of directors*

Under a staggered board arrangement, only a certain number of board members (usually one-third) can be elected in any given year. The effect of this defense is that anyone taking control of the company must wait a number of years before they can fill the board with new members. This defense is widely used in the west. However, according to Kolleeny, Zhavoronko, and Pentsov (2008), the application is not possible in Russia. Article 66.1 of the JSC Law says that the board of directors of a company is to be elected by a shareholders' general meeting pursuant to the procedure stipulated by the Law and the foundation documents of the company, for a period until the next annual general meeting of shareholders.

### *Varied voting rights*

Varied voting rights refer to issuing more than one class of common shares with different voting rights. For instance, two classes of such shares usually referred to as dual capitalization. Furthermore, by allocating the shares with greater voting rights to the current management and groups of shareholders that might support the management increases the management's control over decisions taken at the shareholders' general meeting.

Kolleeny, Zhavoronko, and Pentsov (2008) argue that this defense cannot be used in Russia. Article 31.1 of the JSC Law says that each common share of the company gives its owner (the shareholder) the same rights. In addition, Article 59 says that voting at the general meeting of shareholders will be based on the principle of one voting share, one vote. Furthermore, authors believe it is possible to establish a limit in the company's charter on the maximum number of votes that can belong to a single shareholder under Article 11.3 of the JSC law, to prevent a hostile third party from accumulating too much voting power. However, Kolleeny, Zhavoronko, and Pentsov (2008) are convinced that this limit could be easily evaded by purchasing shares in the name of a number of different companies. And if the acquiring persons are not shareholders in the company, they may not be affected by the limitation.

## **2.5.2. Operational methods**

### *“White Knight”*

Weston, Mitchell and Mulherin, (2006) define the white knight defense strategy as a choosing another company with which the target prefers to be combined. According to Demidova

(2007), companies often use this kind of defense as a lesser evil. However, potential targets are often taken over by the “White Knights” themselves. On the other hand, Kolleeny, Zhavoronko, and Pentsov (2008) believe that this generalization does not apply to Russia, because the managers that resort to such a method generally tend to have good personal relations with the “White Knight,” as a result, an unexpected transformation into a “Gray” or “Black Knight” tends to be out of question. This method may therefore prove quite reliable and advantageous. In addition, the method tends to be not available to those companies that have among their business partners no suitable candidates for the role of “savior.”

According to Demidova (2007), there are many examples of a “White Knight” defense method. For instance, MMK and Tatneft were taking a “White Knight” role in the attempt to take over MKZ. Additionally, there are also examples, in which a company which was playing role of a “White Knight” then gained control over the saved target. Demidova (2007) argues that such cases are more widespread in Russia than cases in which control is not lost. For instance, in spring 2001 control over Varyeganneft was handed over to Slavneft in order to defend it against an attack from the Alyans Group.

### *Counterattack*

Counterattack is also called as a Pac Man defense. The essence of this measure is making of a counterbid to buy up the shares of the raider company (Weston, Mitchell and Mulherin, (2006)). All authors identified few essential points related to the method. Authors (e.g. Demidova, 2007, Weston, Mitchell (2006)) pointed out that the method could be extremely costly and could have devastating financial effects for both firms involved. In addition, Weston, Mitchell and Mulherin, (2006) believe that the method is more likely to be effective if the target is much larger than the bidder.

There is also other types of counterattack used in Russia as well. According to Demidova (2007) and Kireev (2007), in Russia a more widespread form of counterattack involves the purchase of bonds rather than shares. For instance, the counterattack approach was taken by the banks of the Interros Group, which in 1997 obtained the right to call in the credit previously extended to the Renova Company by Inkombank. This was probably an attempt to reduce the pressure resulting from the deal made by Interros to acquire a stake in RUSIA Petroleum.

Furthermore, Demidova (2007) argues that public relations tactics such as publishing compromising material defaming one another in the mass media are also actively employed in a counterattack. For instance, when in 2005 TNK tried to place its representatives on the boards of management of the subsidiary structures of Slavneft, the latter declared that it intended to purchase TNK itself. The most vivid episode in the conflict was the appearance in the sky above Moscow of a dirigible bearing the message: “Branch of Slavneft on Shchipok Street” (the headquarters of TNK are on this street). Slavneft succeeded in drawing the attention of journalists and showing that the company intended to fight against invasion from outside.

### *Asymmetric solutions*

There are a few factors that supported asymmetric solutions defense method's being used more often. First, most defenses against hostile takeovers require substantial outlays. Second, the raider company and the target company are often not comparable in market power. These two factors pushed companies, especially those with limited financial resources, to constantly search for so-called creative or asymmetric solutions. According to Tytihin (2003), the chief advantage of such solutions is their low cost. Furthermore, Demidova (2007) and Tytihin (2003) identified many types of asymmetric solutions. Tytihin (2003) argues that the most cheap and effective way to combat abuse of administrative resource is to contact related Internal Security Directorate department or some sort of internal control body. Another asymmetric solution mentioned by Demidova and Tytihin is PR actions “letters to the president”. According to authors “letters to the president” means sending out complaints to every conceivable state agency such as FSB, MVD, prosecutor-general's office, and even to the president informing that attempts are being made to seize the firm using administrative mechanisms.

Above mentioned asymmetric solutions were used quite often. For instance, an interesting and inexpensive method of defense was provided in the unsuccessful attempt of the investment company Alfa-Eko (a well-known raider) to seize the Taganrog Metallurgical Works (Tagmet) in 2002. Alfa-Eko used quite standard methods in target taking over. First it bought shares, than Alfa-Eko convened an alternative shareholders' meeting, and after that a siege of the firm with the aid of the special police (OMON) was used. However, Alfa-Eko

representatives even offered Tagmet general director S. Bidash a seat in the Federation Council. Bidash responded by asking the directors of Alfa-Eko to sign papers guaranteeing him this seat, and then made these papers public to demonstrate that a private company was trading in the highest state offices, thereby thwarting the seizure of his firm.

#### *“Scorched earth” tactic*

This type of defense is related to reorganizing financial claims. Weston, Mitchell and Mulherin, (2006) define “scorched earth” tactic as assuming liabilities in an effort to make the proposed takeover unattractive to the acquiring firm. This type of defense may be regarded as an extreme form of “poison pill,” taken after a takeover bid has been publicly announced. In the West its forms range from sale of the “crown jewels” to lobbying for regulatory protection. In Russia, according to Demidova (2007), the target company typically tries to conceal information about its profits and balance sheet, or present them in the least attractive light. In addition another popular method is taking out credit at an incredible rate of interest, especially if the company has a “pocket” bank.

There are many examples of “scorched earth” tactic used in Russia. The restructuring of Norilsk Nickel in 2001 is one of them. The main stages of defense mechanism included combination of “scorched earth” and the crown jewel tactics.

#### *Litigation*

This type of defense method might be categorized under administrative resources group. Demidova (2007) is convinced that due to the weaknesses of the Russian judicial system, litigation defensive method may be regarded as a resort to the administrative resource. In addition, the method can occur lawfully and unlawfully. According to Demidova, the unlawful scenario usually applies if the target company has connections in court and/or is able to bribe officials.

However, despite abovementioned weaknesses of the Russian judicial system Demidova finds the positive effect as well. The author believes that due to defects in the civil law system there might be such positive effects as delays in the issue of rulings and the stretching out of court proceedings, affording target companies the time needed to work out defensive strategies.

However, Demidova also states that due to the high likelihood of judicial error in Russia this form of defense can turn out to be very expensive.

### *Share buybacks*

This type of defense refers to the company buying up its own shares on the open market. Demidova (2007) and Weston, Mitchell and Mulherin (2006) argue that besides defending against takeover, share-repurchasing can increase income per share and market capitalization, particularly when shares are undervalued. However, Demidova is convinced that since this competition may sharply increase the share prices, this form of defense can be very expensive.

An example of this method of defense is provided by the open joint-stock company Surgutneftegaz. By various estimates, up to 62 per cent of the shares of Surgutneftegaz belong to its own subsidiaries (stripped shares) (Demidova 2007). According to Article 72, point 3 of the JSC Law, shares that have been acquired by the issuing company itself do not give voting rights, are not taken into account when counting up votes, and do not yield dividends. Such shares must be sold off within one year of the date of their acquisition or redeemed with the corresponding reduction in share capital. However, the management of Surgutneftegaz takes the view that if a subsidiary owns shares of its parent company then these rules do not apply. For many years management maintained control over the firm with the aid of this simple device, using its stripped shares to take part in voting.

### *Poison pill*

The difference between operational poison pills and preventive one is based on timing. Preventive poison pill is applied before any hostile takeover threat rather than after one as operational poison pill. Comment and Schwert (1995) cite evidence to show that operational “poison pills,” in contrast to preventive ones, are highly effective due to the element of surprise. According to their results, takeover bids tend to be less successful when the “pills” used are operational rather than preventive and predictable. Additionally, they argue that “pills” increase the takeover costs for the bidder company and strengthen the position of the target company. The management of the target company also can reduce its attractiveness by offering existing shareholders the right to acquire new issues of ordinary or privileged securities. However, it tends to be the case only in the event of an attempt at seizure, when

any investor concentrates in his hands 15–20 per cent block of shares. This right is backed by an additional emission of securities and may enable shareholders to purchase shares at a lower price. The potential aggressor in this case finds himself in an unfavorable position due to shareholding being diluted and share of real ownership being diminished.

According to Demidova (2007), there are many examples of the “poison pills” defense measures in Russia. For instance, an additional emission of ordinary shares by the Lebedinskii Ore Enrichment Plant (Belgorod Oblast) in summer 1997 reduced the voting power of the Rossiiskii Kredit commercial bank from 24 per cent to 5 per cent. For the Lebedinskii management this tactic proved unsuccessful: the court ruled that the emission was invalid, allowing Rossiiskii Kredit to obtain a blocking shareholding. A textbook example of the successful use of an operational “poison pill” was demonstrated by the private oil company Severnaya Neft when the giant LUKoil tried to take it over in 1999. Apparently, nothing could save Severnaya Neft from being taken over by LUKoil. However, the Severnaya Neft managers held an extraordinary shareholders’ meeting (at which representatives of LUKoil were absent) at which a decision was adopted to issue additional shares. As a result, LUKoil’s share of Severnaya Neft was diluted from 25 to 2.5 percent.

### *Strategic acquisition*

Demidova (2007) and Weston, Mitchell and Mulherin, (2006) believe that strategic acquisition might be used as operational type defense measure as well. According to authors, the most popular methods are the purchase of assets that will be unattractive to an aggressor, which may also create obstacles to the acquisition from the point of view of antimonopoly legislation, or the transfer of assets to associated companies. However, the purchase of unneeded assets may also reduce the value of the target company.



### **3. Methodology and data**

This part of the study examines details related to first, data collected and used in the study. Second, this section will talk about methodology applied within case analysis and critical moments of the methodology applied.

#### *Data*

Two takeover events were chosen for the research. First case is TogliattiAzot's takeover event. Second takeover case is Russneft. Togliattiazot and Russneft tend to be critical cases rather representative ones. The critical cases are chosen because they encompass the most concerned issues that I'm interested in, rather than help to attempt statistical generalization. Data used in the research is a combination of several types and sources. First, juridical databases "Consultant", "Codex" and "Garant" is used to obtain data related to takeover events trials. Databases contain such data as claims filed by plaintiff and courts decisions. However, there might be some limitations due to courts' ruling to hold information related to some particular trials undisclosed. Second, a number of interviews with participants of the market for corporate control is conducted. Through interviews it's expected to obtain data and information related to takeover events not available to the public.

#### *Case analysis*

Units of analysis are two takeover cases to which phenomena under study and research problem refers and about which qualitative data is collected and analyzed. I intend to apply within-case analysis methods. The most essential part of the method is to become totally familiar with the material and event being studied to build up a separate description of event. Becoming familiar with the events and constructing separate descriptions will enable me to identify possible pattern with an attempt to build theoretical generalizations. First, case analysis is expected to highlight usefulness of takeover defense methods via takeover events comparison and identifying methods effect on takeover process. Second, theoretical generalizations will be summarized in Survival Guide part of the research which is expected to have a practical value for entities and serve as some sort of instructions for enterprises in hostile environment.

## **4. Cases Analysis**

### **4.1. TogliattiAzot takeover**

#### **4.1.1. Introduction**

Chemical Corporation TogliattiAzot (ToAz) is one of the world's largest producers and exporters of ammonia. JSC TogliattiAzot is the largest in Russia producer of ammonia (account for about 7.6% of the world market). In 2004, production amounted to 2156 million tons of ammonia, 361 thousand of nitrogen fertilizer, and 387 thousand tons of methanol. In 2004, factory's revenue was \$ 413 million with net profit of \$ 62 million. Vladimir Makhlay controls 71% shares of JSC TogliattiAzot through affiliated with him and his son, Sergei Makhlay companies. Following companies are main ToAz shareholders: Nitrochem Distribution AG (18%), Tech-Lord SA (20%), PPFM SA (20%), Chimrost AG (5%) and CJSC Tolyattihimbank (8%). Yet about 20% of the shares are owned by chemical giant ToAZ employees and top managers. Approximately 9.14 % of the shares owned by Sinttech Group, close to the company Renova owned by tycoon Viktor Vekselberg. Recently ToAz was becoming well-known not because of its activities, but due to conflict around the company and its property.

In 2004, government agencies begun to show interest in ToAz's activities and the company faced endless public inspections from all possible agencies which resulted in law suit challenging company's privatization in 1996. In 2005, the president of ToAz V. Makhlay, the majority owner, was approached by representatives of Renova Group with an offer to acquire his controlling stake in ToAz. V. Makhlay turned down the offer. Next, government agencies' inspections followed by series of attempts to capture power over the company with nowadays familiar "masks shows" (forceful seizure) based on criminal cases initiated by the Ministry of Internal Affairs (MVD) against V. Makhlay and ToAz's CEO A. Makarov and charges of tax evasion for 2002-2004.

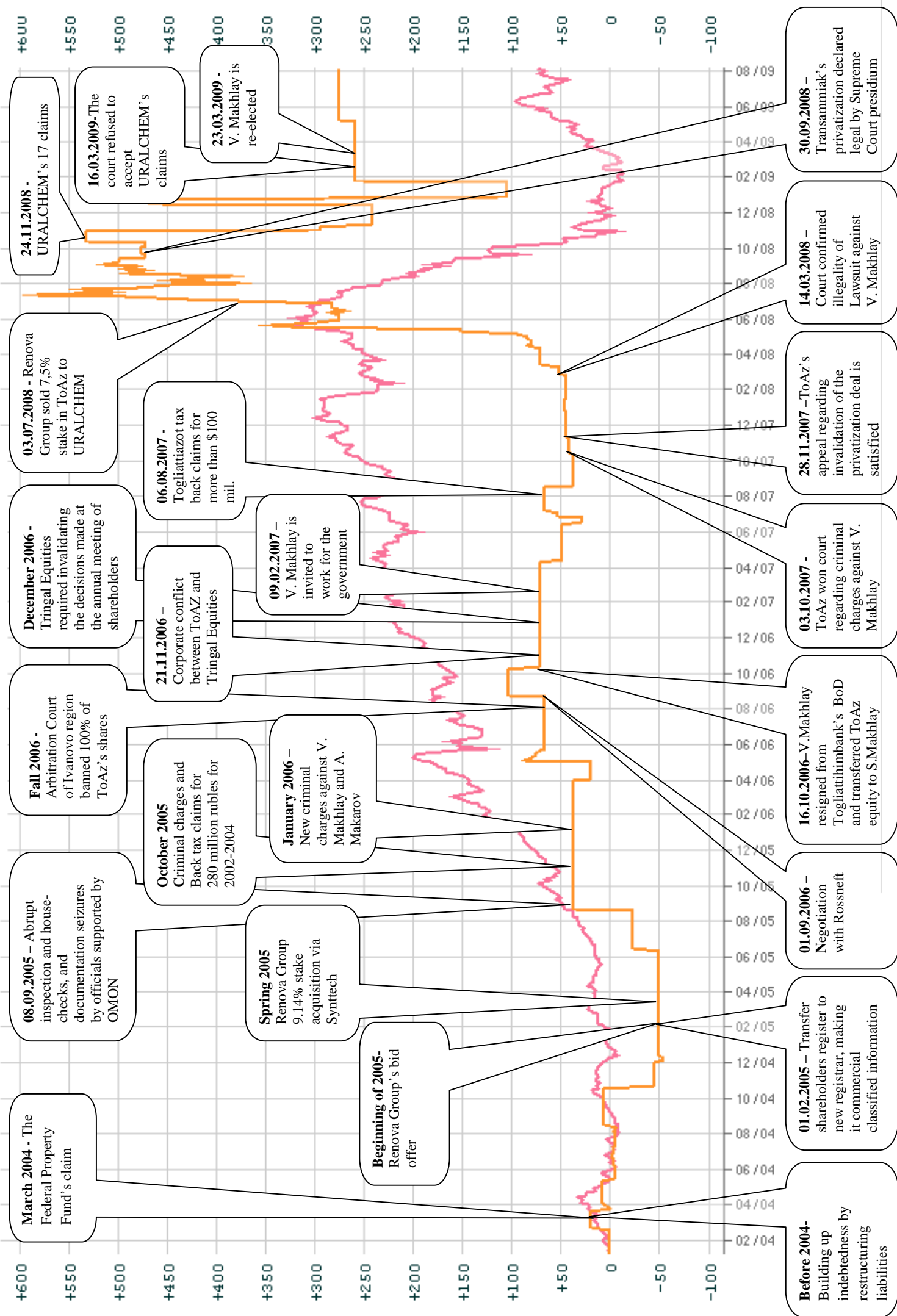
Finally, when neither the first nor the second option did not give the expected result, the company was sued in courts by different, sometimes even not in any way related entities. ToAz suspected that the main purpose of these criminal and civil suits was to force TogliattiAzot's management to give up their assets, but the aim had not been achieved,

target's opponents have not acquired any success. V. Makhlay and A. Makarov were staying in a country, which had not extradited any individual in the last few years. And at that point it looked like the Investigating Committee and the Prosecutor's Office were coming to realize that the case, which was initiated groundlessly, is reaching a deadlock. It seemed that the relevant parties had also realized the lack of prospects in this case, and they had begun to act suspiciously in the arbitration courts. First, out of the blue in the Ivanovo Region Arbitration Court there appeared a case involving two anonymous companies in dispute over the entire share capital of TogliattiAzot. One of them had not fulfilled the provisions of a sale and purchase contract and in turn the other company had asked the court to seize all of TogliattiAzot shares. The judge awarded a ruling to seize the shares. Second, Tringal Equities minority shareholders took ToAz to the court.

A bit later in April 2007 Sibus (Gazprom affiliated company) approached ToAz with offer to acquire controlling stake. However, despite being under huge pressure V. Makhlay wasn't too excited about terms of the Sibus's offer and suggested search for mutually beneficial terms. In July 2008 Renova Group sold 7.5% of ToAz stake to URALCHEM, another top Russian producer of ammonium nitrate and the second largest producer by volume of nitrogen fertilizers. Using ToAz's vulnerable position URALCHEM filed seventeen lawsuits against TogliattiAzot with requirements to provide various documents.

It seemed that TogliattiAzot became an extremely attractive target for various parties approximately at the same time. Figure below highlights main critical episodes in ToAz's takeover event. Next, following sections of the case will take a closer look at interests and pressure aimed at the company and its majority shareholders.

**Dynamics of RTSI index and tlaz (ToAz)**  
 Period: 05.01.2004 - 03.08.2009



**March 2004** - The Federal Property Fund's claim

**08.09.2005** - Abrupt inspection and house-checks, and documentation seizures by officials supported by OMON

**October 2005** Criminal charges and Back tax claims for 280 million rubles for 2002-2004

**Spring 2005** Renova Group 9.14% stake acquisition via Synttech

**Beginning of 2005**- Renova Group's bid offer

**Fall 2006** - Arbitration Court of Ivanovo region banned 100% of ToAz's shares

**21.11.2006** - Corporate conflict between ToAZ and Tringal Equities

**09.02.2007** - V. Makhlay is invited to work for the government

**03.07.2008** - Renova Group sold 7,5% stake in ToAz to URALCHEM

**06.08.2007** - Togliattiazot tax back claims for more than \$100 mil.

**24.11.2008** - URALCHEM's 17 claims

**16.03.2009**-The court refused to accept URALCHEM's claims

**23.03.2009** - V. Makhlay is re-elected

**Before 2004**- Building up indebtedness by restructuring liabilities

**01.02.2005** - Transfer shareholders register to new registrar, making it commercial classified information

**01.09.2006** - Negotiation with Rosснеft

**16.10.2006**-V. Makhlay resigned from Togliattimbank's BoD and transferred ToAz equity to S.Makhlay

**03.10.2007** - ToAz won court regarding criminal charges against V. Makhlay

**28.11.2007** -ToAz's appeal regarding invalidation of the privatization deal is satisfied

**14.03.2008** - Court confirmed illegality of Lawsuit against V. Makhlay

**30.09.2008** - Transsamkiak's privatization declared legal by Supreme Court presidium

#### **4.1.2. Pressure on the company**

This section of the case is devoted to pressure on ToAz as an entity. The pressure initiated by mostly government agencies was pointed at the company directly. First, I will talk about Tax authority's interactions with the target. Second, abrupt inspections and actions of MVD and FSB agencies will be discussed. Thirdly, I will mention lawsuits against ToAz and its affiliated entities by Federal Property Management of the Russian Federation (Rosimushchestvo). And finally I'll give an example of how the above mentioned pressure acts affected the company's status and its access to capital. Now let us turn to tax authorities.

##### *Tax authority*

TogliattiAzot became the focus point of tax authorities in 2005. Then Samara region Federal Tax Service (FTS) administration submitted claims accounted for RUR 280 million rubles (\$10.068mil) for period of 2001-2003. Next, based on results of a 2003 field audit, the Directorate of the FTS in the Samara region served ToAz with tax claims totaling RUR 660 mn (\$25.3mil). The claims were served after a second audit conducted by fiscal authorities at the company. Overall, during years 2005 and 2006 tax authorities held five visiting and 118 desk audits inspections of the plant. The result of tax check conducted in the first half of 2006 was a claim for RUR 13 million (\$479 993) for years 2003, 2004. The company was going to challenge the inspection's outcome. First, ToAz intended to appeal to a conciliation commission. Second, if the commission had rejected the appeal, TogliattiAzot would have filed a lawsuit against the Federal Tax Service (FTS). Representatives of Samara region FTS's administration however refused to comment on ToAz's situation referring to the head of administration's absence. However, being unaware about the inspection outcomes and on holiday at that time didn't stop the head of the Samara region FTS, Bahmurov Alexander to comment on the situation. He said that "the company should not be surprised by the size of the claim's amount".

Next, in August 2007 TogliattiAzot once again received new tax claim for RUR 2.582 billion (\$100.365 mil) as a result of re-visiting tax audit inspection of 2004 operating year. Out of RUR 2.6 billion RUR 1.613 billion accounted for income taxes, and RUR 955 million were value-added tax (VAT). The company considered the claims being unfounded and aimed at

destabilization of the chemical plant, which is almost completely responsible for region's social well-being.

Market participants were linking tax authorities' interest to possible takeovers attacks on the plant with Renova Group and Gazprom, even though both companies were denying it. Market participants suspected that Gazprom's SIBUR-Mineral Fertilizer could also be behind the pressure. Experts considered a possibility that ToAz fall into Gazprom's "wish-list". Troika Dialog's analyst, Mikhail Stiskin believes that tax claim is a consequence of Vladimir Makhlai and Alexander Makarov prosecution. However, Stiskin also added that financial figures of TogliattiAzot will not be affected by the claim.

#### *MVD and FSB*

In April 2005 TogliattiAzot unexpectedly received a request from the Economic Security Department of the Ministry of Internal Affairs (MVD) to provide details of almost every document regarding its economic activities, no matter how trivial the transaction concerned. TogliattiAzot is a huge structure, a corporation serving multiple business functions in addition to the production of nitrogen. The Economic Security Department also took an interest in the register of shareholders. It is common knowledge that the register of shareholders is generally requested for the purpose of making modifications. As a rule, the parties requesting the register in such circumstances are known to be hostile forces that attempt to seize the assets of an enterprise in an underhanded fashion. At that time ToAz suspected that no good would come of the discovery of such documents including the register of shareholders. On 29 June 2005 the Investigating Committee of the Ministry of Internal Affairs filed criminal proceedings against several TogliattiAzot employees. The identities of these employees were withheld. The company's representatives were informed of these events in early September 2005 when a large group of armed individuals rushed into the enterprise by force and demanded all documents. In compliance with the procedural law, an investigator's demands must be presented as a legal resolution on execution of seizure. To conduct a seizure he does not need to resort to armed forces: an investigator will simply need to enter the premises, display his identity card and serve the resolution for the exercise of seizure. Once these steps have been taken, legitimate seizure takes place. No armed forces are required for this purpose. This is in fact the way following seizures have been conducted for following years. However,

in this case the investigators adopted “the use of force” strategy. Undoubtedly this method was used to impose a degree of threat.

Later it was disclosed that a claim had been initiated under Article 199 of the Criminal Code (fraud and legalizations of funds obtained by illegal means). According to representatives of MVD, from 2002 to 2004, ToAz significantly reduced ammonia export prices and in this way a large proportion of profits were evaded for taxation purposes. It was affirmed that ammonia had been sold by an affiliated company or in other words by the company under control of V. Makhlay, ToAz’s President. The allegations were further embellished by a claim filed by Rosimushchestvo claiming the privatization procedure undertaken by the company had been made in violation. ToAz attorneys were made aware of such allegations in the weirdest circumstances. Mr. Shamin, the investigator on this case, submitted his ruling on drawing to the criminal case as the accused person to the Highest Arbitration Court of Russia, where a hearing on a civil case was held on that day. This was an unprecedented occurrence. Investigators on no account visit arbitration courts and arbitration courts are in no way interested in the contents of a criminal case. Thankfully, the Arbitration Court came to a lawful decision by concluding that TogliattiAzot had not committed a criminal act during the privatization process. This decision was made by the Highest Arbitration Court on 22 November 2005. As for the investigator, he was denied permission to enter the courtroom in accordance with the law.

The situation looked critical for V. Makhlay and A. Makarov, ToAz’s CEO. In April 2006, both were put on wanted list and announced in the international search. Furthermore, Tverskoj Court in Moscow ordered their (V. Makhlay and A. Makarov) arrest on 21st of April. Tverskoj Court also refused to consider defense complaints and argumentations against court decision, referring the case’s different jurisdiction. Makhlay and Makarov on the other hand were aware that the criminal case had been initiated with the aim of confiscating the owners’ assets. Coincidentally, during the course of the allegations V. Makhlay had been undergoing a course of medical treatment abroad and A. Makarov had also gone abroad for a training course. They had not come back to Russia and, in this way they had ruined Mr. Shamin’s game.

Let us begin the discussion by focusing on the tax allegations. Article 40 of the Russian Tax Code provides that a reduction in the costs of goods by more than 20% is construed as a tax

violation and the Tax Code stipulates special remedial measures in such an occurrence. The Code also provides guidance for the principles of determining the difference between price reduction and market prices. This was a stumbling point for the investigators as a market price for ammonia does not exist. Ammonia is not traded on the stock exchange, so market forces do not operate explicitly to determine the price for a barrel of ammonia. It becomes clear that the market for ammonia is shaped and led by factors other than market forces. A further stumbling point for the investigators was the fact that the trader dealing with selling of Togliatti ammonia was not an offshore company of Cyprus or the British Virgin Islands but a respectable Swiss company, which is engaged in various business activities and bears no special connection to V. Makhlay or A. Makarov.

A significant point to consider is that the allegations, which led to the criminal suit, were initiated by a company bearing a pompous name LLC Expert-GUM but who is virtually unheard of in business circles in the town of Stupino in the Moscow region. This company bears no link to governmental bodies, but it is common knowledge that the views of any profit-making organizations carry no weight in determining tax violations especially when an official investigation is conducted. That's why defense attorneys asked to operate legal expertise to determine the correlation between the actual price of ammonia and market prices. Mysteriously, the investigator postponed the legal expertise to April 2006. His conduct appeared out of the ordinary when he delegated the legal expertise to a science specialist who was unfamiliar with the ammonia sector and was unheard of amongst the chemist circles. The experts report is still due. In this period of time ToAz had already conducted four expert examinations, two of which have been carried out by the government expert from the Institution of the Ministry of Justice. Following results were obtained. Firstly, the method of calculation, on which the case was based, was flawed and, secondly, no significant reduction in the price of ammonia was identified. These expert conclusions were sent both to the investigator and the General Prosecutor's Office a while ago however they have been disregarded.

In May 2007 MVD Togliatti, based on materials received from the Russian Ministry of Internal Affairs, instituted a new criminal case against V. Makhlay accusing him in tax evasions done while exporting ammonia in 2005. However, in October, Togliatti city's Avtozavodskij's District Court declared criminal proceedings against the president and chairman of the board of directors of OJSC TogliattiAzot Vladimir Makhlay illegal.



*Federal Property Fund of the Russian Federation (Rosimushchestvo)*

In 1995, the Federal Property Fund of Russian Federation transferred 51% of Transammiak (services ammonialine Togliatti – Odessa) shares to ToAz in exchange for a 6.1% stake in ToAz. In autumn 1996, 6.1% stake in ToAz was bought (privatized) by JV Tafco (company close to Vladimir Makhlay). Tafco was required to modernize ammonia pipeline and build two ammonia pipelines to connect two other producers of ammonia. However, according to Rosimushchestvo the company confined itself to the modernization of ammonia pipeline only. In 1999, Rosimushchestvo investigated the investment program in Transammiak, after which the lawyers of the fund came to the conclusion that the sale of shares of ToAz to Tafco is the imaginary transaction (bogus transaction/ sham transaction).

The transaction by which ToAz became the owner of the controlling interest in JSC Transammiak, and the latter, in its turn, received 6.1% of the shares in ToAz occurred in 1996, was initiated by an order of the Russian Federation Government, according to which it was decided to unite the production process and transportation of ammonia into a single chain. Eight years later, when certain parties became interested in the assets of ToAz, the Federal Property Fund of the Russian Federation (Rosimushchestvo) required to declare the transaction void. In the spring of 2004 the Samara Region Arbitration Court's Judge Tatyana Bredikhina, upon examining the facts of the case decided that "the court had no grounds to nullify the transaction". Shortly thereafter her colleague, Olga Kalennikova rejected the claim of the Rosimushchestvo which proposed that privatization of ToAz was illegal.

In the first two instances Rosimushchestvo denied to satisfy the claim. However, in March 2005 Court of Appeal concluded the invalidity of the transaction. As a result of the Court of Appeal decision the Samara Arbitrage Court ruled decision to arrest/seize 30% of TogliattiAzot shares owned by Swiss companies (close to V. Mikhlay) Nitrochem Distribution AG, Tech-Lord SA, PPFM SA, Chimrost AG and Togliattihimbank based in Russia, Togliatti. Due to the court ruled ban, owners of seized 30% stake in TogliattiAzot were not able to either vote with their shares or transfer shares as security to a third person. In response Tafco filed an appeal to the Supreme Arbitration Court of the Russian Federation which then passed the case for review. Moreover, the Supreme Arbitration Court underlined that competitive sale of shares at investment tenders had been performed in full compliance

with law and the Samara Region Property Management had acted in accordance with the Russian Federation President Decree of 29 November 1992.

A retrial of the case in the Samara Region Arbitration Court turned into a real failure for Tafco. The same court, which had earlier rejected the claimant's arguments, went on to completely agree with Rosimushchestvo and obligated the company to return all ToAz shares to the government. The holder of shareholders' register was ordered to make alterations in the register of the company's securities. As for Rosimushchestvo, the court obligated it merely to pay Tafco the nominal value of shares without taking their current market value into consideration. The Court did not take in account that the defendant had completely carried out its investment obligations and invested \$7 million in the development of Transammiak, a related ToAz's enterprise. As a result, Tafco had to file an appeal against this decision to the Federal Arbitration Court of Povolzhsky Territory.

Next two following events tend to be favorable to ToAz. First, in March 2007 the Supreme Arbitration Court had overturned the Samara Region Arbitration Court's decision to ban 30% of TogliattiAzot shares and lifted the temporary equity arrest of the shares in JSC TogliattiAzot. The higher instance court decision was taken on due to the appeal left by Tolyattihimbank, which along with other owners of the securities were not allowed to vote. Second, in December 2007, the Federal Arbitration Court of Povolzhsky Territory had passed the previously nullified case concerning the privatization of ToAz shares (6,1%) by JV Tafco for a retrial at the Samara Region Arbitration Court. The Povolzhsky Court had commented on its decision and explained that the conclusions drawn by the previous courts had not complied with the factual background and evidence. The Federal Arbitration Court of Povolzhsky Territory has also pointed out the numerous defects in the procedural law, which were made with respect to the appealed court decisions. ToAz's representatives called it "a small victory over raiders" and considered it very important for the judicial proceeding as a whole. The appellate court judges especially pointed out the numerous errors made by the previous courts and they explained that the errors were caused by the fact that the examination of the case documents "had been conducted without consideration to all the relevant circumstances which were of great importance to the case".

And finally, in September 2008 The Supreme Arbitration Court Presidium of the Russian Federation declared the privatization of JSC Transammiak legal. The court considered

complaints filed by JSC Transammiak, JSC Togliattiazot and JV Tafco concerning the decision of the Samara Region Arbitration court to invalidate the transaction of exchanged 6.1% of Togliattiazot shares for 51% of Transammiak shares. The court decided to cancel all pleas concerning this affair and rejected the suit of Rosimushchestvo requesting that the transaction be declared invalid.

The allegations of intentional criminal actions in connection to the purchasing of shares can be called illogical even on basis of the fact that there is an evident legal controversy connected with the Russian government decisions. And this controversy is still under consideration of the arbitration courts, which proves there could be no criminal intent.

#### *Access to capital*

As a result of tax claims, abrupt inspections and lawsuits, the company's access to capital became more complicated. According to executive manager, Sergey Korushev, corporate conflict around ToAZ is worsening the company's access to credit resources needed for business development. Executive manager stated that bankers and other stakeholders perceived ToAz with great caution and anxiety. Sergei Korushev noted that inspections and seizure of documents constantly carried out at the plant, the various criminal cases against company which have lasted for years, tended to distract and fidget entity's employees and management. For instance, due to the volatile situation around TogliattiAzot, European Bank for Reconstruction and Development (EBRD) and International Finance Corporation (IFC) suspended credit agreements for 235 million dollars.

However, according to field analysts despite the corporate conflicts the company has been developing dynamically. It almost finished reconstruction of methanol production and managed to double production of carbamide-formaldehyde concentrate (CFC).

#### **4.1.3. Pressure from minorities**

Following sections of the case analysis is devoted to minority groups. First, I will study Renova Group which was accused of putting a pressure on ToAz. Second, an interesting case of false shareholders will be discussed. Third subsection will be devoted to discussion of

pressure on ToAZ initiated by Tringals Equities Inc. And fourth, relatively new ToAZ's minority shareholder will be considered.

### *Renova Group*

Renova Group is a large Russian conglomerate with interests in aluminum, oil, energy, telecoms and a variety of other sectors. The main owner and president is a tycoon Viktor Vekselberg. The Renova Group is primarily active in Russia, the C.I.S. states, Switzerland, South Africa and the United States. Its major assets include participation in the oil company TNK-BP, UC Rusal, Integrated Energy Systems and Sulzer. The value of Renova Group assets was US \$ 24.77 bn.

At the beginning of 2005 Renova Group's representatives approached V. Makhlay with an offer of acquiring his controlling stake in ToAZ. President's repelling the offer did not puzzle the Renova and in spring 2005 Group acquired 9.14% stake in ToAZ through its affiliated company Syntech. Following step for Syntech was an unsuccessful attempt to obtain greater control over the company by filling some of the Board of Directors seats with loyal to them directors. After Renova's failing attempts to acquire greater control over the company minorities started to express their interest towards ToAZ. First, ToAZ learned about anxious to become ToAZ's shareholder company Nega which was able to ban 100% ToAZ equity stake for two and a half months. Second, in December 2006 2% minority holder Tringal Equity Inc. filed a claim requiring compensating damages caused to an offshore company. In the first case of "false shareholders" attack, it's quite difficult to prove any links between Nega and Renova. Tringal's case on the other hand is different. First of all, a fact that A. Kozlov, Renova's top executive was in Tringal's BoD at that time makes you think about possible connections. Second, authorization enabling Tringal's representatives to represent the offshore company during a trial against ToAZ was signed by the same Kozlov or person with the same initials and passport identity number. In addition, Tringal's claims were based on examination reports performed by the same auditing company which conducted audit examinations applied as foundation of MVD's criminal charges and Tax authorities tax back claims. Obviously, such fact as Kozlov's involvement in Tringal's BoD, his signature on a letter of attorney enabling Tringal's representative to participate in trial against ToAZ, and a coincidence of using services of the same auditing company point at Renova when looking for an aggressor in ToAZ takeover case.

### *False shareholder*

At the end of the year 2006 according to reports of an anonymous shareholder, a limited liability company known as Nega appeared unexpectedly in the Ivanovo Region and managed to secure measures of banning transactions with 100% ToAz's shares. LLC Nega in autumn 2006 filed the claim in the Arbitration Court of Ivanovo region requiring the JSC Aspect to perform provisions of a sale and purchase contract. The plaintiff claimed that in August 2006, JSC Aspect, supposedly being in possession of all the shares in TogliattiAzot, has pledged to allocate controlling equity stake to JSC Nega. However, JSC Aspect did not comply with its obligations. As a result, LLC Nega decided to go to court and demanded the court to impose interim arrest (seizure) of 100% of the shares ToAz. Judge of the Arbitration Court of Ivanovo region, Mr. Badin, wasn't alerted by the dispute over the entire stake in a huge chemical corporation, which was a battle-ground between completely unknown companies. Furthermore, the argument provided to the court by the plaintiff was a statement extract from the register. According to LLC Nega the extract from the register was provided to the company by ToAz's registrar, Volga-Uralosibirsky registrar. In addition, Nega provided a certificate which confirmed possession of ToAz shares on JSC Aspects' business account. To be precise, "Nega" was trying to convince the court that the JSC Aspect is a holder of ToAz's equity, no others evidence was provided by the plaintiff.

According to ToAZ's registrar, Volga-Uralosibirsky JSC Aspect never owned either 100 % or even a single share of ToAZ. It was precisely on the basis of forged documentations that LLC Nega wanted to impose security measures in the form of arrest 100 % of ToAz's shares. Apparently, the arrest of 100% stake seemed to be the main objective of the fraud, which was meant presumably to assist aggressors to paralyze ToAz activities with the help of the court. Despite all the doubts which supposedly should have occurred to the court, the court accepted the arguments of the plaintiff and in November 2006 arrested ToAZa shares.

A month later ToAz's lawyers managed to prove that an extract from the register and statement about the availability of the corporation's shares on accounts of JSC Aspect were fake. The Arbitration Court of Ivanovo region had to withdraw the temporary measures imposed by judge Badini. It would seem that the truth prevailed and those responsible for the documentation and evidence forgery in a court will suffer punishment. However, the

prosecutor's office in Ivanovo region for some reason thought differently. Company "Nega" in The Arbitration Court of Ivanovo region was represented by Mr. Gurchen Hovhannisyanyan. During the testimony in prosecutor's office, Hovhannisyanyan told a fantastic story. According to him, he met with man named Gregory about two years ago who offer Hovhannisyanyan a job to represent LLC Nega in court. To be precise, Hovhannisyanyan was supposed to, first, to deliver classified documents, provided to him by Gregory, to the court. Second, Hovhannisyanyan was supposed to represent LLC Nega in the court when it's necessary. In addition, Gregory convinced Hovhannisyanyan that he did not have to speak in court and promised to pay 5000 rubles for performed services. As a result, the investigating prosecutors of Ivanovo city, Kharitonov in his turn refuse to open criminal proceedings taking into account "the lack of objective data indicating elements of a crime in Hovhannisyanyan's actions". Furthermore, it seemed that prosecutors didn't care for initiating a search for those who sent Hovhannisyanyan to the court with apparently forged documents.

Undeniably, there were no traces of Nega amongst the shareholders of ToAZ, thus the acquisition of the shares is another example of the raider's pressure. It looked like aggressors behind the arrest of ToAZ equity tried to prevent TogliattiAzot from performing any transactions with shareholding (such as transferring securities to third entity or person) that may complicate takeover.

### *Tringal Equities Inc*

In November 2006 an offshore company Tringal Equities Inc. (Tringal) which owned a 2% stake in the share capital of ToAZ argued that ToAZ's export prices on ammonia had been devised negligently. As a result of these claims the minority shareholders had demanded \$42 million from OJSC TogliattiAzot and the same amount from eight members of ToAZ's Board of Directors. Tringal's claim was based on the expert analysis of LLC Expert-GUM, who has in turn, used correspondence between ToAZ and trading company Nitrochem Distribution (Switzerland) to make their estimates of damages done by ToAZ and the trading company. Tringal was arguing that in the period between April to December 2005, Nitrochem had sent ToAZ several letters in connection to the ammonia price agreement. However ToAZ's officials denied receiving these letters and pointed out that such correspondence could not have taken place. The relations between ToAZ and their Swiss contracting party evolved from earlier agreements, which had been subject to amendments. Such agreements are highly

confidential and therefore Tringal could not have an opportunity to gain access to such documents. Nitrochem emphasized that the documents containing signatures by the chief executive of the company are forged.

According to experts, Tringal's claims may be considered as revealing examples of pressure from minority shareholders with the aim to force the actual owners to sell valuable assets. The claim is based on an export contract to supply ammonia signed by ToAZ in 2005. Plaintiff was claiming that ToAZ's management exported ammonia at lower level than market prices, thereby causing material damage to its shareholders. It is also not entirely clear what damage could be caused to Tringal (registered in the British Virgin Islands). Field's experts consider the situation around Tringal-ToAZ very interesting. First, it is unclear how the minority shareholders managed to access confidential contracts. However, one assumption that was mentioned by number of experts is that access to the contract could have been obtained via continuing documents seizure at ToAZ conducted by the security forces and MVD's investigation group. Second, the amount of more than 40 million dollars, which the plaintiff demanded to refund, is questionable. According to plaintiff's claim, the amount is a result of LLC Expert-GUM auditing expert's assessment. Ignoring the fact that such company as LLC Expert-GUM is really unknown on the audit-market, it is more important to know how an independent expert was able to calculate the damage incurred in the result of allegedly low price of ammonia.

ToAZ's lawyer Sergei Zamoshkin is convinced that "mythical" Togliatti ammonia price underdeclaration was underlying in formation of several criminal cases. Furthermore, the lawyer has no doubt that these cases are resulting from pressure by raiders. Despite the fact that ammonia's price underdeclaration was proved by auditing expert, investigators, conducting an investigation, have still not been able to prove either the fact of trade with lowered pricing, or any fraud of that matter.

In addition, LLC Expert-GUM mentioned two numbers in its records. First refers to the damage estimated to be \$ 42.8 million. Second record, on the other hand, was mentioning \$ 73 million worth of damage. It was unclear on which basis the first damage amount was applied rather than the second one. However, only the size of the gap between two estimations can be a pretty good indicator of the assessment's reliability, the auditing company, and about the nature of the claim as a whole. According to ToAZ's press secretary,

Igor Bashunov and field experts the purpose of Tringal claim is clearly not money. The press secretary is convinced that the suit is pure provocation with an ultimate purpose of taking over the business.

Despite anticipated great difficulties to prove that the evidence had been forged ToAz lawyers were determined to pursue criminal proceedings and wanted the investigators of the Samara Region to follow all leads in order to find those people who committed forgery of the documents. However, in May 2007 the Court considered the claimant's arguments groundless and has rejected the claims of the minority. The reason for dismissing the claim was notarized letter from the heads of foreign company Beate Ruprecht, who claimed that he never signed Tringal's presented letters, and his signature is done by technical means. In addition, Samara Arbitration Court recognized that documents, namely 9 letters, signed by the head of the importing company which were used as an evidence of ammonia's under-pricing were forged. Based on the fact of letters' falsification criminal proceedings were initiated. The representatives of LLC Expert-GUM however admitted at an interrogation that photocopies of letters were provided to them by JSC named Bona FIDE Finance. And JSC Bona FIDE Finance in particular was the company which signed contract with Expert-GUM to produce the reports. Bona FIDE Finance in its turn also did not have the originals of the letters and claimed finding the correspondence between ToAz and its Swiss partner on the Internet. According to the Expert-GUM, the customer of the report was simply an intermediary between the company and Tringal Equities. Furthermore, Tringal's representatives also couldn't add anything specific about the appearance of forged documents in court. Tringal's lawyer, Vladimir Korobeinikov refused to testify referring to his status. Igor Puho, also was representing the interests of offshore in the court, admitted agreeing to represent Tringal Equities at the trial related to TogliattiAzot "for a decent fee" just a quarter of an hour before the session at Korobeinikova's request.

In addition, the fact that A. Kozlov (Renova Group's Top executive and chairman of Tringal BoD) entrusted his duties of Tringal interest presentation in the court to Igor Puho was described by Puho himself, who didn't even know Kozlov personally. However, despite above mentioned revelations, neither representatives of Bona FIDE Finance nor Alexei Kozlov were questioned in regards to the case of documents falsification. Representatives of Renova Group were still denying involvement in the corporate war, however, they did not even hide that their chemical business began only with the acquisition of a minority stake in



ToAz. By the way, responding to accusations in an attempt to capture another chemical company, Volga Orgsintez, the head of Renova Orgsyntes, Alexei Kozlov said that “if we had wanted to use force, we would have owned the company by now”.

In a bizarre turn of events, the officials from the Prosecutor's Office, who made the decision to pursue criminal proceedings and agreed on arrests, have been replaced by other officials. Furthermore, despite an occurrence of a new figurants and an appearance of new circumstances in the case, the investigation regarding the case of fraud brought by the Prosecutor's Office of Samara's Oktyabrski district, which lasted 2.5 months, was discontinued due to “missing elements of the crime”. Termination of criminal proceedings due to the absence of any justification and Samara Arbitration Court verdict ruled on the third Tringal's lawsuit against TogliattiAzot forced representatives of the company once again to talk about raiders attack.

However, it was not the last time when ToAz heard about Tringal Equity. In December 2006, Tringal Equities filed another lawsuit agints ToAz requirring invalidating the decisions made at the annual meeting of shareholders of the company on June 30, 2006, claiming that late notification about the meeting prevented the minority from becoming familiar with meeting's agenda and prepare for the upcoming meeting. ToAz's lawyers presented to judges extract from the register of postal items, according to which a letter with invitation to the meeting was sent on time according to the law. Nevertheless, the judge who any way agreed with the minorities were not even troubled by the fact that the decisions taken at the meeting were supported by 96% of voting shares, and that representatives of Tringal as well as all others passed ballot to the counting board and participated in the voting process. Furthermore, in November 2007 new criminal suit against V. Makhlay, ToAz's President, and Alexander Makarov, ToAz's CEO was instigated by the Investigating Committee. The new case against them was petitioned by Tringal Equity who was claiming 30 million rubles (\$ 1.162ml) from TogliattAzot, in underpaid dividends. However, the General Prosecutor's Office dismissed this case and the Court had approved the decision.

As a result, the company was forced to spend it's time, effort and resources on sometimes absurd lawsuits rather than use them to stimulate growth of the enterprise. ToAz's representatives believe that Tringal and Nega's lawsuits have had only one objective behind them namely the bankruptcy of the company and its forced sale.

## *URALCHEM*

United Chemical Company URALCHEM Open Joint Stock Company is one of the largest producers of nitrogen and phosphate fertilizers in Russia and the CIS. The company is controlled by Dmitriy Mazepin, who is well-known specialist of working with “troubled” assets. Interesting enough that from Mazepin’s track of record we can find such organizations as painfully familiar Federal Property Fund, potential ToAz’s “white knight” Sibur, where Mazepin held a position of Chief Executive Officer from 2002 till 2003. Market participants also believe that Mazepin cooperated with such companies as TNK and Renova in the past very actively.

In November 2008, Dmitriy Mazepin’s Urachem purchased 7.5% shares of Togliattiazot from Renova Group. According to the market quotations the deal could amount to \$225 mln., yet market representatives were convinced that UralChem bought Togliattiazot stake at 28% discount. Analysts believe that Mazepin is going to try to increase his interest in ToAz by purchasing the shares from V. Makhlay. Given Mazepin’s background and potential net work connections it’s not surprising that almost right away after ToAz 7.5% stake acquisition URALCHEM filed nine lawsuits against TogliattiAzot with requirements to provide such documents as the charter of the joint stock company, a certificate of registration with Tax authorities, the provisions of Council Directors and general shareholders' meeting, minutes of meetings of the board of directors over the past few years, annual reports to 2007 and including accounting books copies of the first half of 2008 year, and more. Furthermore, on 28 of January, 2009 new abrupt inspection supported by representatives from MVD and Special Forces “OMON” took place. During the celebration of tenth anniversary of the sanatorium "Hope"(a unit of ToAz) the investigators, without raising alarm, entered the banquet hall of the sanatorium, carefully studied the individual guests and apparently not finding the right person ordered security guards to provide them records of surveillance camera. Experts associate URALCHEM’s expressed interest towards the company with a following possible wave of attacks against TogliattiAzot.

#### **4.1.4. Pressure on management and owners**

Some of the attacks were directly aimed at TogliattiAzot majority owners and the target's top management. In September 2005 the police brought charges of tax evasion and fraud against General Director Vladimir Makhlay and CEO Alexander Makarov. The police's case rests on the claim that between 2002 and 2004, the factory sold ammonia at artificially low prices to a trading company in Switzerland. The police maintain the Swiss outfit was a front for Makhlay, and that it resold the ammonia at market prices pocketing the difference. The factory disputed allegations and has received backing from experts at the Justice Ministry who support Togliatti Azot's claim that the police case rests on insufficient evidence. Furthermore, in January 2006 Makhlay, and A.Makarov were charged with new criminal charges of fraud and legalizations of funds obtained by illegal means. In addition, in April 2006, both were put on wanted list and announced in the international search. Tverskoj court in Moscow also ordered their (V. Makhlay and A. Makarov) arrest on 21th of April. And surprisingly Tverskoj court refused to consider defense complains and argumentations against court decision, referring to the case's different jurisdiction.

Initially, both cases were instigated by the Moscow Prosecutor's Office. Afterwards, when the cases had been dismissed, the case papers, which were used as the main source for the investigation, were transferred to the Togliatti Department of Internal Affairs for further investigation. On the basis of these papers, the case procedure was revived in Togliatti on 29 May 2007. And on September 29, 2007 the Togliatti Department investigators also cancelled the investigation in the absence of any elements of crime. However, by that time the illegality of the suit had been already been appealed in court. Fortunately both Makhlay and Makarov happened to be abroad when the whole mess around ToAZ started and when they were charged in criminal charges.

Another example of direct pressure on top executives is prosecution of ToAZ's press secretary Igor Bashunov, initiated by investigation committee of the Ministry of Internal Affairs (MVD) of Russia. In July 2006, I.Bashunov was summoned to the investigation committee of MVD as a witness in a criminal case against ToAZ's President, Makhlay and CEO A. Makarov. I.Bashunov, during the questioning at the MVD conducted by investigator Sergei Shamin, took advantage of Article 51 of the Russian Constitution (the right to refuse to testify if it might harm own self). MVD investigation committee on the other hand initiated a

prosecution of ToAZ's press secretary under Criminal Code article 308 (witness or victim denial from testifying) and wanted to bring Bashunova to justice for refusing to testify. Later on, in October 2008, the court suspended proceedings against the press-secretary due to the lapse of time.

Now, before taking a look at defense methods and their analysis let me briefly summarize all takeover schemes occurred in the takeover event. First, attempt to buy controlling stake in the company occurred. Second, a combination of so called administrative methods, challenging privatization scheme and attempt of forceful seizure were applied to convince target's owners in the aggressor's seriousness. When above mentioned combination proved to be not really ineffective, the aggressor resorted to fraud schemes directed through officially unrelated parties to increase pressure on the target and its owners.

#### **4.1.5. Defense**

This subsection will discuss defense methods applied by ToAz in the company's takeover attempt. In addition to methods described, I will analyze methods' impact on the takeover process.

##### *Transfer assets to third person*

Assets protection methods were also used by Togliattiazot quite successfully. First, the management of the company effectively managed to build up indebtedness by restructuring liabilities. Second assets transfer happened in October 2006. Then V. Makhlay first resigned from the founders of JSC Tolyattihimbank, which is one of the ToAz minority owners. Second, all equity owned by V. Makhlay was transferred to his son, Sergei Makhlay, who owned only 1% of Tolyattihimbank before he became a holder of ToAz shares. Terms of the equity transfer are not known. Experts believe that the actions taken by Vladimir Makhlay are consequences of continuing pressure from law enforcement authorities. Now, even if V. Makhlay would be convicted in criminal charges of fraud and tax evasion it would be almost impossible to seize ToAz equity that V. Makhlay used to own. As a result, by transferring assets to his son V. Makhlay is avoiding risk of losing assets due to criminal charges and keeping control over the target thought son. In addition, criminal charges, that according to

analysis and experts' opinions were meant eventually to seize ToAz equity from V. Makhlay, partly lose their purpose of direct pressure.

#### *Commercial classified information*

The most crucial step, that ToAz took to protect itself against possible takeover threat was making all information related to shareholder register and registrar, holder of the register, commercial classified information. In February 2005, Togliattiazot transferred shareholder register to Volgskij-Uralsibirskij registrar. At the same time Togliattiazot made a decision to treat all information related to shareholder register and holder of the register, registrar as the company's commercial classified information. Registrar on the other hand, is obligated as well to treat information about shareholder register as commercial classified information. According to Act of Commercial classified information, an entity is allowed to classify information that possesses actual or potential commercial value. First, to make information classified the owner of information has to determine class-list of information. Second, information access rules and bodies and persons, allowed to access information should be established. And, finally, the owner has to seal a classification code on that information documentation. According to the Act, not all information can be regarded as classified, however, the act does not say anything directly about shareholders register. In addition, the Act obligates information owners to present classified information to government agencies if they in their turn provide strong motivation for their request. As a result, Togliattiazot was able to hold information about its shareholder register classified which disturb aggressor's action plan and gave some precious time to ToAz to regroup. Holding shareholder register as classified information also helped ToAz to complicate aggressor's quick court decisions enforcement and created some room for reaction to any court decisions.

#### *PR campaign*

The target also turned to a variety of PR campaign tools. First of all, the plant's staffers were surprisingly loyal to their boss and have organized dozens of demonstrations. Their banners and placards "Hands off Togliatti Azot!" and "We won't let the dirty raiders pass!" make clear what the workers think of the accusations. Second, ToAz used TV and radio media as well. A number of media packages were put together and provided to different media sources which were willing to work with controversial material. Third, the company ToAz or, to be precise, publishing house "Tribuna" published a book named "White book. Togliattiazot against

raiders” devoted to takeover attempt over ToAz. It seemed that the main idea behind book publishing was not selling the book since it’s almost impossible to find one, but reminding that the battle is still going on and letting the public know that there so is much available material around ToAz conflict that we can write a book on it. The PR campaign seemed to help the target to become noticed, attract attention and create a loud publicity around continuous fight against unfriendly takeover attempts. According to experts, usually raised stink around a takeover event tends to complicate taking over especially if any unethical or illegal measures are applied during a capture. In addition, takeover costs usually increase due to attracted public eye on the target and its fate due to greater risk involved of being caught doing something unethical or even illegal. Attracted public attention to the target also might make government agencies, courts’ judges to think twice before making any controversial decision.

### *Litigation*

Litigation in courts was also one of the tools that ToAz heavily relied on. However, for most of the time ToAz’s lawyers were dragged into the courts to protect ToAz’s interest in sometimes even bizarre cases. It looked that intentions behind some of the claims were just forcing ToAz to channel its time, effort and resources into litigation instead of company growth (more than 280 court hearings had been held so far). Some of the claims on the other hand seemed to be clearly meant to paralyze any activities with ToAz’s equity preventing the target from possible takeover defense steps.

Nevertheless, ToAz lawyer also were trying to attack actors that supposedly were acting in the aggressor’s interests. For instance, in October 2006 another abrupt house-checks and documentation seizures by officials from MVD took place. ToAz’s lawyer referring to that document seizure appealed to the General Prosecutor's Office with a request to initiate criminal proceedings against investigators. Also, in Tringal’s and Nega’s cases criminal proceedings were instituted based on the fact of letters’ and other documentation falsification. However, the investigation of fraud brought by the Prosecutor's Office of Samara’s Oktyabrski district was discontinued due to “missing elements of the crime”, and the investigating prosecutors of Ivanovo city, Kharitonov in his turn refused to open criminal proceedings taking into account "the lack of objective data indicating elements of a crime”.

As a result, it seems as if defensive position of the target has been more successful in a way than a role of a plaintiff in courts for ToAz.

#### *Asymmetrical solutions and Lobbying*

A variety of asymmetrical solutions were used by defense forces of Togliattiazot. First of all, Samara region governor Konstantin Titov was lobbying ToAz interests at least in public. Several State Duma deputies, government officials (e.g. Anatoly Ivanov, Nikolai Ryzhkov, Alexander Konovalov) were expressing their concerns related to corporate war around ToAz and even managed to denounce the message to the President Vladimir Putin. Despite all effort it looked more like PR campaign rather than situation's resolution. Therefore, it's somehow questionable whether "white knights" involved in the case were really "white".

#### *White knight-Gazprom and Rosneft*

There were two possible "white knight" rescuers involved in ToAz's takeover event. First, state owned company Rosneft occurred as a "white knight". To be more precise, in September 2006 close to V. Makhlay trading company Ameropa announced about its plans to create a new chemical giant in Krasnodar region with supplier financial support from state owned company Rosneft which promised to build 100 km gas pipeline specially for the plant and sales force support from of Nitrochem Distribution Ltd. The new chemical giant enterprise was promised to be larger than all nitric enterprises in Russia without an exception. As a result, it seemed that V. Makhlay wanted to clone TogliattiAzot with support from Rosneft in exchange for Togliattiazot and Transammiak. Given Rosneft's and its chairman I. Sechin (Deputy Head of the Presidential Administration of Russian Federation) close relationship with V. Putin it seemed to be one way out of the ToAz's and its leaders's situation. However, despite all brags about new plant pressure on the target has continued and plans were unrealized.

Second, company Sibur Holding expressed its interest in rescuing Togliattiazot. JSC Sibur Holding was registered in St. Petersburg. The Sibur Holding is composed of 29 petrochemical enterprises operating in processing of hydrocarbon and other raw materials. The main products produced by the company are gas, high-octane additive to gasoline, glycol, polyvinylchloride, caprolactam, polyethylene, polypropylene, polystyrene, synthetic rubbers, tires, rubber goods, construction materials, synthetic fibers and fabrics. In accordance with the

company's statements issued in 2006, a bit more than 25% of its shares are owned by JSC Gazprom and 49,99% of JSC Sibur Holding shares are owned by CJSC Gazprombank.

In February 2007 according to one of ToAz close sources, Vladimir Makhlay was offered to remain at the company president's position even after the transfer of the company control to Sibur Holding to become part of Sibur-Mineral Fertilizers. However, according to the representative of TogliattiAzot, the parties were not able to agree on terms of deal. It was stated that the head of TogliattiAzot was unwilling to sell the whole controlling equity stake to Sibur due to reluctance of giving up full control to new potential shareholders. As a result, Makhlay made counter proposal of selling blocking 49% stake instead of 71%. Sibur, on the other hand, was hoping to acquire greater stake and therefore, the parties were looking for a compromise. According to analysts estimated value of a controlling stake in the chemical corporations can range from \$ 300 million to \$ 600 million. It's not arguable that the deal is possible and beneficial to both parties involved. First, taking under consideration corporate conflicts surrounded ToAz at that time acquisition by large state controlled corporation tends to be favorable for ToAz and could have been a way out of this situation for V. Makhlay. Second, potential synergy is undeniable given that 80% of the production cost of ToAz's products is gas supplied by Gazprom. However, the future of the company after possible transaction would be difficult to predict. One possible scenario would be that much of ToAz's profits would remain with the management company, which may affect the wages of target's staff and development of the enterprise. Therefore, ToAz's transition into a scheme of income production means sharing income with other structures of Sibur Holding and potential growth reduction.

#### **4.2. Russneft takeover**

This section of the cases analysis part concerns Russneft takeover event. First, I will briefly go into the company background and prehistory of a takeover. Second part discusses pressure put on the company and third part turns to pressure put on owners. Final section will be devoted to defense methods used.



#### **4.2.1. Introduction**

Oil company RussNeft was established in 2002 and in 2007 found itself among the 12 leading Russian oil companies employing over 20,000 people. In 2007 the company has comprised 30 production assets, 2 refineries and a petrol station network operating in 22 Russian regions and CIS countries. RussNeft has developed over 170 oilfields with total oil reserves amounting to over 630 million tons. In 2006 the company entered foreign markets by joining a field development project in Azerbaijan.

The company is owned by Mikhail Gutseriyev, who was the president of Russian-Belarusian oil firm Slavneft prior to its takeover by TNK and Sibneft in 2002. In September of that year Mr Gutseriyev established Russneft by acquiring Varyoganneft, a 30,000 barrels per day (b/d) outfit. In the following year, acquisitions of Goloil (owned by Teton, US), Ulyanovskneft and Nafta-Ulyanovsk made Russneft a 60,000 b/d company. At the start of 2004 its capacity doubled once again with the purchase of five independents, including Belkamneft, for US\$456m. The year 2005 was most active one for Russneft to date: it acquired Yukos's 50% stake in Zapadno-Malobalyskoye (a 53,000 b/d joint venture with Hungary's MOL) and struck a deal, finalized in January 2006, to buy TNK-BP's 25,000 b/d Saratovneftegaz. In addition, it owns nearly 300 gasoline retail stations (including some 9% of the Moscow retail market) and has two refineries.

Russneft has financed nearly all of its expansion through borrowings. Until it issued a Rb7bn (US\$248m) rouble bond in late 2005, both the company's finances and ownership was opaque. The prospectus for the issue detailed debts of US\$2bn, over 40% of which was owed to Glencore, the Swiss-based raw materials trader that claims to control 3% of the world's oil and products trade and has extensive aluminum and mining assets in the US, Latin America, Europe and Asia. No other creditor holds more than 10% of Russneft's debt. Glencore has been most important partner for Russneft. Gutseriyev's relationship with the Swiss company dates back to his time at Slavneft, when Glencore handled a portion of the oil company's sales. Moreover, it has been documented that Glencore financed Gutseriyev's initial acquisitions and in return received as collateral a 49% stake in the Russneft holding company. It also gained large minority stakes (of 39-49%) in three of the company's operating units such as Varyoganneft, Ulyanovskneft and Nafta-Ulyanovsk, and has an agreement granting it the exclusive right to lift Russneft's crude until 2014.

In 2005 Russneft bought some of the Yukos assets, which, according to some reports, might have upset bigger players in the oil and gas industry. Later this year Gutseriyev was asked to sell Russneft (according to rumors by state controlled structures for \$1bl), but he did not accept the price. In 2006 Gutseriyev began to receive warnings. First, tax authorities started approach the company gradually, starting from subsidiaries. Following back tax claims received by Russneft, criminal proceeding against Gursariyev and few Slavneft's top-executives occurred in Central Internal Affairs Directorate (GUVD) in January 2007. It turned out that criminal proceeding against Gursariyev and few Slavneft's top-executives were reopened and were related to old criminal records of criminal proceeding closed in 2002. Later, Gutseriev was charged with tax evasion and illegal business activity and was ordered to remain within the city limits of Moscow. The arrest warrant was issued after the police suspected that he had left the city.

It looks like already in 2006 the billionaire should have got the hints and quickly and kindly parted with his business for the benefit of the state, or to be more precise, for the benefits of an authorized oligarch appointed by the state (e.g. O. Deripaska) or for the benefits of directly state controlled company such as Rosneft. However, Gutseriyev either didn't understand the hint or decided to fight for his business, or just was hoping to bargain for more money. One way or another, the moment was gone and when he was ready to present Russneft as a gift, the present was rejected. As a result, he didn't want to give away the company voluntarily for the money that was offered, later he had to give it up for less or no money received in return and even go to prison. The questions concerning main initiator behind the takeover still remain open. Let us take a closer look at forces which initiated pressure on the company and its owners in order to understand Russneft takeover even better.

#### **4.2.2. Pressure on the owner**

During the summer 2006, a group of government agencies started showing their interest in Russneft. Interior Ministry structures and Federal Tax Service (FTS) agency begun approaching the company via its subsidiaries. At the same time the Internal Affairs Directorate (UVD) begun to express its interest in owners of the company. Next, in December 2006 a case, initiated by Investigation Department of Moscow's Central Internal Affairs Directorate (GUVD) emerged in the General Prosecutor's Office. The case was initiated in

April 2002 and dismissed in July of the same year. The case was build on accusation a number of Slavneft's top executives in abusing their authority and causing damage of at least 20 million dollars to the main shareholder (the Russian Federation) during 1999 – 2000 period (company was headed by Mikhail Gutseriev). And 3.5 years later the case was reopen.

The pressure on the company and its owners was gaining momentum over the following six months. First of all, a few office searches and document seizures were conducted at Russneft and its affiliated entities with its management being questioned. And in February of 2007 the President and main owner of Russneft Mr. Gutseriev was charged with criminal charges of tax evasion under criminal code Act 199. Gutseriev was charged with tax evasion following a search of Russneft offices in Moscow at the end of January when he and other managers were also questioned in connection with the alleged underpayment of taxes of about 1.1 billion rubles (\$43 million). Criminal charges followed by tax authorities and GUVD's new abrupt inspections. For instance, four banks used by Russneft in its operations were searched as part of the Interior Ministry's investigation of schemes that the oil producer allegedly used to evade tax payments. Simultaneously, Russneft was disputing in court a huge claim in back taxes for three years, which according to industry sources could amount to more than \$600 million. Taken into account back tax claims and other penalties the company was forced to sell some units of its company (e.g. 66% Severnoeneftegas to TNK-BP).

Next, in May 2007 Mikhail Gutseriev had been charged with new additional criminal charges of illegal entrepreneurship under criminal code Act 171, part "a" and "b". The charges of illegal entrepreneurship were part of criminal cases opened in November against the managers of Russneft's three subsidiaries Nafta-Ulyanovsk, Ulyanovskneft and Aganeftegasgeologia, which were accused of making "illegal profits" from overproduction. Charges had been filed against the general directors of the first two companies.

Then, surprisingly for all Mikhail Gutseriyev announced on July 27 that he was quitting as president of oil company Russneft. Before his resignation Gutseriyev published a letter to his staff with an explanation of reasons for leaving the company. In the farewell message to his 25,000 staff members, Gutseriyev claimed that he was standing down to save the company and interpreted the state attacks as being directed at him personally. To be more precise the letter was saying Gutseriyev had been offered to leave the oil business in an amicable way. After he had refused, the company "was subjected to unprecedented persecution. In the last

year Russneft has been inspected by the General Prosecutor's Office, Federal Tax Service and the Interior Ministry structures"... "I am giving control of the holding to an owner, with whose appearance, I am certain, all the problems of Russneft will in time be solved," Mr. Gutseriev wrote. It then emerged that he had negotiated to sell Russneft to Oleg Deripaska's Basic Element, a holding whose major component is the world's largest aluminum producer, United Company Rusal. And on July 30 2007 Gutseriev did not show up for questioning and as a result violated order required staying within Moscow boundaries. Gutseriev's not showing up convinced MVD that he fled the country therefore, the government agency on August 8 seized Russneft shares as part of a tax evasion investigation and on August 24 put Gutseriev on the international wanted list.

#### **4.2.3. Pressure on the company**

General Prosecutor's office, Federal Tax Services and Interior Ministry structures began expressing their interest in the company during summer 2006. First the company was approached gradually by the Internal Affairs Directorate (UVD) and its Economic Crime Department. The government agency was acting on General Prosecutor's office orders aimed at finding a ground for criminal proceeding initiation against Russneft subsidiaries. For instance, in July 2006, UVD of Ulyanovsk region started inspection of JSC Ulyanovskneft (Russneft's unit) in compliance with the tax legislation. Based on the results of the inspection UVD had refused to initiate criminal proceedings Regional Prosecutor's Office on the other hand repealed UVD's decision later. In the same month UVD's Economic Crime Department conducted inspections at JSC JV Nafta-Ulyanovsk, JSC Orsknefteorgsintez and JSC Aganeftegazgeologiya CJSC Gol Oil (Russneft's units) checking financial-economic and fiscal activities. UVD, based on results of abovementioned inspections made a decision not to initiate criminal proceeding against the company. However, despite UVD's decision Ministry of Internal Affairs later initiated criminal case of tax evasion and illegal entrepreneurship. According to the investigation, in 2003-2005 Russneft subsidiaries Nafta-Ulyanovsk and Ulyanovskneft were in breach of license agreements by overproducing oil. Investigators estimated that the losses incurred amounted to 700m rubles and about 2bn rubles as a result of the activities of Nafta-Ulyanovsk and Ulyanovskneft respectively. The heads of these oil companies and Russneft's top executives Sergey Bakhir and Mikhail Gutseryev all maintain their innocence. Russneft was claiming that its earnings from overproduction of oil have been calculated inaccurately. First of all, under the license agreement the company was to produce

15.94m tones of oil and instead, it produced 16m tones. Second, the company's representatives were claiming that unlicensed production by Ulyanovskneft and other companies occurred prior to Russneft's acquisition of these fields.

Furthermore, in period from March till July 2006 Interregional Inspectorate of the Federal Tax Service (FTS) of Russia's largest taxpayer was conducting visiting inspection of JSC Russneft. According to results of the inspection it found that for the period from 1th of July 2004 and till 31th of December 2005 the company eluded tax payments worth of 14.488 billion rubles (\$ 538 mn.). Next, in January 2007 the Ministry of Internal Affairs (MVD) of Russian Federation initiated criminal case on the facts of tax evasion against JSC Russneft with back tax claim equaled 1.702 billion rubles (\$64 mn.). Now having the case against the entity opened, MVD can easily come and conduct unscheduled inspection of the company associated with the open cases at any time. Russneft didn't have to wait for house-checks and document seizures for long time. Expectedly, at the end of January Investigation Committee and the MVD's Department of Economic Security conducted searches in Russneft's offices, its subsidiaries and began the company's management interrogations.

In the next few months government agencies conducted several inspections and document seizures at Russneft's offices and its affiliated companies. For instance, FTS checked and later filed a back tax claim to Russneft's affiliated companies and two of its counterparties which were managing a network of gas stations. In addition, FTS was requiring annulling eighth transactions with Russneft's equity claiming that the sale of the company's shares were performed at significantly lower than market price. Also, central UVD's Tax Crimes Directorate conducted an inspection of the company's claiming possible violations of bill legislation. As a result, in only few months several criminal charges of tax evasion and illegal entrepreneurship were initiated against the company, its owners and Russneft received back tax claims for more than \$ 840,8 millions.

#### *Aggressor behind the scene*

On the one hand, given Deripaska's close relationship with the government and his controversial involvement in a number of unfriendly takeovers in Russia one might easily assume Deripaska's direct involvement in Russneft takeover event. Especially taking into account a combination of such factors as Deripaska's style of taking over companies

previously by applying heavily administrative resources and pressure on controlling stake owners, his expressed interest in entering oil industry and close relationship with the government might convince that Deripaska is the one behind the pressure aimed at the company and its owners.

On the other hand, despite Deripaska's excellent connections the acquisition of Russneft is yet to be approved by the Federal Anti-Monopoly Service. Deripaska has stated that he does not intend to resell. As a result, the impression is given that Russneft is not meant to be swallowed up by either Rosneft or Gazprom, the two state-controlled "national champions" in the hydrocarbons sector. Therefore, if Deripaska becomes the new owner and retains control of Russneft, then this will support the view that the Kremlin does not regard re-nationalization of the oil sector as an end in itself. Rather, it is mainly concerned with ensuring that this strategic industry is run by people who, whether they are state-appointed managers or private entrepreneurs, can be relied upon to do the state's bidding.

In September 2008 Oleg Deripaska increased his chance of getting his hands on Russian independent Russneft after prosecutors dropped a case accusing the company of selling its shares illegally to Cyprus-based Shaddock Trading. The Federal Tax Service had been demanding that the shares be handed over to the state. Market experts think that legal cases involving almost 80% of Russneft's shares have been dropped, while the rest will be decided later. The claims, designed to allow the government to nationalize the company, have prevented the Federal Antimonopoly Service from considering a takeover bid for Russneft from Deripaska's Basic Element holding company.

Observing the situation development around Russneft takeover it seems that either Deripaska is not able to solve Russneft's problems or it's going to take time, or some other parties eyeing Russneft as well. One person familiar with the situation said Rosneft, which is chaired by Kremlin deputy chief of staff Igor Sechin, was now eyeing Russneft as well. According to market sources it looks like Igor Sechin, fought for years to undermine Russneft and win the company for Rosneft, and he was less than pleased when Deripaska came in at the last minute and grabbed Russneft for himself.

Furthermore, aggressive and independent Russneft's behavior was upsetting not only Rosneft. Such entities as Oil Company Lukoil and oil trader Gunvor was also not pleased with

Russneft's behavior. Lukoil, for instance, was upset when Russneft was trying to acquire majority stake in Novatek's oil subsidiary Geolbent while Lukoil was negotiating acquisition of the subsidiary with Novatek. Rumors are that the head of Lukoil, Vagit Alekperov even complained to Vladimir Putin about the incident. In addition, Putin might have his own concerns regarding Russneft's behavior. In spring 2006, oil trading company Gunvor, which is believed to be the Kremlin's oil assets manager and very close to Putin, had to decrease its trading capacity due to its quotas cuts. Moreover, according to market experts part of Gunvor's quotas might have been given to Russneft and its partner Glencore. Next, the heads of Rosenergo and Transneft, which are responsible for oil quotas, were retired from their positions. And surprisingly enough the head of Rosenergo was offered a position of a vice president of Russneft right away after leaving Rosenergo. Additionally, Glencore was considered to be the main Gunvor's rivals on the Russian market. And since Glencore seems to regard Russneft as its vehicle for entry into Russian oil production, neutralization of Russneft would be highly beneficial from many perspectives for Gunvor.

Given Deripaska's current control over the company, still continuing corporate conflicts and different parties' interests in the target it is not easy to finger point actual initiator behind the scene. All companies mentioned above seem to be able to benefit out of Russneft takeover one way or another.

#### **4.2.4. Defense**

At first glance it looks like Russneft didn't even resist a takeover. The most obviously evident defense methods that could be observed were lobbying and "white knight" methods. The first method, lobbying for the company interest with high level officials, did not seem to force any decisions. Defending method of joint forces of "white knight" Basic Element and Russneft seems to be questionable and remind more of "gray" or even "black" knight case rather than white knight one. Now, let us take a closer look at "white knight" defense method observed in Russneft takeover event.

##### *White or Gray knight?*

Russneft's previous owner, billionaire Mikhail Gutseriyev, fled to Britain in August 2007 and sold a majority stake in the company to Deripaska's Basic Element for more than \$3 billion, excluding debts (about \$3.8 bl.). Basic Element is a diversified holding company with assets

both in Russia and abroad. The investment group's core assets consolidate in 6 sectors: energy, machinery, resources, financial services, construction and development. The consolidated revenue of the Group's portfolio businesses exceeded \$18 billion in 2006 and its combined asset value was more than \$23 billion. The member companies are located in Russia, CIS, Europe, Africa, South America and Australia.

For Deripaska Russneft acquisition seemed to be a great solution for his long lasting attempts of entering oil business sector. Basic Element has been trying to expand its operations into oil business for many years and before Russneft's acquisition achieved production capacity of 85 000 tones per year which is obviously not enough for its Afipskij oil refinery with an increased capacity from 1.5 millions up to 3 million tones per year in 2006. Therefore, Russneft acquisition with its yearly capacity of 17 millions tones seemed to be a great entering in oil game for Deripaska.

Another positive aspect of the deal with Basic Element is its close relationship with Russneft's long time partner Glencore. It seemed that Glencore would support Deripaska acquiring Russneft, as the two have a very strong relationship based on their partnership in the aluminum business. Glencore is a minority shareholder in United Company Rusal, which is controlled by Deripaksa's holding company, Basic Element.

Also Rusal's success in becoming a global company suggests that Deripaska is trusted by the Kremlin. He has shown his loyalty by, for example, investing substantially in the initial public offering of state oil company Rosneft on the London Stock Exchange in summer 2006. Deripaska is exceptionally well-connected too. He is married to a step-granddaughter of Russia's former president, Boris Yeltsin, and is often pictured with President Vladimir Putin which should help him to find an answer to Russneft's recent conflicts with government agencies.

To sum up case analysis part lets take a look at table 1. The table summarizes both cases and variety of takeover schemes and defense methods applied in both takeover events. Table clearly points out variety of takeover schemes and defense methods brought in to play in ToAz's takeover event. Additionally, it summarizes only few takeover schemes and few defense methods exploited during Russneft takeover event. Even at first glance it is noticeable that ToAz takeover event can afford to brag about variety of takeover schemes and defense



methods applied during the even compared to Russneft takeover episode. Even though it might be explained by differences between time spans that both takeovers lasted, more reasonable explanations seem to be a difference in defense position. According to ToAZ's takeover event description the target's position was proactive rather than just defensive. Russneft's defense position on the other hand, seemed to be overconfident rather than defensive one. Furthermore, the owner of the target was convinced that he and his company is untouchable which might explain Russneft's almost not existing takeover defense strategy.

**Table 1. Case Analysis quick summary**

<i>ToAz Takeover event</i>				<i>Russneft takeover event</i>		
	<i>Type</i>	<i>Initiator</i>	<i>Aim</i>	<i>Type</i>	<i>Initiator</i>	<i>Aim</i>
<b>Taking over schemes</b>	Administrative	FPM of RF Tax Authority MVD & FSB	Target & Target's owners	Buy out	Close to state entity	Target
	Buy out	Renova Group & URALCHEM	Target	Administrative	Tax authority MVD & FSB	Target & Target's owners
	Litigation	Renova Group & Minorities	Target & Target's owners	White / Grey knight	Deripaska's industrial Group	Target
	Fraud	Minority	Company			
<b>Takeover defense methods</b>	<i>Type</i>	<i>Tool</i>	<i>Aim</i>	<i>Type</i>	<i>Tool</i>	<i>Aim</i>
	Assets transfer	Majority owners transfer	Reduce risk of losing majority ownership Eliminate rational behind criminal charges	Asymmetrical solutions & Lobbying	Networking government officials	Support from government officials
	Commercial classified information	Applying recently accepted law	Preventing unwanted documentation access	Litigation	Trials in court	Increase takeover costs
	PR Campaign	Demonstrations, a book, media packages	Create noise- Increase takeover costs	White knight	Buy out by Deripaska's industrial Group	Potential support from Gazprom & Rosneft
	Litigation	Trials in court	Increase takeover costs			
	White knight	Joint Venture with Rosneft and buy out by Gazprom	Potential support from Gazprom & Rosneft			
Asymmetrical solutions & Lobbying	Networking government officials	Support from government officials				
<b>Results</b>	<i>ToAz is still defending itself against aggressors (e.g. URALCHEM).</i>			<i>The company was sold to Deripaska's Industrial Group; however, the deal is still not finished.</i>		

## **5. Lessons learned**

### Survival Guide

“If you are going through hell, keep going.” W.S. Churchill

A successful raid must give the raider the opportunity to acquire durable long term control of the asset. Seizing control of a jewelry store to sell the diamonds out of the safe and disappear is robbery. Seizing control of a jewelry store to sell diamonds for years or to resell the store is raiding. Raiding requires taking control of the legal narrative, it requires documentation and control. Therefore, next I will go over several tools and measures which can disrupt the raid process to the point of making it nonviable. Following part is divided in two sections. First section discusses tools that should enable business owner to prevent or make hostile takeover more complicated. This group of tools tends to be a preventive one. Second section concerns with rather operational tools than preventive ones. Operational tools enable target to react to hostile takeover threat and hopefully successfully defend target from unwanted capture. Below mentioned tools are basically practical advices supported by defense methods which were introduced in literature review part 2.5.

### **5.1. Preventive tools**

#### *Controlling documentation*

There are key administrative entities that can allow access to core business documents or facilitate the creation/substitution of new enterprise documents. The tax inspectorate has the key company legal documents on file including the Articles and/or Charter, tax ID number, financial reports, etc. The real estate registry holds the documentation relevant to ownership, control, collateralization, etc. of real property. As can be seen from cases analysis conducted, effective raiding relies on information and documentation. Therefore, timely warning of an unauthorized (economically unjustified) effort to access documentation can serve as the first warning sign of a raid. Similar idea regarding any unauthorized access of company's data was brought up by The Public Chamber of Russian Federation against Corruption in its recommendation regarding operating in hostile environment mentioned in literature review part.

In addition, both cases have clearly demonstrated and supported views, presented in literature review, of hostile takeover being divided in several explicit phases. According to literature (e.g. 2.4.1 and 2.4.2.parts), data gathering is one of the first phases which are undertaken by aggressors, noticeably the similar path can be traced in both cases with documentation seizures and house checks conducted by variety of government agencies being one of the first phases. Therefore, by controlling core business documents and making sure you have verified by notary copies of all core business documents filed with key administrative entities would enable owner of potential target lower company's attractiveness as a target to be captured. Possession of verified by notary copies tend to also complicate takeover for an aggressor and prevent the substitution of fraudulent documents into either the tax or real estate files. However, you as a business owner have to ensure that you get a notice quickly in case if someone seeks an access to your documents. Additionally, ensure that you know if anyone tries to file "amended owner lists" or re-register real estate, etc.

#### *Control key employees*

Even though, neither of two cases demonstrated any key employees' involvement in targets' takeover, it is still advisable to take below mentioned measures under consideration and be aware that key current or former employees might get involved in a business capture. One of most obvious examples might be appearance of former General Director with backdated core business document enabling former General Director to capture control over the business. However, there are measures that can help business owners to control key employees and prevent any possible authority abuse.

For legal purposes, every company in Russia/CIS has two key executives, the General and the Finance Directors. For the sake of brevity, these are the only legally meaningful executive positions in a business. I read a story about a General Director who was physically coerced to sign over key assets to a raider. If the Articles/Charter of that entity expressly banned the General Director from entering into any transaction disposing of more than certain percentage of entity assets absent signed authority by another person, this situation would have been avoided. The Finance Director (Chief Accountant) typically has the ability to "form" the company's tax balances and access its bank accounts. Take steps to control this ability. Include provisions that any accounting statement changing the existing company balances by

more than certain percentage or currency amount must be co-signed by another person to be valid. Also rotation of key executives might be a useful practical. Conducting internal audit and security assessments is also advisable.

#### *Internal key documentation control*

Both cases, especially ToAz takeover event demonstrated importance of internal documentation and proved its control to be one of the vital aspects in hostile environment. For instance, an episode with letters, which were essential part of criminal charges, between ToAz and its trading partner might be one of the good examples proving significance of internal key documentation control for an active business. Therefore, an efficient internal key documentation control enables business owner to lower its chances of becoming a target through such takeover schemes as fraud, bankruptcy and other.

Furthermore, if you own an active business, there is probably good reason to keep the corporate stamp on the premises. However, is there any reason to keep your original company documents there as well? Are you keeping originals of key contracts on the premises? Why? Given a high importance of documentation it's advisable to establish and implement a rigorous document retention policy. Furthermore, development a policy for handling correspondence and documentation from key legal/regulatory entities and establishing who has the right to sign a receipt for an incoming tax document, subpoena, court document, etc. will enable a company to enhance control over its documentation. Also it's advisable to decide on procedures to notify you or your agent immediately if documentation from a "high impact" agency such as one of the above is received.

Moreover, courts usually do spend their time and effort to serve any notifying documentation to an entity on the tray. On one occasion, a company subject to over a dozen adverse legal decisions lost the correspondence notifying it of the court hearings. A security guard signed for the envelopes, and the owners did not know that they risked losing their asset. On another occasion, the owner of a natural resource asset was notified that he had 45 days to cure a reporting deficiency, the notice waited 60 days until his next visit to Russia. Additionally, empty envelope warning sign of potential hostile takeover, which was mentioned in literature review part, might be left unnoticed without proved documentation control. As examples

showed it's important to keep internal documentation in orders therefore, it's advisable to spend time and effort keeping internal documentation under control.

### *Legal control*

Legal asset's ownership right is a crucial point in any takeover event and tends to be a decisive aspect of any business capture. ToAz's equity ownership transfer from V. Makhlay to S.Makhlay is one good example supporting legal control importance and demonstrating ability to protect business if legal control over assets is managed properly. Therefore, by having enhanced control over ownership right a company is able to complicate and even prevent hostile takeover. For instance, it is advisable to implement contractual provisions that trigger in the event when the productive asset is seized. Change of ownership provisions providing can be done either for pay-outs or preferential asset purchase rights might be considered as well. This tool seems to be a combination between poison pill defense method and assets protection defense method, both of which were mentioned in defense methods part.

Furthermore, there was nothing about intellectual property right in both cases; however, since it seems to be a very important part of legal control area I'm going to mentioned advice concerning it as well. If your asset produces widgets, you can consider an exclusive sale agreement for these widgets for the next decade, which would enable you to protect your intellectual property right.

Furthermore, spreading an ownership among affiliated entities is also one way of protecting a company's assets from seizure. ToAz entity's ownership structure and examples mentioned in "Asset protection" subsection, and "Creation of strategic alliance" subsection of defense methods part demonstrated efficiency of that method despite some disadvantages mentioned. Nevertheless, to be able to spread an ownership control among affiliated entities you have to first, examine how your assets are owned and whether they are held by one easy to seize entity or several. Second, it may be worth considering splitting up your assets into several legal entities which tends to complicate and disorganize aggressor's action.

### *Onsite security*

Both cases demonstrated documentation seizures and house-checks conducted by different government agencies, and if there were any entry on the targets' private property they were

conducted by only government agencies and officials. However, since there still are cases when entry on a target's private property is done by private security firms, onsite security is an advisable step to take. There are few options that you might consider. First, it might be private security company which tends to scare off only burglars and usually tends to be not very effective against professional raiders. Second option is to employ the militia as onsite security due to their reasonably greater power and recourses that militia's might offer as a security providing body. However, don't forget that professional raiders use administrative resources very heavily as well and it should not be surprising if entry on your private property was not stopper properly. Nevertheless, if you think that you are about to have real raiding issues in near future, it is advisable to employ the militia as onsite security.

#### *Worst case scenario plan*

Simulating worst case scenario which your company might face is a good exercise and evaluation tool which would enable you to identify areas and preventing tools that need to be enhanced. Therefore, it is advisable to evaluate your entity's readiness to face any hostile takeover activities. For instance, assess how ready your company is if it comes under an attack, such as an effort to introduce falsified documentation, lawsuits by non-existent creditors, concerted employee law suits and other storm clouds presaging a raid. Having worst case scenario simulated, it is worthwhile to analyze to which takeover schemes your company is most exposed to and enhance these exposed areas by introduction of related preventive defense methods. For instance, if your company turned out to be most exposed to a bankruptcy scheme you might consider Assets protection method by transferring your debts to other affiliated entity and building indebtedness. Moreover, if your company seems to be exposed to Equity buyout scheme you might consider implementing Poison pill provision or be prepared to engage in Share buyback contest if a hostile takeover threat appears.

Furthermore, it's also advisable to estimate approximately how long it will take your company to file counter-suits, to slow down your opponent and to either retain or gain control over the situation. In addition, it's also worthwhile to check whether your company has established relationship with the arbitrage (commercial) court with jurisdiction over your asset.

## 5.2. Operational tools

This part of Survival Guide is devoted to operational tools that business owners might find practical in real hostile situation. Following tools are dealing with measures which are expected to enable active business owners to complicate or even prevent their businesses captures by raiders by reacting to existing hostile takeover threat.

### *Make noise*

Making noise means letting public, government agencies or officials know that potential hostile takeover activity is going on. In defense method list, mentioned in literature review, such defense methods as “Asymmetrical solutions” and “Counterattacks” are, to a degree, carrying similar functions. Furthermore, both cases demonstrated targets’ reliance on such defense methods as asymmetrical solutions and counterattacks through PR campaigns conducted by ToAz with its demonstrations, a book and several media packages and through networking done by both targets striving for assistance from officials. Such heavy reliance on above mentioned defense methods is obvious due to favorable costs advantages of asymmetrical solutions and some types of counterattacks.

The most cost efficient and effective way to combat abuse of administrative resource is to contact related Internal Security Directorate department or some sort of internal control body. Therefore, do not hesitate to contact government agencies and officials of higher authority than an abusive official. It is also worthwhile to apply such asymmetric solution “letters to the president”. “Letters to the president” means sending out complaints to every conceivable state agency such as FSB, MVD, prosecutor-general's office, and even to the president informing that attempts are being made to seize the firm using administrative mechanisms.

It’s not 100 per cent guarantee that just mentioned methods will deliver you instant value and problem solutions. However, at least taking under consideration resources methods usually require and possible benefit they might deliver, it seems to be worthwhile to spend some time and effort to apply these methods. Nevertheless, it is strongly recommended to not rely on these methods along and treat them as additional tools rather than main defense strategy measures.



### *Hire good lawyer*

As opposite to “making noise” tool litigation tends to be one of the main operating defense tools. As was demonstrated by both cases, litigation is heavily used by defending companies during the whole takeover episode, which should not be surprising to anyone. Even though, litigation, according to cases studied and authors mentioned in literature review, is not considered to be the most effective way to defend a target due to high cost and wasted time, it still can deliver certain advantages such as buying time for a target to regroup its resources, and to figure out defense strategy if counterpunch was done by proper professional lawyer.

Therefore, it is recommendation is to hire top notch professional lawyers. First, to be able to avoid wasting target’s resources and time on meaningless trials business owners have to either be or hire really professional lawyer. Second, if you are going to acquire professional lawyer’s services you might as well consider turning to lawyer specializing in corporate conflicts and hostile takeovers defense. Furthermore, there are also professional lawyer’s services provided by former professional raider companies or individuals who just requalified from an aggressor to defender due to constantly increasing demand for such services. These professional tend to be really effective due to market knowledge, expertise and networking resources acquired by being aggressors. However, be advised that such companies, according to literature review and market participants, occasionally were accused in abusing their authority and taking over theirs clients using their vulnerable position.

### *Pick your battle*

This idea already was mentioned in “hire good lawyer” section. However, since it appeared to be really important I want to repeat myself. It is fundamentally important to be able to pick your battle while being under hostile attack. In other words, strive to avoid wasting company’s resources and time on meaningless trials and administrative/criminal charges. As was demonstrated by both cases and examples mentioned in literature review, professional raider very often file administrative/criminal charges just to disturb targets’ focus forcing the victim to waste it’s time and resources on meaningless aspects while an aggressor get a chance to calmly implement its takeover plan.

Therefore, having hired a good lawyer, it is important to understand weak and strength sides of your business. In addition to strengths and weaknesses, you have to be able to figure out

most attractive assets that might catch the attention of raiders, if these both steps were not done earlier as was recommended in “Worst case scenario” section. Having weaknesses, strengths and most attractive assets established, it is advisable to determine possible takeover schemes which have most potential to be exploited by raiders in order to capture control over whole entity or just most attractive parts (e.g. real estate, hard assets) of it. While working out possible takeover schemes keep in mind legal control aspects, documentation control aspects mentioned above in Survival Guide and other crucial point mentioned in common defense methods part.

Established possible takeover schemes should enable you to make a decision which of defense measures mentioned in this study better suite your company’s financial position, strategically important goals etc. Also, best interest of such stakeholders as long-term partners, employees, and of course shareholders should be taken under consideration as well. For instance, some shareholders might find sale of the most valuable and vital company’s assets (crown jewels in case of assets protection) to a third body or “strategic acquisition” to be a reason to stop being shareholder of that company. Or such defense methods as “White knight”, “Creation of strategic alliance” might not be in line with defending company’s employees or strategically vital partners. On the other hand, your company’s future is at stake in hostile takeover event, therefore, if it is possible to implement all defensive measure without upsetting any of stakeholders it is great. If it is not possible, this is your company that might be captured and is in jeopardy, therefore, you have to do everything you can to be able to salvage it with lowest losses and harm to your vital stakeholders.

When one or combination of defense measures is chosen there’s only one step that ought to be taken which is measure or their combination execution. Depending on complexity of a chosen measure it is advisable to fall back on professional help at this stage if measure or their combination is complicated and require professional help. Professional help would enable you to set all priorities regarding measures’ execution in order, focusing first on preventing company’s vital assets’ capture and second enhancing defense measures spreading them within entity’s boundaries.

Following section will help you to find suitable defensive measure or their combination to protect your company from hostile threat. However, I must warn you that table 2 does not

contain all possible matches and combinations, therefore, I would encourage you think outside matches provided and aim at finding best suited defense strategy.

*Takeover schemes and defensive measures matches*

Now let us take a look at table 2. In the table I attempted to match takeover schemes mentioned in this study and defensive measures that can be applied against these takeover schemes. Defensive measures are divided into preventive and operational ones. A preventive strategy entails devising and implementing a body of measures to create legal and economic barriers to prevent a hostile takeover or impede an aggressor's acquisition of control over the company. Operational measures of defense, on the other hand, are effective when a takeover bid has already been made or hostile takeovers threat occurred. Defensive measures' matching with takeover schemes is based on literature review, interviews with market participants, case analysis and survival guide. However, I must mention that not all matches are presented in the table, only most obvious ones.

**Table 2. Takeover schemes and defensive measures matches**

<b>Takeover schemes and defensive measures matching</b>		
<i>Takeover scheme</i>	<i>Preventive measures</i>	<i>Operational measures</i>
<i>Equity buyout</i>	Poison Pill Asset protection	Share buybacks Poison pill
<i>Fraud</i>	Internal documentation control Documentation control Legal control	Litigation Poison Pill & Assets protection
<i>Administrative method</i>	Creation of strategic alliance Legal control, Lobbying	Asymmetric solutions Litigation
<i>Bankruptcy</i>	Asset protection	Litigation Asset protection
<i>Forceful seizure</i>	Asset protection	Asymmetric solutions “White Knight”
<i>Formation of governing bodies</i>	Poison pill Executive rewards	Share buyback Scorched earth” tactic
<i>Challenging entity’s privatization</i>	Asset protection	Litigation “White Knight”
<i>The table contains only most obvious matches, different, not mentioned combinations and matches are possible</i>		

*Survival Guide summary*

To summarize Survival Guide part let me quickly go through main steps that ought to be taken to increase your company chances of existence in highly hostile environment. First, it is advisable to get in order such measures as documentation control, internal documentation control, make sure that your company’s legal aspects are in place, hire onsite security if necessary, and conducts “worst case scenario” analysis which is the most important step at prior hostile threat stage.

However, if takeover threat is already occurred do not be shy and ensure that public, officials, and government agencies are aware of potential hostile activity. Also, make sure you have right legal resources which should enable you to focus on essential aspects of hostile attack and save time, effort and resources which should increase your chances of better company defense.

## 6. Conclusion

Despite all recent developments that have been introduced in corporate governance legislation, there is still huge amount of hostile takeovers taking place in Russia (Kireev, 2007). The presence of evident loopholes combined with abundant corruption enables raiders to take over entities and strip off most valuable entities' assets while an entity is under their control. Therefore, ability to protect an entity or prevent hostile takeover at its initial stage seems to be a relevant subject currently for most small, median and large size enterprises with valuable assets in possession in Russia. Additionally, current financial crisis seemed to increase an exposure to hostile takeovers and tends to make the subject even more vital due to the tendency of raiders to use entities' debts as one instrument in hostile takeover scheme.

Therefore, the research problem of the thesis is as follows: How enterprise can protect itself from hostile takeover and raiders on Russian market? The research problem was divided into three sub-problems. The first I examine most common schemes of hostile takeovers in Russia. Having most common hostile takeovers' scheme established it was possible to pursue the second sub-problem which was identifying already well-known anti-hostile takeover defense methods used in Russia. Last, third sub-problem was to describe which of above mentioned defense methods or their combination are most effective against takeover schemes mentioned in the study. Furthermore, the main purpose of the thesis was to create some sort of instructions that would be valuable to both SME, with their limited resources, and large entities for protecting an entity from potential hostile takeover threat or preventing an attack on its initial stage applying the instructions as a result of this thesis.

As a result of the this thesis, it turned out that there are several steps that could help enterprises to be become less attractive as target for raiders and a number of measures and defense methods which enable enterprises and SME to fight back protecting its assets. Most essential part of the thesis is Survival guide that offers instructions which should make enterprise, regardless of its size, better prepared for hostile activity towards the whole entity or just most attractive parts of it. The Survival Guide offers several steps which are expected to help enterprises and potential targets to establish preventive measures against hostile threat. Furthermore, it helps to plan and implement defense strategy against hostilely aggressive behavior towards an entity and complicate or even stop possible entity's capture.

The results of the thesis are consistent with ideas mentioned in the previous research used for this study. For instance, Demodova (2007) mentioned almost the same hostile takeover defense methods used in Russia as other authors and market participants interviewed for the thesis. Kireev (2007) also stated the same features concerning the market for corporate control in Russia which were identified in both cases and mentioned by other authors as well (e.g. Demidova, 2007; Borisov, 2009; Chernykh, 2008). Furthermore, Volkov (2004) mentioned core ideas behind hostile takeover which were consistent with hostile takeover rationale mentioned by other authors and demonstrated in both case as well.

Both cases and their analysis demonstrated consistency with ideas mentioned by other authors in previous research. However, as a contribution to the previous research, this thesis, or to be exact the Survival Guide part adds new ideas and thoughts concerning measures that need to be undertaken in order to decrease company's attractiveness as a target and complicate or even stop hostile takeover activity towards the company. The Survival Guide first of all, is more practical and detail oriented than just defense methods mentioned. Second, it tends to be an additional part to the whole defense strategy and especially to defense methods rather than just stand along measures.

#### *Practical implementations / recommendations*

Considering the Survival Guide to be more practical and an addition to defense methods mentioned in this thesis there are few recommendations that can be taken from the results. First, it is advisable to apply preventive tools mentioned in the Survival Guide, which would enable company's owners and management to decide company's most attractive and vulnerable areas. This step would help to decide which of preventive defense methods are most convenient from practical and economical standpoints. Second, worst case scenario simulation recommended in preventive tools section also supposed to help to exercises possible operational defense methods in event of hostile takeover threat. However, even though not every takeover event is unique, and in most of the cases there are common patterns, there still might be details that won't allow applying defense measure or methods recommended in the Survival Guide. Therefore, it is advisable to acquire professional help, become familiar with variety of methods available, and try to think out of the box for most convenient problem solution.

### *Limitation*

There are several limitations regarding this thesis. First limitation that comes to mind is number of cases analyzed. There were only two cases which might restrict number of tools and measures borrowed from these cases and number of defense methods examples. Second limitation which seems to be quite obvious is reluctance to talk about issues, concerning takeover events and general practice regarding hostile takeover activity on Russian market for corporate control. However, I managed to gather reasonable amount of information and data on both event and common practice overall. Therefore, even though it is still a limitation, it has been overcome to a certain degree. Third limitation concerns availability of any statistics on such topic as hostile takeover activity. This constraint probably could be explained (1) by reluctance of any government agency to show such negative aspects taking into account recent Russia's attractiveness as an emerging market, and (2) by the fact that there was not any law regarding hostile takeover activities and most of criminal charges which were initiated regarding illegal hostile takeover activities were initiated mostly via Acts concerning robbery or fraud. Fourth and the last limitation regarding this thesis is subjectivity. Great part of information and data regarding the market for corporate control, takeover schemes and defense methods, and especially takeover events were collected through interview with market participants. Therefore, opinions regarding above mentioned aspect, especially many detail regarding takeover event tend to be subjective.

### *Suggestions for further research*

The most obvious suggestion for further research would be a conduction similar research with fewer takeover events, and most importantly with data and information from individuals who have been directly involved in the defense strategy planning and implementation. First of all, main sources involvement in takeover event would enable to collect detail data and accurate information regarding these events. Second, detail data and accurate information regarding these events allow making stronger statistical generalization regarding such aspect as costs of defense methods used, most applied defense methods, effectiveness of methods applied and other constructive aspect.

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