

M&A BACK IN PLAY



While foreign investors are very cautious towards Ukrainian assets and M&A deals are dramatically determined by the general investment climate in the country, lawyers have to monitor the situation and work out timely solutions for proposed deals.

We asked Vladimir Sayenko, partner of Sayenko Kharenko law firm, to share his vision of the M&A market from the perspective of a Ukrainian legal counsel.

UJBL: What are the key trends on the global M&A market?

VLADIMIR SAYENKO: Global M&A activity remains at record low, with a reported 14% drop in volume and 9% drop in value of deals as compared to last year.

But the actual trends in the global M&A market are not quite what experts had predicted. You would expect that the political instability in Europe and continuous talk about the breakup of the Eurozone would push bargain shopping for distressed assets. That, however, was not the case. While global investors were scouring for cheap assets, with the yield potential higher than the risks, the sellers were adopting a “wait-and-see” policy, and the gap between buy-side and sell-side price expectations was way too big to get deals done.

During the past year, the global M&A market has seen new buyers coming into play. Asian corporates, which have accumulated high levels of cash, are shopping for foreign assets. Sovereign wealth funds are becoming increasingly active, especially in the energy and natural resources (ENR) sector, which can be explained by the size of ENR deals and the fact that they involve government clearance.

Even though investment bankers say that the global market is ripe for M&A activity, it seems like potential acquirers feel safer to hold their capital tight until the global economy and politics become, hopefully, more predictable. Legal advisors more often speak of a challenge associated with completing transactions. The pace of transactions remains somewhat protracted and takes longer than the historical average. To get a deal done requires even more skill in planning and execution than usual.

UJBL: Have Ukrainian deals been affected by global trends?

V. S.: They certainly have. The Ukrainian M&A market shadowed the global trends of which we spoke earlier. The total number of deals in Ukrainian M&A market was valued at USD 2 billion in 2012 — that is only 40% of the 2011 figure, and is far lower than during the pre-crisis years (in 2008 the Ukrainian M&A market volume was USD 3.69 billion, and in 2007 — USD 21.49 billion). The average value of deals dropped to USD 70-100 million. Apart from the acquisition of Lemtrans by SCM Group, which is Ukraine's largest M&A deal in 2012 (according to Forbes.ua), other Ukrainian assets were acquired for less than USD 100 million.

UJBL: What has been the investors profile in recent years? Who is hunting for Ukrainian assets?

V. S.: I would say that investors are scrutinizing Ukraine very carefully to fish out the best opportunities. They are not hunting for anything in particular though their attention is still on Ukraine's strategic sectors.

Having advised on the majority of recent M&As (No.1 by the number of Ukrainian M&A deals in 2012, as well as in a number of preceding years according to Thomson Reuters), we indeed saw changes in the profile of acquirers. At the time when large multinationals are held back by economic volatilities and political hurdles in Ukraine, Russian companies and large Ukrainian financial and industrial groups that are better adjusted to local realities, mentality and legislative framework, are playing first fiddle. Nine out of ten of the largest Ukrainian acquisitions in 2012 were done by Ukrainian or Russian investors.

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The most recent example was the acquisition of a grain terminal in Russia's Krasnodar Region by Kernel and Renaisco in 2012.

Strategic sectors of the Ukrainian economy remain attractive. Energy/renewable energy and natural resources (as Ukraine attempts to reduce its dependence on gas imports from Russia) is one, as is agriculture and IT (as demonstrated by the Government's abolition of VAT on software supply operations for all software producers in Ukraine starting from 1 January 2013). Other sectors such as financial services,

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for instance, offer M&A opportunities either as an attempt to consolidate, or based on the strategy of international players to exit the country so as to focus on their core business elsewhere.

UJBL: How does the involvement of legal advisors change?

V. S.: The role of legal advisors has at all times been essential in M&A deals. Depending on the type (local-to-local; foreign-to-local; foreign-to-foreign) and scale of the anticipated transaction, the involvement of the Ukrainian legal counsel could be very different: from full-scope legal, tax, and compliance due diligence followed by transaction structuring, documents drafting, negotiation support and post acquisition corporate governance matters to a limited-scope due diligence review.

**SAYENKO
KHARENKO
KEY FACTS:**

- **Year of establishment**
2004
- **Number of lawyers/
partners**
60/6
- **Core practice areas**
Antitrust
Banking and Finance
Bankruptcy and Debt
Restructuring
Capital Markets
Corporate and M&A
Intellectual Property
International Arbitration
International Trade
Labor
Litigation
Real Estate
Tax



However, since very recently, even the classical roles of legal advisors on M&A deals are changing. The reasons behind the shift are clear: tighter corporate budgets for legal consultants; extreme caution on the part of the very few investors which are looking to invest; and a sizable gap between buy-side and sell-side price expectations, which very often push investors to make a business decision not to buy. Every single one of the above factors determines the nature and degree of the involvement of legal counsels.

Finally, in a highly competitive legal market lawyers become more entrepreneurial. They spend significant time trying to find deals for their clients and may be willing to take a higher risk in alternative fee arrangements, such as fixed fees and contingency fees.

UJBL: How do lawyers see their new roles?

V. S.: The legal market reacts just fine, making adjustments to their business on the way. Top law firms watch the market closely and talk to businesses trying

OUR OBSERVATIONS HAVE SHOWN THAT CLIENTS NOW TEND TO BREAK THE TRADITIONAL SCOPE OF LEGAL WORK INTO SMALLER CHUNKS AND NEGOTIATE LEGAL FEES SEPARATELY FOR EACH PORTION OF THE WORK, ENSURING THAT NO ADDITIONAL LEGAL FEES WILL BE INCURRED BEYOND THE ORIGINALLY AGREED BUDGET

to predict the shifts in client behavior in advance to stay flexible and react to market challenges. Tight client budgets and extreme competition has, obviously, been the toughest one for law firms to face.

External legal counsels react differently to the new market conditions. Some law firms go to extremes and create new pre-made mass market products which seemingly offer “more for less”. An example would be a packaged service of legal due diligence for a record low fixed fee. The problem with such due diligence is that it is simply too limited to unveil serious legal risks.

The client will most likely receive a standard report, compiled automatically by customized software, with light editing input from a junior lawyer. Non-standard issues of regulatory compliance, background checks of the target, licensing/permits, labor issues will almost certainly be omitted, even though they constitute serious legal risks and can easily be deal breakers. There are other similar half-automated legal products on the market. I believe that such pre-made products can be very useful analytical tools to collect specific information and lay it down in an organized reader-friendly format. However, I would not advise basing any business decisions solely on this data as it lacks human input from experienced lawyers.

Our observations have shown that clients now tend to break the traditional scope of legal work into smaller chunks and negotiate legal fees separately for each portion of the work, ensuring that no additional legal fees will be incurred beyond the originally agreed budget. This trend was quite predictable. Investors are now shopping mostly for distressed Ukrainian assets. For example, when owners are forced to sell. There can be various reasons for selling: bankruptcy, excessive debt or regulatory constraints, or all of the above. When bidders are looking at such potential targets they do not want a comprehensive full-scope legal audit. They come to legal advisors looking for an initial, comparatively low-cost review of their target, primarily intended to uncover any “deal-breaker” issues before significant time and resources are invested into further investigations or negotiations. Thus, the involvement of legal advisors in a potential deal is often agreed on a stage-by-stage principle, starting with the most basic scope, which may later be expanded if investors retain their interest in the target.

UJBL: What other peculiarities of the Ukrainian M&A market exist from the lawyer’s perspective?

V. S.: Another factor impacting the role of legal advisors is the value of deals. The majority of Ukrainian M&As in 2012 included targets valued at USD 80 million or less. The value of some deals was reported at the nominal value of one US dollar or similar. On the one hand, nominal transaction value creates a lot of interesting issues in the drafting of the SPA, traditional limitations on warranties become less relevant. On the other hand, clients are not interested in incurring significant legal fees to document the acquisition or sale of an asset for one dollar. They do not appreciate that the legal risks of a mistake made in such transaction can lead to damages that would be evaluated in the millions. This issue can be illustrated by recent trends in the engagement of English law counsel.

While almost 99% of all share acquisitions in Ukrainian transactions are structured under English law, often with non-Ukrainian holding companies, for small and middle-size deals, many investors are not quite willing to engage UK law firms to handle such transactions properly, including the structuring of the transaction, drafting and negotiating transaction documents.

In response, local firms are trying to provide full legal support for deals governed by English law. This creates a high risk of a mistake, if no experienced English lawyers duly qualified to advise on English law issues and admitted to practice in the UK are involved. Our firm has found a solution where the involvement of English lawyers is minimized without jeopardizing the quality of the legal advice that is required in cross-border M&A deals and other firms are likely to follow this model.

Client instructions in recent years have shown that compliance audits and other compliance issues are gaining momentum. This trend can be attributed to the bulk of brand new legislation introduced in Ukraine during the last two-three years and the increased attention that Ukrainian companies get from various state inspections and audits. The *Tax Code*, the *Criminal Procedure Code*, privacy and personal data protection legislation, anticorruption laws, antitrust laws, the upcoming *Labor Code* and ever-changing corporate legislation set out new rules for doing business. Many companies have learnt the hard way (through fines, penalties, administrative and even court proceedings) that new legislation is not as simple as it may seem at first glance. The increasing importance of compliance in Ukraine — in which the term “compliance” is broadly understood to mean a company’s obligation to ensure

the fulfilment of its legal obligations — also brings new responsibilities for M&A lawyers. The acquisition of a company that does not comply with these obligations may result in substantial legal risks and costs, and could even lead to personal liability on the part of the acquirer’s management. Big multinationals face an even bigger challenge, because their domestic legislation, such as the *Foreign Corrupt Practices Act*

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(FCPA) in the US and the *UK Bribery Act*, may create even bigger problems for these multinationals in their home jurisdictions. At Sayenko Kharenko, we have established niche practice groups for anticorruption (including FCPA and *UK Bribery Act* compliance), personal data protection, criminal defense and white-collar crimes. Their expertise is difficult to overestimate when we work on M&A deals.

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