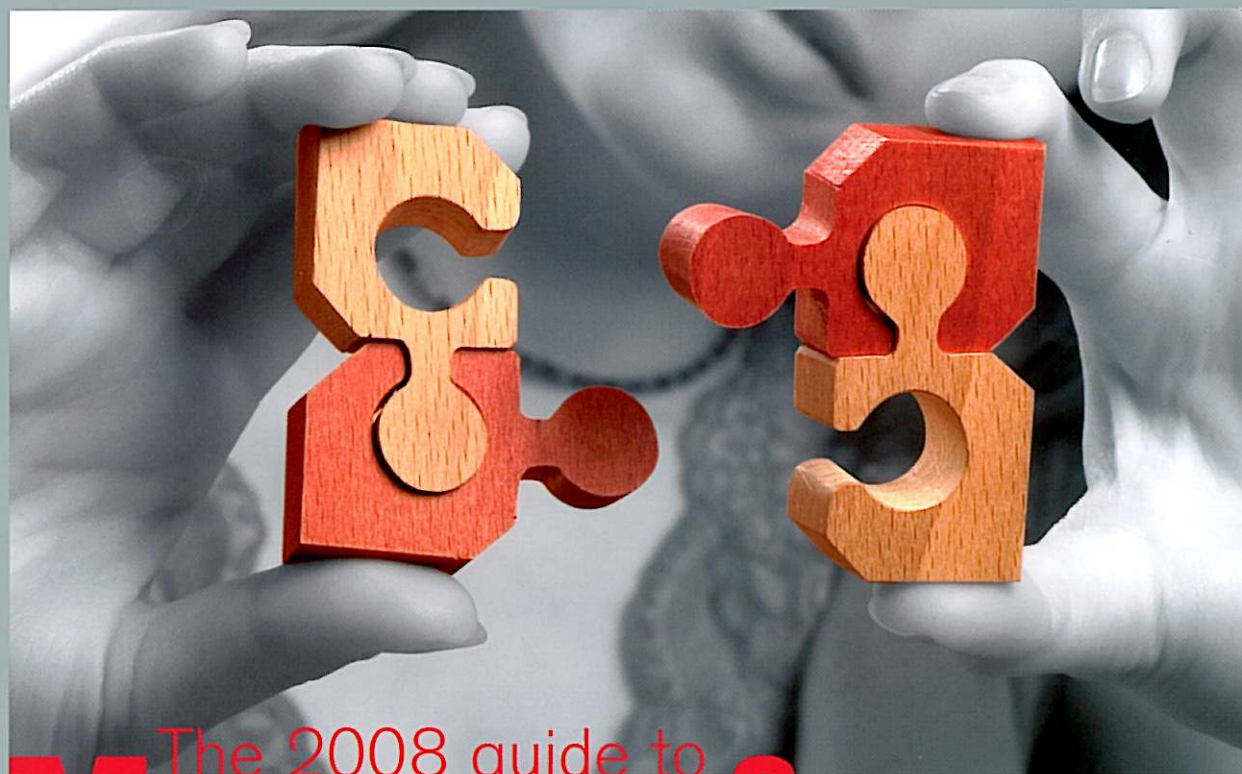


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The 2008 guide to
Mergers & Acquisitions

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A Romanian perspective

Patchy legislation makes M&A more difficult than it should be, argue Iulia Stoianof and Adrian-Catalin Bulboaca of Bulboaca & Asociatii

Market overview

In the background of the growing Central and Eastern Europe M&A market, Romania has had its share of M&A transactions. Despite the sometimes unstable political regime and the changes in national regulation, investors began to find a market that was more open and mature.

Romania's accession to the EU in January 2007 has increased investors' interest in entering the Romanian market and consolidating their position in the region. Investors have opted either for greenfield projects, or for acquiring control over existing entities. Although domestic players sometimes tried to fight back and strengthen their position on the local market, the value of M&A transactions involving local partners only has been significantly outrun by transactions in which a foreign partner was involved.

Regardless of a slight decrease in foreign investments since 2006 when it was considered that Romania had its best year since 1990 (with a value of foreign investments estimated at €9.2 billion), the Romanian market remains attractive to investors. According to the National Bank of Romania, direct foreign investments have reached €7.076 billion (\$10.85 billion) in 2007, and are expected to remain at this level in 2008.

Naturally, increases in foreign investments have driven increases in M&A transactions on the Romanian market. They reveal a preference, if not a necessity, of local companies for foreign strategic partners. The value of the M&A Romanian market in 2007 has been estimated at €5 billion, half of this being the takeover of 75% of Rompetrol group by KazMunaiGas, a transaction estimated at €2.5 billion. The M&A market was marked mainly by real estate transactions last year, but investors have also shown interest in telecom, IT, constructions, pharmaceutical and financial services industries.

Romania remains advantageous due to the size of its market (with a population of about 21 million) and its sustained economic growth. There are still disadvantages to be considered by foreign investors. They relate to the floating exchange rate, the risks associated with the financial market and the insufficient labour force, which has triggered a rapid increase of salaries, often exceeding the productivity increase. In addition, even after its accession to

the EU, Romania is still trying to adapt the European Community legal requirements to local realities and legislative system.

Mergers

On an ever-growing market, companies have used mergers because of a necessity to consolidate their position on the market, especially in the banking sector. Small or medium companies entered into strategic partnerships that were finalised with a predicted merger. Companies have merged either for tax purposes or to simplify the group's structure. In this context, upstream or downstream mergers have been carried out to ensure a transfer of assets (lands, mostly) from an SPV to another company within the group.

Under Romanian law, mergers can take place between companies of the same or different type, organised under the Romanian law, irrespective of whether the merging entities are: a) partnerships (Romanian: *societati in nume colectiv*); b) limited partnerships (Romanian: *societati in comandita simpla*); c) joint stock companies (Romanian: *societati pe actiuni*); d) partnerships limited by shares (Romanian: *societati in comandita pe actiuni*) or e) limited liability companies (Romanian: *societati cu raspundere limitata*). Certainly, when making decisions in the merger process, the rules specific to each type of company have to be observed.

A merger in Romania may involve either (i) the merger of two or more companies that cease to exist, resulting in a newly established company; or (ii) the absorption of one or more companies ceasing to exist, by another already existing company.

Mergers are operations structured in several steps to be undertaken internally, by each of the involved companies, as well as externally, by performing certain formalities in front of

competent authorities. A merger would require: (i) the approval of the merger by the shareholders general meeting; (ii) a merger plan; (iii) certain evaluations reports based on which the merger is carried out; (iv) registration and publication formalities performed with relevant authorities by each of the companies involved; and (v) the approval of the merger by the competent judge.

In some cases, special approval may be required. For instance, mergers between financial institutions have to be approved by the National Bank of Romania; mergers between insurance companies are subject to the approval of the National Insurance Supervisory Commission.

As an effect of the merger, all the assets, rights and liabilities of the company ceasing to exist are transferred to the successor company. Given the timing set forth for different stages, it may be estimated that a merger in Romania could require about six months for implementation.

Cross-border mergers

Although briefly mentioned in Law Number 105/1992 regarding private international relationships, cross-border mergers are not properly regulated under Romanian law. Consequently, any plan for a cross-border merger involving a Romanian company is now subject to legislative and administrative constraints, mainly determined by the lack of procedural norms.

Further to its accession to the EU, Romania was required to implement the Directive 2005/56/CE on cross-border mergers of companies, in order to create a local framework allowing such mergers. In this respect, a proposal for legislative change to Law Number 31/1990 regarding companies (the Company Law) is being publicly debated. The legislative proposal has basically undertaken the provisions of the Directive 2005/56/CE, which shall therefore become a part of the internal legislation once the amendments are approved by the Romanian Parliament.

Based on the proposed amendments, only joint-stock companies, partnerships limited by shares, limited liability companies and European companies established in Romania will be able to participate in a cross-border merger, following the rules set forth by the Company Law.

Like mergers between national companies, cross-border mergers will lead to the universal

“In an asset sale it is important to note that under Romanian law, only rights can be freely assigned. A transfer of obligations requires the consent of the creditors”

Author biographies



Iulia Stoianof
Bulboaca & Asociatii SCA

Iulia Stoianof is a senior associate at Bulboaca & Asociatii SCA. Before joining Bulboaca & Asociatii, Stoianof was an associate with the corporate practice of the Bucharest office of a magic circle law firm. She has been extensively involved in large privatisation projects and a significant number of corporate, M&A, environmental, real estate and banking matters. Her expertise also includes labour law and she has represented clients in highly sensitive cases.

Stoianof graduated from the Law School of Bucharest University and is a member of the Romanian Bar Association. She is fluent in English.



Adrian Bulboaca
Bulboaca & Asociatii SCA

Adrian Bulboaca is the managing partner of Bulboaca & Asociatii SCA and a member of the Romanian Bar Association. Before joining Bulboaca & Asociatii, Bulboaca led the banking and finance practice of Linklaters, Bucharest office, between 2001 and 2006, and its energy practice during 2001 and 2003.

Bulboaca has extensive experience in M&A transactions. He has managed significant projects such as: (i) the privatisation of Petrom SA (the largest privatisation in CEE to date); (ii) the disposal by General Electric of a sizable equity stake in BancPost SA and Pater Bank SA, respectively, (iii) the acquisition by OTP Bank Rt of Banca Comerciala, RoBank SA, and (iv) the proposed acquisition by a bidder of Banca Comerciala, Ion Tiriac SA.

His legal experience focuses on acting on behalf of domestic and international banks and borrowers in syndicated and bilateral credit transactions, secured and unsecured, and advising security takers and providers on the creation and perfection of guarantees and securities. He also has extensive experience in project equity, project and asset finance.

Since 2003 Bulboaca has consistently been ranked by Chambers and Partners in its top tier. The publication said that interviews described him as: "One of the country's top names for banking and finance" and that: "He has used his extensive experience to take the lead on many sophisticated projects and asset finance transactions." He holds a MBA in international banking from City University in Seattle, Washington.

transfer of assets, and rights and obligations from the company ceasing to exist to the new/absorbing company. From this perspective, and in the light of the current Romanian legislation, the proposed amendment to the Company Law will have to be reconciled with the Romanian legal provisions concerning acquisition by foreigners of land located in Romania. At the moment, there are restrictions on acquisition of land by foreigners, which continue until January 1 2012. For agricultural land and forest, the prohibition extends until January 1 2014.

Based on the proposed amendments to the Company Law, a Romanian or European company headquartered in Romania owning land there may not enter into a cross-border merger until January 1 2012, if the absorbing company or the newly established company is a foreign entity. However, this limitation does not apply in the case of agricultural or forest land.

In this context and from a practical approach it is interesting to see if and how the two legal acts will be conciliated before the amendments to the Company Law are enacted, or whether it will remain a matter of interpretation and will be finally settled by a court decision, if the amendments are passed as currently proposed.

Acquisitions

In recent years, domestic companies have grown to maturity and sellers have proven to be more and more sophisticated in M&A transactions. A better understanding of the value of their companies has often helped sellers negotiate a better position and has given them advantages over foreign investors.

M&A transactions have become increasingly complex. We are now able to see the foreign mechanisms of structuring an M&A deal applied to transactions carried out on the Romanian market. Sellers are now more willing to accept a material adverse change clause, to represent and give a warrant for the business they sell, and to undertake liability in a way similar to the mechanisms applied in other jurisdictions.

Nonetheless, while often used in the agreements governing the acquisition of a Romanian privately-owned company, clauses that are common in other jurisdictions (especially the UK) must be carefully treated under Romanian law. Romanian courts have rarely ruled in M&A deals governed by Romanian law and the enforceability of certain clauses, such as clauses entitling the buyer to terminate the sale-purchase agreement for a breach of any representation or warranty made

by the seller, even if this is not regarded as material has not been tested yet in front of Romanian judges. As a result of such lack of practice, investors usually defer disputes arising in relation to the agreement to international arbitration courts, but sellers often prove reluctant to introduce such clauses.

Acquisitions in Romania are structured either as share deals or asset deals. Both scenarios have particular implications, a final decision largely depending on the acquirer's assessment of the advantages and the disadvantages presented by each option, as well as by the particularities of each deal.

From a certain perspective (for example, restrictions on the transfer of ownership rights over the land, taxes), the sale of assets might not be an attractive structuring under Romanian law. Nevertheless, for companies with valuable assets and, to some extent, undetermined liabilities, the structure may be a suitable way to separate such assets from any unidentified liabilities of the acquired company. Still, an asset deal would most probably involve a potential increase in the purchase price (due to retained liabilities and, if the case, of the VAT costs), as well as the need to obtain the approval of the company's creditors for any transfer of obligations.

Our experience in past transactions suggests that in terms of logistics an asset deal may be more appropriate for companies that have relatively limited operations or have entered into a limited number of agreements. Conversely, companies routinely entering a large number of agreements are unlikely participants in an asset deal. Considering these factors, investors usually opt for a share deal.

Share deals

In contrast with previous years, when share deals were usually structured as a 100% acquisition of the share capital, with the seller exiting the company and sometimes remaining as manager for a short period, now we often see deals in which foreign investors acquire a controlling stake, with the seller remaining co-interested in the company as a minority shareholder. This type of structuring not only allows the buyer to smooth the transitional period until the acquired company is integrated into the buyer's corporation, but it also motivates the seller to remain involved in the management of the company.

Relationships between the new and the initial shareholder are usually treated by provisions inserted into the Articles of Association of the acquired company, to the extent that they are permitted by law. Certain matters, such as the quorum and majority requirements for making decisions, have to be mandatorily included in the corporate documents.

Matters outside the express legal provisions are usually set forth in shareholders agreements executed as part of the transaction documents. It has lately become a practice that certain aspects, such as the nomination by the buyer, as

majority shareholder, of the members of the board of directors or of the managers, are agreed between the parties in a shareholders agreement; in that case, however, members of the board, irrespective of their nomination by the majority shareholder, will have to be finally appointed by the shareholders' general meeting.

As a response to the increasing need for flexibility in M&A transactions, Romanian law has been recently amended to allow shareholders' agreements on the exercise of the voting right. From a total interdiction of the agreements on voting, which were until December 1 2006 considered null and void, the law has recently become more flexible. Conventions on the exercise of the voting right are now restricted only if the shareholders undertake to vote according to the company's or its representatives' instructions.

Provisions of the shareholders' agreements will need however to be carefully treated regarding their enforceability. Although binding on shareholders, they may not operate on third parties. For instance, any restrictions on the transfer of shares in the company (including a pre-emption right or restrictions on sale to third parties) will need to be inserted into the Articles of Association in order to be binding on third parties. Acting differently might entitle the buyer to indemnities, but the courts might not rule for the specific performance of the seller.

As regards the formalities required for the implementation of a share deal, in limited liability companies shares are transferred when parties agree on such a transfer. However, a registration in the company's shareholders' register and with the Commercial Registry is subsequently required, in order to make the transfer binding and enforceable on third parties. The formalities are slightly different if a joint stock company is acquired. In such cases, shares are transferred by a statement made and signed in the shareholders' registry by both the seller and the buyer, unless other formalities have been previously agreed in the Articles of the Association of the relevant company in this respect. Registration with the Commercial Registry is also required in order to make the transfer binding and enforceable on third parties.

Asset deals

In an asset sale it is important to note that under Romanian law, only rights can be freely assigned. A transfer of obligations requires the consent of the creditors. Thus, a true "sale of business" would need the consent of all the creditors of the company selling its business; such consent cannot be obtained automatically and in most cases would be almost impossible from a practical point of view.

Without the creditors' consent, a company may only transfer its assets and rights under the agreements to which it is a party, but will remain liable for all its obligations. Trying to complete the transfer of such obligations would at best significantly delay the process, at

worst it would be unachievable. In this particular case, depending on discussions with the seller and the management of the company selling its business, a list of key material consents to the obligations transfer is usually identified and the obtaining of the creditors' consent is set forth as a condition precedent to the completion of the asset deal.

As regards the liability attached to the sold assets, although parties may usually agree on how liability will be shared or transferred between them, in certain cases, the liability is transferred to the acquirer by operation of law.

As a general rule, the transfer of ownership right over movable and immovable assets takes place when the parties agree on it; no other formalities are required. As an exception to this rule, sale-purchase agreements by which the ownership right over the land is acquired must be executed formally before a public notary. This involves potentially high costs and taxes that must be paid by the acquirer, depending on the value of the land and, to a certain extent, increased notary's fees. Furthermore, an asset deal might require a number of individual registrations or other formalities to be performed, depending on the sold assets. For instance, the transfer of ownership right over land and buildings becomes binding and enforceable towards third parties provided that the appropriate registration with the Land Book has been performed. A particular registration is also required in case of trademarks assigned to third parties. In this case, the transfer has to be registered with the Romanian State Office for Patents and Trademarks.

Employment aspects

Due to its legislative framework, foreign investors consider Romania one of the most employee-protective countries in the region. In a business where the employees are sometimes the core asset of a company, such as software development, consultancy or construction, employment aspects should be considered in any decision about an M&A transaction in Romania.

While in the case of a share deal, investors usually focus on determining the main laws and regulations applicable to the employees, for the observance of which they become responsible, in an asset deal investors are required to observe certain formalities triggered by the transfer.

In a share deal no particular issues regarding the transfer of employees should arise, since the employees continue to be employed by the same entity. The new owner of the company becomes bound to observe all rights and obligations provided by the collective labour agreements applicable to the employees, by the employees' individual labour agreements or by any other document regarding working conditions and salaries in force at the time of the transfer.

In practical terms, however, one of the most frequent issues faced by the investors relates to

the fact that labour agreements are usually drafted in a simplified manner, based on a template provided by law. In this context, any new clause that the investor would want to have in the labour agreements (such as a non-competition clause) requires an amendment of the respective labour agreements. Consequently, the consent of the employees, who might prove to be reluctant to such change, is also required.

For asset deals or mergers, starting on January 1 2007, Romania implemented the Council Directive 2001/23/EC on the approximation of the laws of the member states relating to safeguarding employees' rights in the event of a transfer of an undertaking, business or part of undertaking or business. Because the enactment is recent, the competent courts and authorities still have to set clear practice in this field.

In an asset deal, as well as in case of a merger between two companies, employees are entitled to be informed and consulted 30 days before the transfer on certain elements of the transaction, such as its timing, its economic, legal and social consequences for the employees and their new working and employment conditions or changes envisaged in their labour relations.

Employment relationships are automatically transferred from the former employer to the acquiring party. Following such a transfer, the acquiring party shall be liable towards the employees not only for the obligations arising after the date of the transfer, but also for those that arose before that date. Therefore, given the legal consequences, appropriate indemnification has to be sought in sale-purchase agreements to protect investors against liability for past infringement.

From a practical perspective, investors also face another issue: although the employment relationships should be automatically transferred, in practice certain labour authorities refuse to perform the registration based on the legal provisions and the document attesting the asset deal, and usually require specific documentation to be executed attesting the termination of the employment agreement with the transferor and the execution of new individual employment agreements with the acquiring party.

Neither the seller nor the acquirer of the assets is entitled to use the sale-purchase transaction as an alleged reason for individual or collective layoffs. While the provision aims to safeguard the employees, from an investment perspective the restriction leads to a decreased flexibility for investors in shaping their business after an asset deal. Although it has been argued that the aforementioned provision does not affect the rights of the employer to dismiss employees on other grounds (for business reasons in particular, such as a reorganisation), in practice it is difficult to separate the two, especially if the timeframe between the acquisition and the reorganisation is rather short.