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ROMANIA

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I OVERVIEW OF 2006/2007 M&A

As Romania's long awaited accession to the European Union on 1 January 2007 approached, 2006 was a notably positive year, with strong economic growth estimated at approximately 7.5 per cent of GDP. Throughout 2006, Romania's economy maintained and consolidated the economic performance of previous years, with inflation continuing to decrease to a record post-Communist low of 4.87 per cent, less than the official target-forecast of 5 per cent. Essentially, last year ended a distinctly positive pre-accession period, and created the foundation for further and better results during the years to come.

This relatively long period of solid economic results, beginning back in 2000, as well as the major legislative reforms implemented with a view to harmonising the local laws with the *acquis communautaire*, significantly improved the Romanian business environment and generated increased confidence in both foreign and domestic investors in the local economy.

In line with such unprecedented positive economic results, the Romanian M&A market has expanded during the last few years from €0.5 billion in 2003 to over €5 billion in 2005 and 2006, while direct investments reached an aggregate record high of €9.1 billion in 2006. The milestones of 2005 and 2006 in the market have been represented by the acquisition of mobile operator MobiFon in a US\$2.5 billion transaction by UK-based Vodafone and the privatisation of Banca Comerciala Romana SA (BCR), Romania's largest commercial bank, in a €3.75 billion transaction awarded to Austria's Erste Bank. Each of these transactions represented more than half of the funds that entered the market in 2005 and 2006, respectively.

II GENERAL INTRODUCTION ON THE LEGISLATIVE M&A FRAMEWORK

i Companies Law

The fundamental legal enactment relevant for M&A transactions is the Companies Law No. 31/1990 as significantly amended by the Law No. 441/2006 and the Emergency Government Ordinance No. 82/2007. The Companies Law provides for specific rules applicable for selling and purchasing participations in Romania-based companies, while Chapter IV of the Companies Law regulates in detail the concepts of ‘merger’ and ‘spin-off’ and the procedures to be pursued in the context of such transactions.

Importantly, Romania is yet to transpose in its domestic legislation the provisions of the Directive 2005/56/EC on cross-border mergers of limited liability companies, which according to its implementation rules, needs to be transposed before 15 December 2007.

ii Privatisation legislation

A second set of rules relevant for the M&A sector is established by the special legislation regulating the privatisation field. The relevant legal enactments on privatisation were the main legal instruments that allowed former state-owned companies to be turned into privately controlled entities. The general rules on privatisation are provided by the Emergency Government Ordinance No. 88/1997 on the privatisation of companies and Law No. 137/2000 on certain measures for accelerating the privatisation process. As privatisation involves making strategic decisions that have a significant impact on the economy, it is carried out by the Romania’s government as the coordinating authority entitled to approve the national privatisation strategy. These laws establish the main rules and procedures to be observed for initiating a privatisation procedure, conducting the competitive process in a transparent and non-discriminatory manner and concluding the share sale-and-purchase agreement.

iii Capital market law

Although still young, the capital market field has nevertheless expanded notably during the past few years. The relevant statutory act regulating the capital market is Law No. 297/2004 on capital markets. This act mainly transposes into the local legislation the relevant European legal rules. Currently, there are two regulated markets in Romania, namely the Bucharest Stock Exchange and Sibiu Monetary-Financial and Commodities Exchange. In addition, one electronic alternative trading system, Rasdaq, has been implemented, aiming to mirror the US NASDAQ system (based on a cooperation agreement between Romania and the US), which does not however qualify as a regulated market.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

The latest amendments to the Companies Law, implemented by means of Law No. 441/2006 were intended to make final statutory adjustments before Romania joined the EU.

The amendments relevant for the M&A market concern a more accurate legal definition of the concept of ‘merger’ in line with Council Directive No. 78/855/EEC, and those revising the provisions that must be included in the merger or spin-off plan and

intended to consolidate the protection granted to shareholders and third parties.

Another substantial novelty brought by such amendments is the implementation of two alternative systems governing the structuring and operation of Romanian joint stock companies, namely the one- and the two-tier systems. As such, shareholders may opt for a 'classical' one-tier management mechanism (whereby the main managing competencies are to be carried out by the board of directors) or for the new two-tier system consisting in the company being operated by two separate bodies, namely the directorate and the supervisory board. All these significant changes are expected to improve the local business environment, by streamlining the decision-making processes in Romanian entities.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Following the favourable economic trends, the involvement of foreign investors on Romania's M&A market represented the broad majority (approximately 90 per cent) of the aggregate investment flow placed into local transactions, higher than the EU average. The number of transactions also increased as much as threefold during 2005 compared with 2004, while 2006 brought a further 25 per cent increase in the volume of transactions compared to 2005. Out of these, more than 70 per cent of the deals concluded in the M&A market in 2006 represent private-sector acquisitions, pointing to the direction in which M&A business is expected to develop in the following years.

In absolute figures, between 120 and 130 transactions were finalised in 2006, most of them representing foreign investments. According to certain reviews, the number of transactions increased by 15 per cent during 2006 as compared to the previous year, while the average value of a transaction amounted to €45 million.

Out of the total foreign investment, Austria ranks first in terms of capital invested in Romania with an estimated US\$868 million; investment originating from the UK and the US secures places in the top five (despite being slightly lower than previous years), closely followed by Indian investments (approximately US\$324 million). Romanian investments amounted to roughly 8 per cent of the entire M&A local market. From the perspective of number of transactions, the British (15 transactions), Americans (11 transactions) and Austrians (10 transactions) were the most active foreign investors.

Although far from being as impressive as the foreign investment in Romania, local companies' behaviour underwent a strategic change in 2006. As such, local entities made a further step away from consolidating their presence on the domestic market and oriented towards neighbouring markets. The most significant M&A transactions in 2006 completed by Romanian entities abroad were the local metallurgic company Cuprom's winning bid for RTB Bor (an integrated complex of mines and foundries in Serbia) around US\$400 million, as well as Petrom's (the largest participant in the oil and oil products field) acquisition of the Bulgarian OMV retail network for US\$284 million.

Another important pillar supporting the growth of the local M&A market in general and the interest of foreign investors, in particular, is the gradual consolidation of the capital market. Last year's listing of Transelectrica through an initial public offering valued at €34 million was also a test for an emerging local capital market and a great success. Aside from such high-profile transactions, the capital market constantly

developed, driven by the successful merger of the two main stock exchanges (the Bucharest Stock Exchange and RASDAQ), entities which braced themselves for an increased and more effective presence on the market.

V SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND HOT INDUSTRIES

i Significant transactions

2006 was not as spectacular as the preceding years in terms of high-profile deals. Nevertheless, two significant transactions are worth mentioning, firstly, the acquisition by Indian drugs manufacturer Ranbaxy of local manufacturer Terapia Cluj for approximately US\$324 million and secondly Erste Bank's gradual acquisition of 7.2 per cent of BCR's share capital through a series of transactions with BCR employees, resulting in an aggregate investment of US\$543 million.

Another defining feature of 2006 was a genuine boom in the real estate market, with transactions involving land of an average six hectares and located on the industrial platform of formerly state-owned plants dominating the market. The significant transactions on the Bucharest market involved approximately 500,000 square metres, the average price ranging between €400 and €500 per square metre.

As stated above, the highest profile transaction in 2006 was the takeover by the Indian group Ranbaxy Laboratories of the Romanian pharmaceutical products manufacturer Terapia Cluj. Terapia is the largest producer of generic drugs in Romania and also Romania's leading medicines exporter. Terapia is also active on Eastern European markets with a significant presence in Poland, Russia, Ukraine and another 12 countries. The controlling stake was acquired from the American Investment Fund Adent International, for a massive US\$324 million consideration (approximately €270 million).

The above-mentioned acquisition by Erste Bank of the share capital of BCR conducted in 2006 was only the latest phase of the complex process, begun back in 2003, transforming BCR from a state-owned bank into a private one. The restructuring of BCR started in 2003 when the European Bank for Reconstruction and Development (EBRD) and International Financial Corporation (IFC) acquired an aggregate stake of 25 per cent plus two shares in BCR, while an additional eight per cent of the share capital was sold to BCR employees. In 2005 the State sold, together with the EBRD and IFC, a majority stake to the Austrian Erste Bank. Although the privatisation agreement was signed in 2005, the completion of the 3.75 billion transaction and the payment of the purchase price only occurred in 2006.

As such, the acquisition of the shares held by BCR employees was a strategic move towards Erste consolidating its control over the Romanian bank.

The utilities sector also attracted a significant amount of investment, the above-mentioned successful listing of Transelectrica representing the main achievement in this field. By the end of 2006, after Transelectrica's listing, the price of its shares almost doubled at the Bucharest Stock Exchange. Further, major investments have been made in the production and transport sectors, while services faced a decrease in the value of investments.

For the year 2007, an increase in M&A transactions is expected, while the average value of a transaction could decrease owing to a structural shift from large transactions in the telecommunications and banking sectors to medium-sized transactions in real estate development, construction, IT, media, the food industry and pharmaceuticals distribution.

ii The 'depletion' of the privatisation pool

In years past, the privatisation process was the engine that powered the shift from a post-Communist centralised economy to the market economy and constantly represented a significant part of the overall M&A market. The value of privatisations peaked in 2005 when the majority stake in BCR was sold to Erste Bank and in 2006 registered a noticeable decrease. Basically, after five years of intense privatisation, the so-called privatisation pool gradually reached its limits. Another factor triggering the drop in privatisation was the unexpected delay in the privatisation of Electrica Muntenia Sud and the postponement of the privatisation of Casa de Economii si Consemnatiuni SA (CEC).

Irrespective of such setbacks, the Romanian Privatisation Authority (AVAS) reported for the first 11 months of 2006 solid revenues of 8.5 billion Romanian lei (approximately €2.75 billion) the great majority of such income resulted from privatisation transactions and management of state participations in Romanian companies. AVAS was also active on the capital market, with more than 25 companies being privatised on the stock exchange, while another 46 privatisation agreements were concluded by competitive procedures (mainly auction and competitive negotiations). AVAS's forecasts for 2007 are highly optimistic with an estimated 67 companies in AVAS's portfolio being prepared for the privatisation process to be launched.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Aside from the solid foreign direct investment anticipated on the Romanian M&A market, EU-granted structural funds are expected to be a notable source of funding and have significant impact on the Romanian business environment. Romania's accession to the EU coincides at the European Community level with the start of a new phase of the reform of regional development policy. The new plan, scheduled for the period 2007 to 2013, establishes a set of structural measures to grant financial assistance to member states and to reduce economic and social disparities within the EU region. Basically the EU has allotted a generous budget, amounting to approximately €336 billion, to be distributed under three structural instruments, scheduled to be gradually spent until 2013 by member states less developed than the EU average standards.

Owing to its relatively poor economic status, as compared with other EU countries, Romania will be one of the main beneficiaries of the structural funds as it will be in a position to access all of the three structural funds: the European Regional Development Fund, European Social Fund and the Cohesion Fund.

These instruments will be used to achieve clearly established strategic aims, such as convergence, regional competitiveness, territorial European cooperation, etc.

Romania has been allotted €19.668 billion, out of which over €12.5 billion

shall be distributed through the structural funds within the convergence objective and over €6.5 billion through the Cohesion Fund. Between 2007 and 2009, the structural instruments shall allocate approximately €6 billion as follows: 67 per cent (European Regional Development Fund and European Social Fund) and 33 per cent (Cohesion Fund).

VII EMPLOYMENT LAW

The most important amendment to employment legislation is the implementation of the provisions of the Council Directive 2001/23/EC on the approximation of the laws of member states relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (Directive 2001/23/EC). Thus Law No. 67/2006 on employees' protection in the case of transfer of undertakings or parts of undertakings (Law No. 67/2006) transposed Directive 2001/23/EC into local legislation.

The rules stated under Law No. 67/2006 refer to the transfer between companies of assets and activities and of the employees that carry out work in relation to such assets and activities.

The central rule established by Law No. 67/2006 is that the rights and obligations of the transferor, deriving from individual labour agreements or collective bargaining agreements, in force at the date of the transfer, shall be fully binding on the transferee. Both the transferor and the transferee of the business shall be under the obligation to inform the representatives of their own employees in writing, at least 30 days prior to the transfer of the business with respect to:

- a* the proposed transfer date;
- b* the reasons for the transfer;
- c* the legal, economic and social consequences of the transfer of the business on the employees;
- d* the measures to be taken with respect to the employees;
- e* the working conditions at the place of work after the transfer.

VIII TAX LAW

In December 2003, Romanian tax law was subject to significant reform consisting in the consolidation in one statute of Romania's most important tax laws (including corporate income tax, individual income tax, withholding tax, VAT, excise duties and local taxes). The fiscal reform resulted in the enactment of the Fiscal Code. Since its issuance date, the Code has been subject to several important amendments and supplements.

Starting on 1 January 2005, the central tax measure, which has also proved successful for the M&A market, was that the standard corporate tax rate is 16 per cent.

The Fiscal Code has been significantly amended and supplemented through Law No. 343 of 1 August 2006. The amendments are mainly aimed at fully harmonising Romania's tax legislation in the context of the 1 January 2007 accession to the EU. As from accession, customs barriers ceased to exist between Romania and other EU

member states. The provisions of the Savings Directive (2003/48/EC), Interest and Royalty Directive (2003/49/EC) and Mutual Assistance Directive (77/799/EEC) have also been transposed.

In the field of excise duties the most important changes have been introduced to achieve harmonised taxes. After Romania joined the EU and customs barriers disappeared, new concepts were introduced to regulate the exchange of excisable products between member states (eg, registered operators, fiscal representatives).

IX COMPETITION LAW

In 2006, the Romanian Competition Council assessed some important international transactions since they met the turnover threshold conditions triggering a notification requirement in Romania. The conditions are that the aggregate worldwide turnover of the undertakings concerned exceeds the equivalent in Romanian lei of €10 million and there are at least two undertakings involved which each have a Romanian turnover exceeding the equivalent in lei of €4 million.

Transactions such as the acquisition of Arcelor by Mittal Steel, the merger between Suez and Gaz de France, the acquiring of joint control over AMSA Steel Service Centre (Pty) Ltd, South Africa by Arcelor Steel Service Centres SAS, France and Mitsui & Co UK plc, were considered compatible and cleared by the Romanian Competition Council in 2006. Due to the division of competences at EC level, most international merger operations occurring in 2007 that will also affect the Romanian market will escape domestic review and be directly examined in Brussels.

Some other transactions such as the acquisition of Romania's largest state-owned commercial bank, Banca Comerciala Romana, by Erste Bank were notified to the Council but proved to be below the turnover thresholds (the Romanian turnover of the acquiring group was below €4 million).

In addition, mention should be made of the rather frequent use by the Competition Council of its powers of sanction against parties that breach the prohibition on closing a deal without clearance. Past dealings that have not been notified in time and have been implemented without the Council's clearance may not only trigger fines up to 10 per cent of the parties' turnover in the year preceding the sanctioning decision but also delay the assessment of current transactions notified by the groups involved in earlier merger operations.

X FUTURE DEVELOPMENTS AND OUTLOOK

The positive trend in the Romanian economy in general and in M&A market in particular is expected to be maintained or even to improve.

In the privatisation field, a significant number of transactions are still expected to be initiated or even completed in 2007, in strategic sectors. Key privatisations in heavy industry are scheduled this year, such as the recently signed transfer of the majority stake in Daewoo Automobile Craiova (one of the largest automotive manufacturers in Romania), a former joint venture of the Romanian state with Daewoo Motor Company, as well as the privatisation of Electroputere Craiova, the country's top manufacturer of

locomotives, railway equipment and high-voltage electrical equipment.

Moreover, in the energy sector, the state is planning the privatisation of the remaining energy distribution companies: Electrica Transilvania Sud (valued at €930 million), Electrica Transilvania Nord (€916 million) and Electrica Muntenia Nord (€904 million). Further upstream, the Ministry of Finance and Economy has announced its plans to sell the country's top energy producers (thermo-electrical), which include the energy complex Turceni (valued at €546 million), the energy complex Rovinari (€533 million) and the energy complex Craiova (€417 million), all three located in the south-western part of the country, this year.

The outlook for 2007 appears also to be promising for stock exchange participants who are preparing themselves for the listing of Transgaz (the country's largest distributor of natural gas) through an initial public offering (IPO) of 10 per cent of the shares and the long-awaited listing of Romtelecom (the former fixed-line monopoly) through an IPO with respect to all or some of the shares held by the state (which still owns 46 per cent of the shares). These will most probably represent the major market drivers this year unless the state decides to push forward with the listing process of the major energy producers still in its ownership such as Nuclearelectrica, Hidroelectrica and Romgaz (the main natural gas producer). Revenues derived from the listing of minority stakes in these companies (together with Transgaz) are expected to top a figure in the range of €1-1.5 billion and the listing procedures are scheduled to be finalised by the end of 2008.

Furthermore, the role of the stock exchange is set to increase in the future because almost all companies privatised through the mass privatisation programme in the nineties have ended up listed on RASDAQ (now part of BVB). Consequently, any capital increase, IPO, takeover or delisting will have to be carried out through the specific mechanisms available on the stock exchange. Additionally, the participation of foreign investment funds and the increasing role they are expected to assume in the right market conditions will most probably continue to represent a further catalyst for the synergy between the M&A business and the capital markets.