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Newsletter of 22 June 2014
Reforming Russian company law

As you may know, the Russian company law is mostly contained in the three main sources: in the Chapter 4 of the Russian Civil Code (the Civil Code), which is also the longest statute passed to date in Russia, in its original form running to over 1550 sections, and the two special laws - on joint-stock companies of 25.12.1995 and on limited liability companies of 08.02.1998 - both based on the Civil Code.

After an extensive and fundamental review of the company law the newly adopted Federal Law of 5 May 2014 No. 99-FZ has changed practically all sections of the Civil Code (sections 48-68, 87-106) relating to joint-stock companies (AOs) and limited liability companies (OOOs).

The prevailing part of the new regulations shall come into force in the autumn on 1 September of this year. Starting from this date the Russian companies shall be established in the legal forms envisaged by this new version of the Civil Code. The closed joint-stock companies shall not be registered anymore.

Which other important amendments are addressed in this newsletter?

1. Amendments to the articles of AOs and OOOs and the company names of AOs
2. Public and non-public companies:
   Public joint-stock companies. Non-public joint-stock companies and OOOs. How to deal with ZAO ? Special confirmation of the shareholders resolutions
3. Management: Board. Dual-control principle
4. Alloted share capital
5. Joint ventures and shareholders' agreements
6. Liability:
   Expulsion of a shareholder from a OOO or a non-public AO. Liability of directors.
   Liability of persons actually determining actions of a company (shadow directors).
   Liability of liquidators
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1. Amendments to the articles of AOs and OOOs and the company names of AOs

It could be recommended to amend the articles of association of existing open and closed AOs and OOOs as well as to change the company names of AOs since, starting from 1 September 2014, the company's articles shall be applied insofar as they do not conflict with the new regulations. Previously some administrative penalties and even compulsory winding up were used to be applied as sanctions for delay in re-registration of articles. No deadlines and sanctions are set up this time. The amendments can be registered together with the other first planned articles' amendments. However, by further using the old articles, the company shall in some sense be punishing itself through practical disadvantages of their use, reputation and compliance risks in relation to authorities, investors, banks, stockholders registrars (for AOs) and creditors.

In this regard we could recommend you the following changes to the articles:

(i) to indicate a location of the company in the broader terms by identifying the city or the other settlement where the company is located. The full registered ofiice's address that must be provided on the application for registration with the Unified State Register of Legal Entities (EGRYuL) can be excluded from the articles at present. In case of termination of office lease and the company relocation in Moscow you will not be obliged to change your articles again;

(ii) to substitute a necessity to assign the public notary with certification of resolutions of OOO's shareholders by an alternate reasonable provision, such as signing by all the shareholders;

(iii) anyway, to review and adjust the ZAO's articles, to change its company name;

(iv) to check the current articles and tailor a procedure for calling and holding of general meetings of shareholders and meetings of the collegial management bodies to particular circumstances of the company;

(v) to add further necessary bodies, such as a second managing director or an additional supervisory board, into the corporate management structure or, vice versa, to expressly exclude from it some unnecessary bodies, such as an internal audit committee, which the company would be obliged to appoint otherwise;

(vi) taking into account the new more flexible regulations, to separate authorities between the management bodies of the company in a more efficient way, e.g. by extending the list of reserved matters of the general meeting of the shareholders or, conversely, by delegating some of its powers to the supervisory board and/or the management board.

No registration fee is due for payment for registering these articles' changes.

A further Federal Law of 5 May 2014 - No. 107-FZ - has enacted some changes to procedure for the company registration, according to which application for registration of the articles' changes can be filed either by an applying company - represented by its general director -, or by its representative acting on the basis of the notarized Power of Attorney, who can also collect the registration certificates from the companies registrar (EGRYuL). This option shall discharge the company's and its shareholder's directors from redundant administrative and time costs.

2. Public and non-public companies

From 1 September 2014 the Russian companies may act in one of the following legal forms:

(i) as a public joint-stock company;

(ii) a non-public joint-stock company; or

(iii) a limited liability company (OOO).

2.1 Public joint-stock companies

A joint-stock company whose stocks and securities convertible into its stocks are offered to public for subscription (by public offering) or publicly traded on the terms set up by securitites laws shall be deemed to be a public joint-stock company.

A public joint-stock company (a public AO) must file data on a company name containing an indication on that the company is public with the EGRYuL. Starting from registration of these data with the EGRYuL the company shall be authorized to offer its stocks to public.

Unlike a non-public AO, the competence of the general meeting of stockholders of a public AO cannot be extended by its articles. The supervisory board shall consist of at least 5 directors to be elected by cumulative voting. An internal audit committee is another obligatory body of a public AO.

A public AO is obliged to publicly disclose information required under the securities law, such as an annual directors' report and the annual accounts, the lists of affiliated persons, etc. It should recruit a professional independent auditor in order to verify and confirm the correctness of its annual accounts.

Activities of the quoted public AOs are subject to recommended application of the newly adopted Russian Corporate Governance Code (letter of the Bank of Russia of 10.04.2014 No. 06-52/2463). The new Code replaced the first version of the Russian Corporate Governance Code produced in 2001 and took into account the changes of economic and legal systems occured within this time frame. Also, it reflected international experience in this field, in particular, the UK Corporate Governance Code 2012. The application of the Code is not compulsory. All the AOs are required to disclose in their annual directors' reports whether they follow the recommendations of the Corporate Governance Code. In follow-up to comply or explain approach, a publicly-traded company shall declare whether it does not comply with all or some of the recommendations and disclose reasons for its non-compliance. Thus, investors shall be informed of whether the company's management is consistent with the established principles of the corporate governance and be capable of more complete assessment of risks connected with investments into the quoted stocks.

2.2 Non-public joint-stock companies and OOOs

After all, OOOs (there are currently approximately 3 million companies registered in this form) as well as non-public AOs, which substitute closed AOs (ZAOs) (some 140,000 companies), will remain the main legal forms of incorporated business in Russia. For instance, there are currently just about 25,000 open AOs (OAOs), which will be the public AOs in future. The lower cost of running both non-public companies and more freedom in their management structuring will support their further broad use in the practice.

The articles of non-public companies may contain provisons that differ from the statutory regulations:

For example, the different procedure for convening, preparation and holding of the general meetings of shareholders can be set up by the articles. It can be stipulated that if the supervisory board of the non-public AO fails to adopt a resolution convening a general meeting of stockholders, the stockholder is entitled to convene it on his own and without recourse to the court, which is required if no other provision is agreed.

Except for statutory reserved matters falling within the exclusive competence of the general meeting of shareholders (including amending the articles, distribution of profits, reorganization and liquidation, etc.), its competence authorities can be re-allocated in favour of the supervisory or the management board. The supervisory board of the non-public company might be assigned to resolve issues of proportional increase of the share capital, appointment of the auditor and placement of corporate bonds.

The articles of non-public companies are free to abandon apponitment of internal audit committees.

The articles of OOO may limit the maximum number of shares that can be owned by one shareholder. At the moment, the similar restriction can only be fixed for AOs.

2.3 How to deal with ZAO ?

The stockholders of ZAO may opt for amending its articles and company name by excluding the word "closed" from it. Also, it will be necessary to notify the counterparts, substitute the company seals and file the adjusted documents with the bank, amend the corporate, contractual and employment documentation of the company.

Also, ZAO may pass a resolution on the company's reorganization in form of conversion into OOO, which, unlike other reorganization forms, can be accomplished according to simplified re-registration procedure (please see below).

In comparison with OOO, a non-public AO is obliged to register its placement of stocks and is subject to further mandatory statutory regulations set up by securities laws. Silimarly like a public AO, starting from 1 October 2014 a non-public AO shall be obliged to assign an independent stockholders' registrar holding the relevant license of the Russian capital market authority to keep its register of stockholders. It is also obliged to annually appoint the independent auditor. The necessity to choose between the stockholders' registrar and the notary for the purposes of certification of its stockholders resolutions does not make use of the form of non-public AOs attractive.

2.4 Special confirmation of the shareholders resolutions

From 1 September 2014 passing a resolution by a general meeting of shareholders and composition of the shareholders attending the general meeting must be confirmed according to the special procedure:

Resolutions of the stockholders of public AOs should be certified by the stockholders' registrar.

Resolutions of the stockholders of non-public AOs should be certified by the stockholders' registrar or by a public notary.

Fortunately, OOOs are subject to more flexible rules. Although notarization of the resolution is envisaged as a general rule, the articles of an OOO may set up the more simple procedure for the above-mentioned confirmation of the shareholders resolution, such as: (i) by means of its signing by all or some of the shareholders; (ii) with use of technical devices enabling it to be reliably established that the resolution is passed; or (iii) in some other manner consistent with the law. If the articles do not contain a respective provision, use of the alternate manner for the said confirmation other than notarization shall require an unanimous resolution of the shareholders and, thus, will not be allowed in the event of disagreement.

3. Management

3.1 Board

The Russan company law maintains a two-tier board structure as a general rule, which distinguishes between a controlling body (the supervisory board) and a collegial executive body (such as a management board).

Members of the collegial executive body of a company may not comprise more than 1/4 on the supervisory board of an AO or an OOO, whose main function is defined as control over activities of the executive bodies, and may not hold the office of the chairman of the supervisory board. Thus, 3/4 on the supervisory board are reserved with the non-executive directors.

The articles of non-public AOs and OOOs may re-allocate all the authorities of the management board to the supervisory board and, thus, set up a one-tier (one-board) board structure similar to the board structures common for US and UK companies.

3.2 Dual-control principle

From 1 September 2014 a company may simultenously appoint more than one sole executive bodies (managing directors), provided for a respective provision is included into its articles and all the directors are registered with the EGRYuL. Each of the directors may be equally authorized to act for the company.

Alternatively, all the executive directors may be required to exercise their powers jointly under the articles, e.g. by simultaneous signing of the company's documents and contracts to create binding obligations for the company ("dual-control" or "four-eyes" principle). The alternative approach can be applied specifically for international joint ventures, which may employ both a local experienced manager and a foreign qualified director at the same time and thus set up a joint control at the management level that could not be done previously.

At present just one sole executive body (the general director) is allowed to act and make day-to-day decisions on behalf for the whole company. All other executive directors should obtain a Power of Attorney signed by him in order to represent the company. It is possible for a company to disclose data only of one sole executive body in the companies register.

4. Alloted share capital

According to the Russian law the company must have alloted shares at least up to the value of the authorized minimum ("minimum charter capital"), which has not been changed recently and is currently:

- RUB 10,000 (or the euro equivalent of ca. EUR 200) for OOOs and non-public AOs; and

- RUB 100,000 (approx. EUR 2,000) for public AOs.

Starting from 5 May 2014 the shareholders of an OOO shall pay its share capital within the maximum statutory period which cannot exceed 4 months after the state registration of the company. There is no need to open so-called accumulation bank accounts that previously were required for payment of the share capital before the company's registration. Also, it is easier to justify a payment of an in-kind contribution into the share capital of the existing entity.

All the companies must satisfy strict statutory requirements where consideration for shares is other than money. An independent valuation of any in-kind contribution into the share capital of a public AO, a non-public AO and OOO shall be required from 1 September 2014. At the moment, independent valuation is only required if a non-cash consideration exceeds RUB 20,000 (or ca. EUR 400).

Shareholders of an OOO and an AO shall bear a vicarious liability for debts of a company arisen before full payment of the alloted share capital of the company.

5. Joint ventures and shareholders' agreements

The new version of the Civil Code adds some basic rules on shareholders' agreements involving AOs and OOOs, on which international joint venture (JV) agreements between the Russian and foreign companies are based in the practice.

Not only stockholders but also founders of AOs (i.e. acting before the company's registration) are expressly allowed to enter into shareholders' agreements. The answer to a question whether creditors or other third parties could be parties to a shareholders' agreement will also be positive now, provided for the agreement is entered into for the sake of securing the third party's legal interests.

Shareholders' agreement may not impose obligations on the shareholders to give votes in accordance with instructions of the company's bodies, set up a structure of the company's management bodies or their competence (which is a task of the articles). The terms and provisions of the shareholders' agreements which are inconsistent with this prohibition rule are deemed void. The following exceptions are expressly admitted:

First, shareholders' agreement may set up an obligation of its parties to vote in a general meeting of shareholders for amendments to the articles determining a structure of the company's management bodies or their competence.

Second, shareholders' agreement whose parties are all the shareholders of a non-public company (which is common for a JV) may envisage a procedure for exercise of a pre-emptive right to purchase a share in OOO in a different way from a statutory approach. According to the Law on OOOs a shareholder, who intends to sell a share to a third party, shall give written notice to his co-shareholders disclosing the price and the other terms of the proposed sale but not identifying the third-party purchaser (right of first offer). As a result, the co-shareholder may be compelled to make a decision in circumstances where the sale to a third party may not be a real likelihood. However, at present the parties are free to oblige the selling shareholder to disclose the third-party purchaser as well (right of first refusal). Thus the co-shareholders will be aware of a specific person that will adhere the JV in place of the selling shareholder if they do not exercise their pre-emption rights.

Third, although a volume of the rights of the shareholders is generally determined in proportion to the number of shares owned by them (one share one vote), shareholders' agreement or the articles of a non-public company may rebut this presumption of equality and provide a different approach, e.g. on disproportionate counting of votes. In other words shares or stocks owned by a specific shareholder may be issued with restricted or weighted voting rights in comparison with other common shares or stocks. Similarly like in English law, a shareholder, who is simultaneously a managing director of a JV, could protect himself against the risk of removal by stipulating that his shares would carry the right to three votes per share on a resolution to remove him and/or amend the articles (Bushell v Faith (1970) clause). In such a case the company is obliged to disclose a fact of existing shareholders' agreement (but not its terms) as well as a volume of the rights envisaged by it with the EGRYuL.

The parties to shareholders' agreement may not challenge it with reference to its inconsistency with the articles of the company.

A breach of shareholders' agreement may justify invalidation of the company's body resolution by the court, provided for all the shareholders of the company are parties to the shareholders' agreement. E.g., a party to the shareholders' agreement may sue for a breach of the obligation to vote in a pre-agreed way for a candidate proposed by it on a resolution to appoint the managing director.

Also, a breach of shareholders' agreement may justify challenge of a transaction entered into by its party. The court will satisfy the claim if the other party to the transaction knew or knowingly should have known about the limitations determined by shareholders' agreement (such as non-compete clause). In practice it could be rather hard to prove this fact due to confidentiality of the agreement that shall only be disclosed where it is concluded by the shareholders of a public AO or the competition/antitrust clearance is required or in some other rare cases.

6. Liability

6.1 Expulsion of a shareholder from a OOO or a non-public AO

From 1 September 2014 a shareholder is inter alia obliged:

(i) to participate in approval of corporate resolutions without which a company cannot continue its activities in accordance with the law where his participation is required for approval of the said resolutions;

(ii) not to commit any actions intentionally aimed at causing of the company's losses;

(iii) not to commit any actions (allow omission) that materially hinder attaining the objective of the company's activities or make it impossible.

In case of a material breach of these or other obligations by a shareholder of a non-public AO or OOO, especially leading to a deadlock, the other shareholder shall have the right to demand a court to expel a defaulting shareholder from the company accompanied by payment of the actual value of the shares owned by him. Neither refusal to effectuate this right nor its restriction is valid.

6.2 Liability of directors

A company or shareholders acting on behalf of the company may sue a director for recovery of losses incurred by a company due to a breach of his duties. The director is liable if it is proved that, on exercising his rights and on performing his obligations, he acted dishonestly or unreasonably, including where his actions or omission were inconsistent with the ordinary course of business or the ordinary business risk.

This liability is expressly extended to members of the supervisory and management board, except for those who voted against a resolution causing the company's losses or, by acting honestly, did not participate in the voting.

6.3 Liability of persons actually determining actions of a company (shadow directors)

A person (such as a major and/or a controlling shareholder), which has the actual possibility to determine actions of a company, inter alia by means of giving instructions to executive and non-executive directors, is also obliged to act reasonably and honestly in the interest of the company and is liable for losses caused to the company due to a breach of his duties. The rules on these persons in the Civil Code are similar to regulations of shadow directors under UK Companies Act 2006 since both laws address the liability of persons who, without a formal directorial appointment, ultimately influence the decisions of the company. Any agreement excluding or limiting liability of the said persons shall be deemed invalid.

6.4 Liability of liquidators

Members of liquidation committee or a sole liquidator which are appointed by a shareholders' resolution on liquidation for the purposes of administration of the company's affairs in the course of winding up may be liable for damages incurred by the shareholders or creditors due to a breach of duties.

7. Termination

7.1 Reorganization

From 1 September 2014 a mixed reorganization, i.e. including simultaneous application of various reorganization types, of companies will be allowed as a general rule. For instance, previously in the event of formation of two OOOs as a result of division of an AO, this AO was first subject to re-registration into OOO and then to the further division into two OOOs. Starting from autumn it will be possible to accomplish two different procedures within a single reorganization procedure.

State registration of the company to be formed as a result of reorganization is allowed only upon expiry of 3 months after insertion of a record into the EGRYuL on commencement of a reorganization procedure.

In the event of conversion of a company of one legal form into a company of a different form (for example, of an AO into an OOO) rights and obligations of a company will not be changed with regard to other persons. This form of reorganization affects only rights and obligations relating to the company's shareholders.

Hence, the Russian company law also acknowledges at present that no complete reorganization and just re-registration should be effected in the event of conversion. The simplified reorganization procedure applicable to conversion is reflected in absent duties to notify the companies registrar and the creditors and to give public notice in mass media on resolution of reorganization. Also, unlike the complete reorganization, creditors of the converted company are not entitled to demand termination or the early performance of obligations, together with recovery of damages.

7.2 Liquidation

Apart of the Civil Code and the 2 above-mentioned acts, rules on liquidation under Russian law are currently also contained in a law on insolvency of 26.10.2002. Whereas the insolvency laws have been changed in a fast moving way for the last two decades, the liquidation rules of the Civil Code have shown admirable persistence. The new version of the Civil Code has extensively reviewed and changed the existing winding up procedure.

A list of grounds for which a company is liquidated on resolution of the court has been extended. It is noteworthy that a company may be liquidated on claim of a shareholder of a company where it is impossible to achieve the objective of the company's activities, especially where exercising of activities of a company becomes impossible or is materially hindered. E.g., a shareholder refuses to vote for liquidation in breach of his pre-agreed obligation to give his vote for it. In this way he can block a winding up resolution, which requires an unanimous consent of all the shareholders of an OOO and a qualified 3/4 majority of stockholders. This rule opens new opportunities for a JV deadlock resolution.

In an event of compulsory liquidation the shareholder or the liquidation committee (the liquidator) may be imposed duties to effect liquidation of the company by virtue of a court decision. If they do not perform the court decision voluntarily, the court will appoint an insolvency officer to accomplish a liquidation at the company's cost. Where the company does not own funds sufficient to cover costs necessary for liquidation, the shareholders of the company shall bear these costs on a joint and several basis.

In an event of voluntary liquidation the shareholders of a company are obliged to accomplish liquidation of the company. This obligation arises irrespective of grounds for which they have passed a liquidation resolution. Where the company does not have sufficient funds, the shareholders shall jointly effect the liquidation at their own cost.

Where shareholders do not perform an obligation to liquidate the company, an interested person or the competent state authority can claim for a liquidation of the company by virtue of a court decision and an appointment of an insolvency officer. An obligation of the shareholders to liquidate the company arises, for instance, where the net assets of the company become lower than the minimum charter capital.

Current expenses of the liquidation rank before other debts.

Kind regards,

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