

Insight

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Special Alert

This alert examines a recent resolution of the Presidium of the Supreme Commercial Court of the Russian Federation ("SCC") dated 26 March 2013 No. 14828/12 on case No. A40-82045/11 (the "Resolution"). The Resolution addresses the important issues of disclosing information about an offshore company's ultimate beneficial owners to the Russian courts and the legal effect of Russian court judgments on foreign companies affiliated with parties to those proceedings. These developments can be regarded as a further step in the integration of the concept of "piercing the corporate veil" into Russian law.

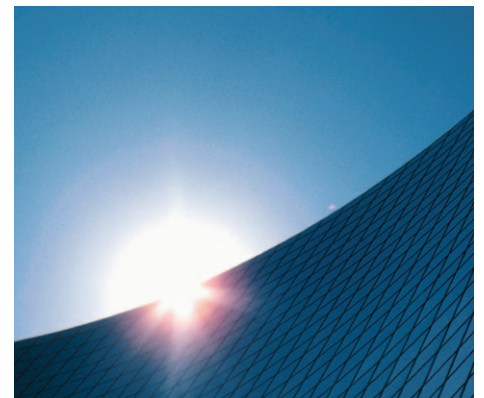
It is very common practice in Russia to hold assets through a foreign company incorporated in a jurisdiction whose laws do not permit third parties to access information about its beneficial owners. In view of this, the conclusions drawn in the Resolution could be of great importance for both Russian businessmen and representatives of foreign business interested in investing money in the Russian economy.

Facts and Earlier Proceedings

The lawsuit was initiated by Russian entity TSJ Skakovaya 5 ("TSJ") against Dominican entity Arteks Corporation ("Arteks"). TSJ sought to repossess non-residential premises (the "Premises") registered to Arteks. TSJ's title to the Premises had been earlier confirmed by a Russian commercial court judgment (the "Judgment") in respect of a claim raised by TSJ against KomEx LLC ("KomEx"), the previous owner of the Premises. However, enforcement of the Judgment turned out to be impossible because KomEx had since sold the Premises to Arteks. Due to this, TSJ had to file a new claim against Arteks seeking the return of the Premises.

In this new action Arteks argued that the Premises did not belong to TSJ and presented new evidence that the title to the Premises belonged to KomEx.

The courts of all three instances that reviewed the case decided that the Judgment issued in the earlier proceedings (to which Arteks was not a party) did not preclude Arteks from filing new evidence and challenging the findings of the court in its Judgment. As a result, the lawsuit lodged by TSJ against Arteks seeking return of the Premises was dismissed.



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The SCC Proceedings

The SCC's judicial panel granted TSJ's request for leave to appeal and referred the matter to the SCC Presidium. When referring the case to the Presidium, the panel noted in its Ruling that there were factual indications that Arteks could be affiliated with KomEx. The relationship between Arteks and KomEx was found to be material to the resolution of the following issues: (i) whether Arteks abused its procedural rights by challenging the findings of the Judgment, which were binding on its allegedly affiliated entity; and (ii) whether Arteks was a bona fide purchaser of the Premises, taking into account the conclusions drawn in the Judgment regarding TSJ's title to the Premises.

The panel noted that under Dominican law it was not possible for TSJ, which was not a shareholder in Arteks, to access information regarding Arteks' beneficial owners and to thereby verify Arteks' affiliation with KomEx. In these circumstances, the panel decided that the offshore company must bear the burden of proof to show the presence of circumstances in its favor. It was therefore for Arteks to show that there was no affiliation between its beneficial owners and KomEx.

The Ruling underlines that registering rights to immovable property located in Russia in favor of offshore companies incorporated abroad is not illegal per se. At the same time, the use of offshore companies to organize asset ownership should not be permitted to lead to the abuse of legal rights or deprive third parties of legal protection. To this end, if the corporate form of an offshore company is chosen, additional obligations may be imposed on the offshore company to prove circumstances where the law recognizes a need to protect other market participants: in particular, offshore companies may be obliged to disclose their shareholding structure. Shifting the burden of proof in this manner is aimed to compensate for the non-public nature of information about offshore companies and the inability of third parties to obtain such information.

On 26 March 2013 the SCC Presidium agreed with the conclusions of the Ruling, reversed the judgments of the lower courts and remanded the case to the court of first instance for reconsideration. We expect the full text of the Resolution with reasons for the SCC Presidium's decision to be released within the next three months.

Significance for Future Cases

If the SCC maintains the above legal position, this will mean that a Russian court may request an offshore company to disclose information about its corporate structure, affiliated entities and beneficial owners, where such information is necessary for third parties to protect their rights or to prevent an abuse of rights by the offshore company. If the offshore company fails to comply with the request, the court may draw an adverse inference from such behavior and therefore decide the case against the offshore company.

This approach could potentially have ramifications in various types of disputes. For example, it is likely to be of great importance in the context of corporate disputes in which interested-party transactions are being challenged and where it needs to be established whether or not an offshore company is affiliated with the other party to the transaction.

Other points of note

The other notable conclusion of the SCC panel was that, to prevent the abuse of procedural rights, an entity should not be permitted to present new evidence to contest the facts established in an existing judgment if a party involved in the earlier case is affiliated with it. This means that the facts established in a judgment have a prejudicial effect on entities affiliated with the parties to the case. This conclusion reflects the recent increased focus of the SCC's judges on the doctrine of "piercing the corporate veil" which has been developed and applied in other legal systems.

The adoption of this position by the SCC panel is aimed at preventing inability to enforce a judgment that has come into legal force as a result of the unsuccessful party initiating new proceedings using an offshore entity that is not formally affiliated with it for this very purpose.

We will be tracking the publication of the Resolution of the SCC Presidium on this case.