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Russian Legislation Update

Civil Code Reform

On 27 April 2012 the State Duma adopted in the first reading Draft Law No. 47538-6 amending Parts I, II, III and IV of the Civil Code of the Russian Federation and certain other legislative acts.

The Draft Law has been prepared on the basis of the Concept of Evolution of Civil Legislation developed by the Committee on Codification and Improvement of Civil Legislation established in 2008 specifically for this purpose and chaired by the Russian President. These are the most significant and long-debated revisions to the Russian Civil Code since its adoption in mid-1990s. The proposed amendments extend to a wide range of issues, including, corporate, property rights, contracts, obligations, security instruments and intellectual property. Some of the provisions approved in the first reading keep being criticized. It is therefore very likely they will be amended by the second reading.

It is expected the amendments will come into force on 1 September 2012, save for a number of provisions that come into force at later dates.

In this alert we provide an overview of certain proposed innovations to the Civil Code. We will elaborate on these in more detail in due course once the Draft Law is adopted by the Russian Parliament (the State Duma and the Federation Council) and signed into law.

Corporate

New Articles 53.2 and 53.3 incorporate into the Code the concepts of affiliated and controlling persons, the liability of controlling persons, and the basic characteristics of affiliation and control. The intent of new provisions is to entirely invalidate and supersede the existing the 1991 Law "On Competition and Restriction of Monopolistic Activity on the Commodities Markets."

The amended Chapter 4 ("Legal Entities", Articles 66 - 66.3) of the Code provides - in addition to the existing forms of a limited liability company, general partnership and limited partnership - a commercial entity may be established in the form of: (i) *a public joint stock company* (replacing a form of an open joint stock company) or (ii) *a non-public joint stock company* (replacing a form of a closed joint stock company). Companies with additional liability have been excluded from the Code. Existing companies are to be reorganized in accordance with the new types of legal entities (at the time when they seek amendments into their charters).

New Article 67.2 provides that a company's participants (shareholders) may enter into *a corporate agreement* among themselves setting up their rights and obligations as to the company management, voting and disposal of its shares. A company's participants may enter into the similar agreement with its creditors and investors. Information on the corporate agreement of a public joint stock company must be disclosed in due course, while information on the corporate agreement of a non-public entity (LLC and non-public JSC) is confidential.

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Obligations and liability

The amendments seek to incorporate some common law concepts to the Code, in particular, a concept of *representations* (Article 431.2). Where the negotiating or contracting party has given misrepresentations to another party (and such misrepresentations matter to the formation or performance of the contract), such party in breach must compensate for losses sustained by the party that reasonably relied on such representations. The right to be compensated for loss belongs to the injured party in addition to the right to demand invalidation or termination of the contract.

The amendments also define a concept of *indemnities* (Article 406.1) whereby a contract may provide that a debtor must compensate a creditor for its losses occurred due to performance, alteration or termination of the contract but not resulting from the debtor's breach of its obligation (e.g., third party claims to the creditor). The parties may limit such compensation to a particular amount of money.

The amendments envisage *pre-contractual liability* for negotiating a contract in bad faith and define bad-faith behavior and activity for this purpose (Article 434.1). The party negotiating (or terminating negotiation of) a contract in bad faith must compensate the good-faith party for all losses resulting therefrom, including expenses incurred by such party in connection with the negotiation and those expenses incurred due to loss of opportunity to contract with a third party.

A *good-faith* concept is being incorporated as a guiding principle of civil relations. It is incorporated in Article 1 and is reiterated in other articles of the Code. A person that acted in a transaction in bad faith may not challenge the validity of that transaction, including where the subsequent behavior of such person supplied grounds for third parties to believe the transaction was valid (Article 166).

Article 393.1 envisages the *full compensation of losses* by the party in breach to the other party; it details what kind of actual damages and abstract losses can be claimed. Furthermore, the court can not refuse to enforce the creditor's claim for the compensation of losses incurred as a result of the debtor's breach solely due to the fact that the amount of loss can not be established (Article 390). The court instead must estimate such losses, taking into consideration all facts and using the principles of equity and proportionality (of liability to the breach).

Security instruments; bank accounts; new contracts

The amendments extend and develop regulations on security instruments and, among other things, (i) provide that a pledge may secure all the current and/or future obligations of the debtor, (ii) allow pledging pools of existing and future rights (Article 336), and (iii) introduce the concepts of a *bank account pledge* (Article 358.1) and a *pledge manager* (Article 356.1). They replace the currently existing bank guarantee with an *independent guarantee* (*nezavisimaya garantiya*), which may be issued by any commercial legal entity (Article 368).

The amendments recognize an intercreditor agreement whereby a debtor and its creditors can define the procedure for creditors' exercising their claims towards the debtor and the priority of such claims (Article 309). They also develop regulations on bank accounts, introducing new types of accounts such as *joint accounts, nominal accounts* and *escrow accounts* (Chapter 45).

The amendments define new types of contracts such as *framework* (Article 429.1) and *option* (Article 429.2) contracts. They substantially revise the definitions of certain existing contracts such as adhesion contract (Article 428) and preliminary contract (Article 429), removing the requirement that a preliminary contract must contain all material terms and conditions of the principal contract. The Draft Law introduces an irrevocable power of attorney (Article 188.1), which is effective until its expiration date or may only be revoked due to events directly stipulated in it (currently the issuer of the power of attorney may revoke it at any time).

Immovable property

The Draft Law envisages the principle of an *integrated object of immovable property* (*ediniy ob'yekt*) where a land plot and the building(s) on it belong to the same person, which means that these form a single object for the purpose of transactions (Articles 130 and 133).

Furthermore, it introduces a wide range of new types of limited property rights; in particular: (i) *the right to develop a land plot (pravo zastroiki)*, allowing its holder to construct buildings on a land plot belonging to another person (Chapter 20.1, Articles 300-300.7); and (ii) the *right to acquire an immovable property belonging to another person* where its holder, by virtue of a contract with the property owner, may reserve exclusive and priority (before other persons) rights to acquire the immovable property in question (Chapter 20.5).

The amendments limit owners' right to land in favor of neighbors by defining *neighbors' rights* (Articles 293 and 294) which apply to both adjoining and non-adjoining land plots. Also, the nature of the limited right to use immovable property belonging to another person – *servitude* – has become substantially more detailed (Chapter 20.2).

Intellectual property

The amendments, among other things, establish general principles of *liability of Internet providers* for IP infringements (Article 1253.1); the concept of *limited free use* of a copyrighted work that can be granted by the copyright holder to general public (Article 1233); the definition of a *website* (Article 1260). The amendments also propose certain developments to regulation of patents, trademarks and know-how.

The provisions of the Draft Law will apply if adopted by the State Duma in three readings, approved by the Federation Council, signed by the President, and officially published.

Concession Agreements

On 25 April 2012 the President signed Federal Law No. 38-FZ amending the Federal law "On Concession Agreements."

Under a concession agreement an investor (concessionaire) commits to build and/or reconstruct, at his/her expense, a facility whose title is or will be with the state, Russian region or a municipality (grantor), with its further use during the term specified in the agreement.

In relation to transportation infrastructure facilities, the amendments allow a grantor to commit to reimburse expenses to the concessionaire for the (re)construction and use of transportation infrastructure facilities if so envisaged by the terms of a tender. In this case, the concessionaire will not have the right to charge the ultimate users.

The amendments allow a concession agreement to be concluded with budget-financed entities exercising the right of operating control over transportation infrastructure facilities. In this case, such entities act together with the grantor under a concession agreement.

The amendments also remove the mandatory requirement for concluding a concession agreement in accordance with the model agreement approved by the Government in relation to transportation infrastructure facilities. In addition, the amendments specify cases when a concessionaire may be replaced without holding a tender and the procedure and terms for alteration or termination of a concession agreement.

The Law entered into force on 6 May 2012.

Subsoil

On 3 May 2012 the Government issued Resolution No. 429 on establishing and changing the boundaries of subsoil plots granted for use.

In accordance with Article 7 of the Law "On Subsoil", the Resolution approves the procedure for establishing and changing the boundaries of subsoil plots which are granted for geological study and (or) exploration and production of natural resources.

Under the Resolution, a change of boundaries may be implemented on a basis of an application to be submitted by the subsoil user to (i) the Federal Agency on Subsoil Use ("Rosnedra") in relation to subsoil plots of federal significance and large subsoil deposits; (ii) regional authorities in relation to subsoil plots of local importance and (iii) territorial bodies of Rosnedra in other instances.

The Resolution, in particular, lists the grounds for changing of the boundaries of a subsoil plot which may be extended or reduced spatially in terms of area and depth. As opposed to reduction, an extension of boundaries may only be implemented once notwithstanding the number of cases when the subsoil use license was transferred or re-issued. The volume of reserves to be added shall not exceed 20% of subsoil deposit reserves included in a state balance register.

In addition, the Resolution establishes requirements to the contents of a subsoil user's application in relation to the change of the boundaries of a subsoil plot and the documents supporting the application and defines the grounds for a refusal to change the boundaries.

The Resolution will enter into force seven says after the date of its official publication.

Anti-Money Laundering

On 24 April 2012 the Government adopted Resolution No. 375 amending its Regulation on submission of information to the Federal Service for Financial Monitoring (*Rosfinmonitoring*) by companies that carry out activities with their clients' monetary funds and other assets ("controlling organizations").

The Resolution follows the recent changes to the Anti-Money Laundering Law (see our update for 31 October – 13 November 2011). Under the Law, controlling organizations (e.g., lending organizations, professional participants of the securities market, insurance and leasing companies) must provide Rosfinmonitoring, at its request, with additional information they have regarding transactions of their clients, and lending organizations must additionally provide information on the cash flow in their clients' accounts (deposits).

According to the Resolution, controlling organizations (other than lending organizations) must provide Rosfinmonitoring at its request with additional information on all those civil law contracts of certain clients that they are aware of, as well as on all the transactions with monetary funds and other assets performed by the controlling organizations upon instruction of such clients.

Lending organizations must also provide Rosfinmonitoring at its request with quite a broad range of information on transactions of their clients, including, among other things, copies of civil law contracts, copies of transaction passports and banking control sheets, account statements for a certain period, data on the incoming balance in their clients' accounts as of a certain date and copies of client files.

The requested information must be provided to Rosfinmonitoring within five business days of receipt of the request.

The Resolution entered into force on 10 May 2012.