

Overview of Corporate Legislation Developments in 2010

January 2011



From the beginning of the global economic crisis, the Russian M&A market went through a challenging period; however, given the pick-up in business over the past few months and the overall market recovery, a significant increase in transaction activity in Russia may be expected in 2011 in line with the global trends. At the same time, the Concept of the Social and Economic Development of the Russian Federation until 2020 provides for an increase of the competition level to stimulate business activity and attract investments in the economy by, among other things, (i) supporting the establishment of new companies and new types of businesses based on innovations, (ii) reducing investment and business risks by protecting property rights and increasing the ability to predict state economic policy, and (iii) improving the terms and conditions of companies' access to long-term financial resources and by developing financial markets.

This Overview outlines the most important legislation developments of 2010 and takes a look forward to 2011.

Legislation Developments in 2010

Insider Information

The Law on Insider Information¹ (discussed in detail in our special update issued in August 2010) amended a number of regulatory acts to improve the legal framework for combating unlawful use of insider information and market manipulation on financial and commodity markets and to enhance investors' confidence. In particular, it:

- introduces the definition of "insider information"² and lists the information that may not be considered insider information (e.g., investigations, forecasts and evaluations in respect of financial instruments, foreign currency and/or commodities);
- lists the persons that are considered insiders (e.g., issuers and management companies, entities with a dominant position on the market, members of the board of directors and the management board); and
- provides for a detailed list of actions that are recognized as market manipulation (e.g., entering into transactions that provide false or misleading indications related to offerings of financial instruments, the demand for them or their prices, or that maintain prices of one or more financial instruments on an unusual or artificial level) and defines actions that do not constitute market manipulation.

The Law on Insider Information also introduces new types of offences entailing criminal and administrative liability for, among others, market manipulation and unlawful use of insider information.

Most of the provisions of the Law on Insider Information entered into force on 27 January 2011.

In this issue

Developments in 2010

Insider Information.....	1
Skolkovo Innovation Center.....	2

Prospective Developments

Liability of Management Bodies.....	2
Civil Legislation Reform.....	3

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Skolkovo Innovation Center

The Law on the Skolkovo Innovation Center³ (discussed in detail in our special update issued in November 2010) regulates the establishment and operation of the Skolkovo Innovation Center in Moscow Oblast to encourage research and development in certain areas and to commercialize the results of research and development. The covered areas include: (i) energy efficiency and energy savings; (ii) nuclear technology; (iii) space technology; (iv) medical technology related to the development of equipment and medicines; and (v) strategic computer technology and software.

Russian companies established to engage in exclusively research activities and operating in the Skolkovo Innovation Center are granted (subject to certain statutory requirements) tax, customs and other benefits, as follows:

- Employment benefits are provided with respect to employment of foreign citizens (e.g., no need to obtain permits to employ foreigners, obtain quotas, work permits are issued for up to 3 years).
- Tax incentives depend on the company's financial performance with regard to annual revenue and cumulative profits and include exemptions from profit tax, VAT, property tax payer obligations and reduction of social contributions' rate for up to 10 years.
- Accounting benefits are provided in the form of an exemption from the obligation to maintain full-scale accounts until annual revenue exceeds RUB 1 billion.
- Customs benefits are provided in the form of reimbursement out of the federal treasury of the expenses for payment of customs duties and import VAT with respect to goods imported in order to: (i) build or equip real estate in Skolkovo, or arrange for its technical support facilities; or (ii) perform research activities in Skolkovo.

The Law on the Skolkovo Innovation Center entered into force on 30 September 2010.

Prospective Legislation Developments

Liability of Management Bodies

One of the most important short term prospective corporate legislation developments is a Bill amending a number of Russian laws with respect to liability of members of management bodies.⁴ The Bill, in particular, establishes:

- requirements for the persons to occupy positions of the general director, members of the board of directors and the management board ("directors") (e.g., persons having a valid criminal conviction for intentional crimes or persons not meeting the requirements set under the company's charter for the relevant positions may not be directors);
- the list of directors' rights and obligations (e.g., the obligation to inform the board of directors in case of an existing or prospective conflict of interest), which may be important for determining the grounds for bringing them to liability;
- the grounds for termination of directors' powers and the relevant



consequences (which may help to resolve the problem of legitimacy of membership in management bodies and decisions adopted by the relevant bodies);

- the criteria of unreasonable actions (e.g., adoption of a decision without considering the information the director had); and
- the criteria of bad faith (e.g., non-performance or deviation from performance of the relevant duties without a valid reason or adoption of a decision in breach of the law, the company's charter or internal documents).

In addition, the Bill provides that in certain instances, members of the board of directors and the management board shall bear not only liability to the company, but also subsidiary liability with the company to shareholders and other persons (e.g., in case of a breach of the procedure for acquiring more than 30% of shares).

The Bill was adopted by the State Duma in the first reading on 5 October 2010. Its consideration in the second reading is tentatively scheduled for June 2011. We note that its provisions will apply if adopted by the State Duma in three readings, approved by the Federation Council, signed by the President, and officially published.

Civil Legislation Reform

Substantial changes to be introduced to the Civil Code (including regulations on legal entities) are currently being developed on the basis of the Concept of Civil Legislation Development approved by the Codification Committee chaired by the President on 7 October 2009. In line with these amendments a number of changes will be introduced to currently effective legal acts and the new acts will be adopted (e.g., a unified federal law on business entities). The amendments affect a broad scope of corporate relations ranging from regulations concerning the organizational forms of legal entities to reorganization of legal entities.

General Regulations on Legal Entities

The amendments provide for the following changes to the general regulations on legal entities:

- reducing the number of the types of economic entities to joint-stock companies ("JSCs") and limited liability companies ("LLCs") (i.e., cancelling the division of JSCs into open and closed and removing additional liability companies from the list of economic entities);
- introducing specific requirements to public JSCs (i.e., JSCs whose shares are publicly traded), including an increased amount of the minimum charter capital, mandatory membership of independent directors in the board of directors; and
- limiting the possibility of cross shareholding.

Establishment of Legal Entities

State Registration

According to the amendments, state registration functions will be transferred from the tax authorities to the state justice authority (currently, the Ministry of Justice). In addition, the registration authority will be required to check the authenticity of

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information provided for the state registration of legal entities, including information on the founders and composition of the governing bodies of the legal entity. The amendments establish a mandatory expert review by the registration authorities of the charters to verify their compliance with statutory requirements. These changes may result in an extension of the term for the registration of legal entities.

The amendments also introduce the general principle of public authenticity of information contained in the Unified State Register of Legal Entities. It means that the company will have to compensate damages caused by non-provision or delayed provision or provision of untrue information to the Register.

Charter Capital

The amendments provide for a substantial increase of the minimum charter capital of Russian companies:

- for LLCs from the current 10,000 rubles to 500,000 rubles;
- for JSCs from the current 10,000 rubles (closed JSCs) and 100,000 rubles (open JSCs) to 5 million rubles (ordinary JSCs) and 100 million rubles (public JSCs).

The minimum charter capital must be paid in cash (currently, it may also be paid by other property). At least $\frac{3}{4}$ of the charter capital must be contributed by the founders before state registration (currently – 50%) and the rest must be paid within one year of the moment of the company's state registration.

Offshore Companies

The amendments provide for certain limitations on an offshore company's operation in Russia. A company is deemed to be an offshore one if it is registered on the territory of a foreign state with favourable tax arrangements and/or not requiring disclosure of information on the performance of financial operations. A list of such foreign states is to be approved by the competent government authority. According to the amendments, an offshore company may only engage in business in Russia if it deposits information on its founders/ shareholders and beneficiaries with the registration authority. Such information may be disclosed by the relevant offshore company on its own initiative or on the basis of a court ruling.

Corporate Governance

The amendments introduce the possibility to establish a two-tier corporate governance structure: (i) a collegiate body – supervisory board, which controls the operation of the executive bodies; and (ii) a collegiate executive body – board of directors/ management board, which reports to the general shareholders' meeting and the supervisory board. The above structure will be mandatory only for public JSCs.

In addition, the amendments require notarization of the resolutions of the general shareholders' meeting and the other standing collegiate body of the company, as well as notarization of the composition of participants in the relevant meetings.



Shareholders' Agreements

The scope of matters regulated by the shareholders' agreement is substantially limited by the amendments. In particular, it may not:

- oblige a shareholder to transfer the right to participate in the company's management separately from its relevant share, including the right to vote at the general shareholders' meeting; and
- determine the structure and decision making procedure of the company's management bodies in breach of the law and contain other provisions contradicting the law and/or infringing the rights of other shareholders, as well as the essence of corporate relations.

According to the amendments, the scope of shareholders' rights shall be pro-rated to the amount of their share in the charter capital of the company.

Rights, Obligations and Liability of Shareholders and Members of Management Bodies

The amendments provide for a shareholder's obligation not to compete with the company. In addition, the amendments introduce the possibility of piercing the corporate veil (i.e., establishing subsidiary liability of shareholders of sole-shareholder companies for debts or transactions of such companies if the relevant company's property is insufficient, where the company executed a transaction under binding instructions from its sole shareholder). They also prohibit contractual limitations on directors' and officers' liability for damages caused to the company.

Reorganization of Legal Entities

The amendments, in particular, provide for: (i) a prohibition on reorganization by way of transformation of commercial legal entities into non-commercial ones and vice versa, and (ii) performing a reorganization in different forms simultaneously (e.g., a division or a spin-off performed at the same time with a merger or an accession). Should reorganization be performed in breach of the law: (i) the relevant company's participant should have the right to reinstate its corporate control; and (ii) the transactions executed by the companies established as a result of such reorganization should be considered valid. Creditors of the reorganized legal entity have a limited right to claim early performance by the company of its obligations and such right may be terminated by agreement between them and the company.

The amendments are currently very widely discussed, but have not been submitted to the State Duma yet. The texts of the draft amendments are available at www.arbitr.ru.

This update is a general summary of recent and prospective legislative developments and should not be treated as legal advice. Readers should seek the advice of legal counsel on any specific question. All translations of terminology in this update are unofficial.
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¹ Federal Law No. 224-FZ "On Combating Unlawful Use of Insider Information and Market Manipulation and on Amending Certain Legislative Acts of the Russian Federation", dated 27 July 2010 (the "**Law on Insider Information**").

² Insider information is defined as accurate and precise information (including information classified as commercial, official, bank secrets and other legally protected secrets) that has not been disseminated or provided, but the dissemination or provision of which may significantly affect the prices of financial instruments, foreign currency and/or commodities.

³ Federal Law No. 244-FZ "On the Innovation Center 'Skolkovo'," dated 28 September 2010 (the "**Law on the Skolkovo Innovation Center**").

⁴ Bill No. 394587-5, submitted to the State Duma by the Government on 23 June 2010.