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SUMMARY OF RECENT CHANGES TO THE CIVIL CODE (CORPORATE LAW)

Federal Law No. 99--FZ of 5 May 2014 ("Law 99") will substantially change essential provisions of Russian corporate law.

Some of these changes are interesting and likely to render Russian corporate law significantly more flexible and adaptable to clients' individual needs.

The changes will become effective on 1 September 2014. The relevant corporate laws (law on limited liability companies[1], law on joint stock companies[2], etc.) have not yet been brought into line, but in our understanding the new rules will prevail in case of contradictions.

Articles of association and corporate names do not need to be adapted to the new rules until the next time when the legal entity will decide to amend its articles. However, contrary provisions of the articles registered before the new rules came into force will be overruled.

The changes are complex and will be presented only selectively and in summary form.

I. CATEGORIES OF LEGAL ENTITIES AND CORPORATE FORMS:

In addition to the distinction between commercial and not-for-profit organizations Law 99 introduces a new distinction between corporations and "unitary" legal entities. Corporations have members (shareholders, etc.), while "unitary" entities (e.g. state and municipal enterprises, foundations, establishments, etc.) do not. Law 99 further defines the position of the members vis-à-vis the company and thus completes earlier amendments to the Civil Code introducing the concept of "corporate rights" (e.g. Article 2) or defining the status of corporate decisions (e.g. Chapter 9.1).

[1] hereafter LLC Law
[2] hereafter JSC Law

There will be several categories of commercial organizations:

- commercial partnerships (хозяйственные товарищества);
- commercial companies (хозяйственные общества);
- farms (крестянские/фермерские хозяйства);
- economic partnerships (хозяйственное партнерство);
- production cooperatives (производственные кооперативы);
- State and municipal unitary enterprises (унитарные предприятия).

Not-for-profit organizations will equally be limited to the forms defined by the Civil Code (previously the admissible corporate forms were defined by the law on non-commercial organizations). Law 99 provides, in particular, for companies regulated by public law (публично-правовые компании), which are an entirely novel concept for Russian law and are likely to include the current State corporations (Rosnano and similar).

Commercial companies will include only limited liability companies[3] (общества с ограниченной ответственностью) and joint stock companies[4] (акционерные общества). The company with additional liability, rarely used, will disappear. ***Most importantly the traditional distinction between open and closed joint stock companies (ЗАО / ОАО) will finally be abandoned in favor of a new distinction between private and public companies (публичные / непубличные общества).*** Companies are deemed public if they offer their shares or convertible securities publicly or if their articles or corporate name designate them as being public. Limited liability companies (ООО) are always private companies. Joint stock companies can be either private or public.

The Civil Code will contain general provisions on legal entities (incorporation, representation, liquidation, reorganization, etc.), general provisions on corporations (members' rights and obligations, general meeting, management, etc.), general provisions on commercial organizations (management, corporate agreements, etc.) and provisions on specific corporate forms (chapters on LLCs, JSCs, etc.). The latter will further continue to be regulated by specific laws (e.g. LLC Law, JSC Law, etc.), but such laws should comply with the general principles set forth in the Civil Code. As a consequence some of today's differences between LLCs and JSCs (management structure, corporate agreements, etc.) will disappear. In general Law 99 strengthens the importance of the Civil Code in the area of corporate law.

II. GENERAL PROVISIONS:

The ***domicile*** (место нахождения) of legal entities is now clearly defined as the municipality where the entity is registered. The legal entity must be registered at the place where it has its permanent executive body (in our understanding this refers to

[3] hereafter LLCs
[4] hereafter JSCs

the body authorized to act in the name of the company). The Company Register (USRLE[5]) must contain the legal entity's address.

Law 99 now clearly indicates that communications sent to the legal entity's registered address are considered duly delivered. The legal entity bears the risk if it fails to receive the communication at such address.

If a foreign company has a representative in Russia communications sent to the address of such representative will be considered received by the foreign company. This new provision will certainly apply to branches and representative offices, which will be included in a special and public register as from 1 January 2015[6], but might potentially extend to other situations where a foreign company appoints a "representative" with a Russian address (e.g. under a power of attorney)[7].

The rule that an LLC cannot be a 100% subsidiary of a parent company with a single shareholder will be abandoned (the same rule will be maintained for JCSs).

At least ¾ of the share capital must be paid upon incorporation. In kind contributions to the capital of commercial companies will be limited to things (objects), shares in other commercial companies or partnerships, State and municipal obligations as well as exclusive and other intellectual property rights having a monetary value (excluding, for instance, rights and claims). All in kind contributions will require an official appraisal. An amount of at least the sum of the minimal hare capital prescribed by law must be paid in cash.

III. CORPORATE DOCUMENTS:

All legal entities will be governed by their constituent document (normally called "устав"[8], translated variously as charter, by-laws, articles of association, etc.), which must be deposited with the Company Register. The legal entity is incorporated based on the decision of its founder(s).

The new rules provide for the possible introduction of model articles approved by the competent government authority.

The members of a corporation will have the possibility to adopt – in addition to other internal regulations - ***internal bylaws (внутренний регламент)*** regulating their relationship with the corporation (corporate rights). The bylaws cannot contradict the

[5] Unified State Register of Legal Entities (Единый государственный реестр юридических лиц)
[6] Federal Law No. 16 of 5 May 2014.
[7] To reduce this risk it may be useful to make an addition to special powers of attorney to the effect that the representative is not authorized to receive communications other than those implied under the power of attorney.
[8] except for partnerships which are governed by the partnership agreement.

articles of association. Unlike a contract the bylaws bind all existing and probably also future members[9]. The bylaws do not require registration and are therefore not public.

Law 99 contains more extensive and partly new rules on ***corporate or shareholders' agreements (корпоративные соглашения)*** and eliminates some of the existing uncertainties in respect of such agreements. Shareholders' agreements can be entered into by all or part of the shareholders of an LLC or a JSC and, if entered into by more than two shareholders, remain effective if one of the parties ceases to be a shareholder. Shareholders' agreements can be entered into before or after the incorporation of the company. They must be in the form of a written document signed by all parties and are binding only on the parties. The shareholders must notify the company of the agreement, but not of its content, which is confidential. If they fail to do so the agreement remains effective, but the other shareholders can sue for damages. Public companies must disclose the content of shareholders' agreements to the extent required by applicable law. The parties to a shareholders' agreement cannot demand its invalidation for the reason that it contradicts the articles.

Shareholders agreements regulate (restrict) the exercise of corporate rights by the participating shareholders. The parties engage to exercise their rights in a specific manner or to abstain from exercising them, e.g. to vote in a coordinated manner or to acquire or sell their shares at a specific price or upon the occurrence of specific circumstances, respectively not to sell them until such circumstances occur. The shareholders can also undertake to vote for an amendment to the articles.

If all shareholders are parties to the shareholders' agreement each can file a claim for the invalidation of corporate decisions taken in breach of the agreement. However, the invalidation of a corporate decision does not entail the invalidation of a transaction with a third party entered into pursuant to such decision[10]. Transactions with a third party (e.g. a sale of shares) entered into by a shareholder in breach of a shareholders' agreement to which such shareholder is a party can be invalidated only if the third party knew or should have known about the restrictions contained in the shareholders' agreement.

Shareholders will also be able to enter into agreements restricting the exercise of their corporate rights with creditors or other third parties to secure the interests of such creditors or third parties (e.g. under loan agreements).

[9] This is at least our interpretation, otherwise there would be no difference between the bylaw and the corporate agreement. Under the LLC and JSC Law members (shareholders) are entitled to copies of internal regulations.

[10] Third parties should be affected by shareholders' agreements only if they knew or should have known about them (see the explanations on Article 174 Civil Code below). It will nevertheless be expedient to include a representation in contracts confirming the absence of any restrictions provided by internal bylaws or shareholders' agreements.

IV. REPRESENTATION:

The legal entity is represented by its corporate bodies (органы) acting in its name and on its behalf. ***Under the new rules it will become possible to grant the authority to represent and bind the company without power of attorney to several persons acting individually or jointly.*** The persons having the authority to bind the company without power of attorney should be registered in the Company Register. It is not entirely clear whether the authority can be granted to any person (we tend to think that the authority to bind the company without power of attorney may be granted only to persons entrusted with the day-to-day management of the company).

Pursuant to Article 174 Civil Code a transaction can be invalidated if the authority of the person acting in the name of the legal entity without power of attorney is restricted by its articles of association or another document regulating the legal entity in comparison with the authority as defined by the law or resulting from the circumstances in which the transaction was concluded provided the person acting for the legal entity exceeded his authority (acted *ultra vires*) and the other party to the transaction knew or should have known about the restriction. A transaction can further be invalidated if it is to the prejudice of the legal entity provided this was or should have been obvious to the other party or there is evidence of collusion or other joint action to the prejudice of the legal entity between the person acting in the name of the legal entity and the other party to the transaction.[11]

Pursuant to an amendment to the Civil Code which became effective in mid 2013[12] third parties can rely on information published in the Company Register (including with respect to the identity of the person authorized to act in the legal entity's name) except if the legal entity proves that such information was included in the Company Register pursuant to illicit actions of third parties or beyond its will.

V. MANAGEMENT:

General meeting (общее собрание):

Unless otherwise provided by the Civil Code or the specific laws applicable to the relevant corporate form the general meeting of a corporation has exclusive authority for:

(i) the definition of the priority business focus, the principles guiding the acquisition and use of assets;
(ii) the approval and amendment of the articles of association;
(iii) defining the procedure for the acceptance or exclusion of members (unless defined by the applicable law);
(iv) the election of the corporate bodies and the termination of their authority;
(v) the approval of the annual accounts;

[11] new provision introduced by Federal Law No. 100 of 7 May 2013 (effective as from 1 September 2013).
[12] Federal Law No. 134 of 18 June 2013.

(vi) the incorporation of, or participation in other legal entities;
(vii) the reorganization and liquidation, the appointment of the liquidator(s) and the liquidation balance sheet;
(viii) the appointment of the internal auditing commission and/or external auditor.

If the law and articles so provide the matters under (iv) - (vi) can be referred to the authority of another collective body of the corporation.

The articles of association of a privately held commercial company can refer all matters to another collective body of the company except:

(i) the approval and amendment of the articles of association;
(ii) the reorganization and liquidation;
(iii) the definition of the number of members of the collective management board (and collective executive board if its members are elected by the general meeting);
(iv) the definition of the number, nominal value, categories (types) of shares, respectively increase of the capital of an LLC disproportionally to existing shares or by the admission of a new member (new members);
(v) the approval of internal bylaws or other internal regulations[13].

The articles of privately held JSCs can extend the authority of the general meeting beyond those matters which the law refers to its (exclusive) authority (under current law this was possible only for LLCs).

Privately held commercial companies will be free to define the procedures for general meetings (notice periods, meetings by correspondence, majorities, etc.) as long as the members are guaranteed the right to take part in, and receive information on the meeting.

Resolutions of the general meeting of public companies will have to be certified by the company responsible for keeping the register of shareholders (all JSCs must transfer the register of shareholders to an external registrar until 1 October 2014[14]). Resolutions of privately held JSCs can also be certified by notary. Resolutions of LLCs must be certified by notary unless the articles or a unanimous resolution of the general meeting provide differently, but always in a manner which allows to establish that the resolution was passed by the general meeting (e.g. signature of the minutes by all or part of the members).[15]

[13] This is slightly in contradiction with the new Article 67.1, which adds the alteration of the share capital, the transfer of the management authority to an external manager or managing organization and the distribution of profits.
[14] Federal Law No. 142 of 2 July 2013.
[15] It is worth considering making the necessary arrangements for this before 1 September 2014 when the law becomes effective.

Collective management board (supervisory board, board of directors, etc. - коллегиальный орган управления):

The company must form a collective management board (hereafter "supervisory board") if provided by the law or the articles of association (currently required only for JSCs with 50 shareholders and more). The board controls the company and can have additional functions defined by the law or the articles. The members of the corporation's executive bodies cannot make up more than one quarter of the supervisory board's members. The members of the supervisory board are entitled to obtain information on the business and access to the accounts and documents. On par with the shareholders they will have the right to file claims for compensation of damages caused to the company by persons authorized to act in its name, respectively for the invalidation of transactions based on Article 174 Civil Code (see above) or the provisions of the applicable corporate laws.

Privately held commercial companies are free to define the number of members of the collective management board[16], the manner of their election (appointment) and procedures for holding meetings.

Collective executive board (management, direction, etc. – коллегиальный исполнительный орган):

The company must form a collective executive board if provided by the law or the articles of association. The executive board decides all matters not referred to the general meeting or the supervisory board.

Privately held commercial companies do not need a collective executive board or can refer the matters within its authority to the supervisory board or single-person executive body.

Privately held commercial companies are free to define the number of members of the collective executive board, the manner of their election (appointment) and procedures for holding meetings.

Single-person executive body (director, general director, president, etc. – единоличный исполнительный орган):

Pursuant to Law 99 the articles of association can provide for several single-person executive bodies (hereafter "directors") acting individually, i.e. independently from each other (under current law there can be only one director). ***The articles can also confer the authority of the single-person executive body to several persons acting jointly.***

It will also become possible to appoint a corporate director instead of an individual, which does not exclude and is different from the faculty to appoint a manager

[16] Current law requires at least five members for all JSCs.

(управляющий) or managing company (управляющая компания) provided by the current LLC and JSC Law[17].

Although the novel provisions of Law 99 will be welcomed by the business as adding flexibility these provisions appear exceedingly complex and somewhat confusing. They are likely to give rise to difficulties in practice.

Contractual relationship:

Pursuant to Law 99 the relationship between the legal entity and the members of its corporate bodies will be regulated by the Civil Code and the relevant corporate laws (LLC Law, etc.). In our view this should not exclude regulation by contract, respectively employment agreement (see also section on liability below). However, contracts cannot contradict the Civil Code. Similarly contradictions between the Civil Code and the Labor Code should be resolved in favor of the Civil Code.

VI. AUDIT:

Privately held commercial companies do not need an internal auditing commission (under current law all JSCs, but not LLCs, were required to have such a commission). The articles of privately held companies can further define specific cases where such a commission should be appointed.

For LLCs the external audit remains voluntary except if the law provides otherwise (e.g. above certain asset or turnover thresholds). An external audit *can* also be held on the request of a member. However, ***the annual external audit will become compulsory for all JSCs*** (under current law it is compulsory only for open, i.e. public JSCs). If provided by the law (which is currently the case) an audit must further be held if requested by shareholders holding in aggregate 10% or more of the shares of the JSC.

VII. CORPORATE RIGHTS AND OBLIGATIONS:

Members of a corporation have the following rights:

- to take part in the management (through the general meeting, etc.);
- to receive information and to have access to the accounts and documents as provided by the law or the articles;
- to appeal against decisions of the corporate bodies as provided by the law;
- to sue on behalf of the corporation for damages caused to the corporation by the corporate bodies of the corporation;
- to file claims for invalidation of transactions made by the corporation based on Article 174 Civil Code (see above) or provisions of the applicable corporate laws (e.g. LLC Law);
- other rights defined by the applicable corporate laws.

[17] Cf. new Article 67.1 Civil Code, which maintains this latter faculty.

A member who intends to file a claim must take reasonable measures to notify the other members and the corporation of his intent to sue. Other members can then join the proceedings and should be precluded from filing identical lawsuits separately. These provisions should be further detailed in the relevant corporate laws or the articles of association.

A member has the following obligations towards the corporation:

- to make contributions to the corporation's assets as provided by the law and the articles of association;
- not to disclose confidential information;
- to take part in decisions which are necessary for the continuation of the corporation if such decisions cannot be taken without such member;
- to abstain from actions intended to cause prejudice to the company;
- to abstain from actions (inaction) which make it impossible or materially difficult to achieve the purpose for which the corporation was established;
- other obligations defined by the applicable corporate laws.

Members of commercial companies have the right to share in profit distributions and liquidation proceeds. They will also have the right to demand that the court exclude a member which caused significant damage to the company or otherwise hinders its activity or the achievement of its purpose (previously this right existed only for LLCs). The exclusion will further become possible if the member seriously breaches his obligations under the law or the articles.

Law 99 makes it further possible to define additional rights and obligations in the articles of the corporation (under current law this possibility existed only for LLCs).

As a general rule members of a commercial company can exercise their rights proportionally to their share in the capital. However, the articles of association or a corporate agreement (shareholders' agreement) can provide otherwise. In this case, however, the shareholders' agreement and the rights must be mentioned in the Company Register.

The articles of association of privately held companies can also regulate the manner in which shareholders can exercise their right of first refusal with respect to the acquisition of shares or convertible securities (a right of first refusal currently exists in closed JSCs and in LLCs). Finally the articles can set a maximum threshold for holdings of individual shareholders.

VIII. LIABILITY:

Management:

Law 99 streamlines previous rules on management liability and extends their application to all legal entities.

Persons entitled to act in the name of the company pursuant to the law or the articles are liable for losses caused to the company by their fault if it is proven that they acted in bad faith or unreasonably, in particular if their action or failure to act is contrary to normal business practice or normal business risk. The burden of proof is on the claimant. The members of the supervisory or executive board incur the same liability except if they voted against the relevant decision or did not attend the vote in good faith. Claims can be filed by the company, its shareholders and the members of its supervisory board (the latter do not have this faculty under current law).

Persons having *de facto* the possibility to determine the actions of a company (e.g. by giving instructions to the persons listed in the previous paragraph) must act in its interests in good faith and reasonably and are liable for losses caused by their fault.

Importantly the new rules seem to admit the possibility of an agreement between the company and the members of its corporate bodies (excluding persons having de facto influence) restricting or even eliminating their liability except for dishonest and, for public companies, unreasonable behavior. This might also render possible the "décharge" as practiced in Switzerland (i.e. the waiver of liability claims at the annual general meeting following the approval of the annual report).

Parent company:

A company is considered the subsidiary of another company (parent company) if the latter has the possibility to determine the subsidiary's decisions by virtue either of its majority vote or of a contract between subsidiary and parent company.

A subsidiary is not liable for the debts of a parent company. Reversely, the parent company is jointly liable for debts under transactions which the subsidiary concluded ***pursuant to the parent company's instructions or with its consent*** (under current law the parent incurred joint liability only if it had the right to give instructions which were binding on the subsidiary and the transaction was entered into based on such instructions, i.e. the new wording considerably increases the risk of parent liability)[18]. If the parent company causes the subsidiary to become insolvent it incurs subsidiary liability for the subsidiary's debts. The other members (shareholders) of the subsidiary can claim compensation of the damages caused to the subsidiary by the fault of the parent company.

[18] Article 1202 Civil Code was changed by Federal Law No. 260 of 30 September 2014: the liability of shareholders of a foreign legal entity carrying out its business primarily in the Russian Federation (or of other persons entitled to give such entity binding instructions) is governed by Russian law or the entity's personal law, at the choice of the claimant.