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newsletter
russian law update

Russian Civil Law Reform: Recent and Upcoming Amendments

Russia continues to adopt significant civil law reforms in an effort to improve the business and economic environment generally and to incorporate a number of modern commercial concepts into the Russian legal system. In 2012, the State Duma (the lower house of the Russian parliament) approved the "first reading" of a draft law on extensive amendments to the Civil Code. Subsequently, it was decided that these amendments would be separated into several groups to expedite their passage.

The first set of amendments, principally affecting Part One of the Civil Code, has been adopted and became effective as of March 2013. The next set will come into force in September 2013. These amendments relate to such topics as general principles of civil law, legal entities, powers of attorney, and transactions. Further draft amendments with respect to contract law, intellectual property, and international private law are currently awaiting consideration by the State Duma.

Amendments Effective from March 2013

The following is a brief overview of the most important changes that became effective as of 1 March 2013.[1]

Good Faith

The Civil Code contains a new concept – *good faith* – which requires that a person must act in good faith and cannot benefit from unlawful or bad faith conduct. It is presumed that all conduct complies with this rule, until proven otherwise. The Civil Code does not provide a definition or specify criteria for determining whether conduct is in "good faith", thereby granting Russian courts considerable flexibility in evaluating the actions taken by parties to a contract or dispute. However, the concept of good faith has already been analyzed by the Russian commercial courts, and existing judicial precedents provide useful guidance.[2]

Abuse of Rights

Under new language in the Civil Code, bad faith conduct is deemed to constitute an *abuse of rights*. A party committing such abuse may be denied its legal remedies in whole or in part and may be required to compensate the losses incurred by other parties as a result of the bad faith conduct. Further, under certain circumstances, a Russian court may impose other remedies, including setting aside a transaction based on bad faith conduct.

Circumvention of Law

Another amendment specifies that *circumvention of law* is a form of abuse of rights. Based on preexisting doctrine and court practice, "circumvention of law" may be understood as any action that aims to achieve illegal results (or avoid legal results) by manipulating gaps or inaccuracies in existing laws. For example, in one case, state-owned real property was transferred to a state unitary enterprise, which was subsequently converted into a limited liability company. This was found to be a circumvention of the law on privatization, which requires a different procedure for the alienation of state property.

Decisions of Meetings

Decisions adopted at corporate meetings (e.g., meetings of shareholders in stock companies or participants in limited

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liability companies) have been added to the list of matters that may establish rights and obligations under civil law (along with contracts and tortious actions, for example). Further, Article 12 of the Civil Code has been amended to include the invalidation of the decisions of a corporate meeting as a means for protection of civil rights. Other legal mechanisms available include the judicial recognition of rights, invalidation of transactions, invalidation of government bodies' decisions, specific performance, damages, monetary penalties, moral damages, and others. These changes serve to synchronise the Civil Code with Russian corporate laws and eliminate certain ambiguities concerning protection of the interests of shareholders.

Compensation for Losses Caused by Actions of State Authorities and Officials

Previously, losses could only be compensated when caused by the *unlawful* actions of state authorities and officials. Under the amendments, compensation will also be available when the *lawful* actions of state authorities cause damages (for example, if police officers in pursuit of a suspect have caused damage to a third party's car or other property).

Amendments Effective from September 2013

On 7 May 2013, President Vladimir Putin signed a second set of amendments to the Civil Code. These will come into force on 1 September 2013.

The amendments will affect transactions, powers of attorney, corporate meetings, and several other topics. Below is a brief overview of the key changes.

Powers of Attorney

For the first time in Russian law, the concept of an irrevocable power of attorney has been established.[3] A person conducting business activities will be entitled to grant an *irrevocable power of attorney*, provided that the power is expressly stated to be irrevocable and is notarized.

Further, Article 186 of the Civil Code currently provides for a maximum three-year term for a power of attorney. The amendments remove this time restriction. However, if no term is specified, a power of attorney will be effective for one year.

Invalidation of Transactions

The amendments introduce significant limitations to the list of persons entitled to apply for a transaction to be invalidated. Under current law, "any interested party" can file a claim arguing that a transaction is void and apply for the transaction to be unwound. Historically, courts have exercised broad discretion in determining who qualifies as an "interested party" for this purpose.

Under the amendments, only a party to a transaction may file such a claim, except in cases where the law specifically provides otherwise. For example, the Federal Antimonopoly Service can file a claim to invalidate a transaction that violates the law on foreign investments in strategic companies.[4]

Claimants will also be subject to certain new requirements to act in good faith. For example, if a person acting in bad faith deceives other parties into wrongly believing that a transaction was valid, such person may not later make a claim to invalidate the transaction.

In another key change, a transaction conducted in violation of legal requirements will be deemed *voidable* (and thus subject to challenge), instead of automatically *void*, unless otherwise provided for by law.

The amendments also introduce new grounds for challenging a transaction. These include if it was (1) entered into without the consent of a third party, governing body, or state authority, as required by law; (2) a sale of property prohibited or restricted by law; or (3) in violation of the terms of a power of attorney.

Consent to a Transaction

The amendments also clarify the general rules governing consent to a transaction that is not otherwise provided by law. Specifically, the new Article 157[1] states that consent may be validly granted either before or after a transaction is conducted.

Decisions at Meetings

The amended Civil Code will include a new chapter governing decisions adopted at meetings. It will address decisionmaking procedures as well as the grounds and procedures for challenging decisions. These rules will apply not only to decisions adopted at meetings of corporate shareholders or participants but also to meetings of co-owners, creditors, and other persons.

endnotes

1 These amendments apply to legal relationships arising after 1 March 2013. For legal relationships already in effect, the amendments will apply to rights and obligations arising after that date.

2 *See, e.g.,* Russian Supreme Commercial Court Presidium Resolution No. 12499/11 (21 Feb. 2012); Russian Supreme Commercial Court Presidium Resolution No. 1884/11 (14 June 2012).

3 Currently, Article 188 of the Civil Code provides that a power of attorney may be revoked at any time.

4 Federal Law No. 57-FZ, On Foreign Investments in Legal Entities of Strategic Importance to the National Defence and State Security of the Russian Federation (29 Apr. 2008).

Anti-Corruption Laws: New Compliance Requirements for Russian Companies

On 1 January 2013, substantial amendments[1] to Russia's existing anti-corruption legislation took effect, impacting compliance requirements for domestic companies. These included changes to the Russian Civil and Labor Codes and to Federal Law No. 273-FZ, "On Fighting Corruption", dated 25 December 2008 (the Anti-Corruption Law).

Despite being a signatory to a number of international anti-corruption conventions,[2] Russia has often been criticised for its lack of progress in fighting corruption. By way of response, in 2011 the Russian government adopted various amendments to existing anti-corruption laws, including increases in the penalties for corrupt activities, and specific measures addressing corporate liability.[3]

Under new Article 13[3] of the Anti-Corruption Law, all Russian organizations are now required to develop and implement measures to prevent corruption. These may include the following:

- Designating departments and officers who are responsible for the prevention of bribery and related offenses
- Cooperating with law enforcement authorities
- Developing and implementing standards and procedures designed to ensure ethical business conduct
- Adopting a code of ethics and professional conduct for all employees
- Preventing and resolving conflicts of interest
- Preventing the creation and use of false or altered documents

If a company fails to put the recommended measures in place and an employee (or another person acting on the company's behalf) offers, promises, or gives a bribe, this will be evidence that the company has not done everything possible to prevent corruption. Accordingly, under Article 19.28 of the Administrative Violations Code, "Unlawful remuneration on behalf of a legal entity", the company could face a substantial administrative fine. Such fines may range from up to three times the amount offered for performing illegal services (but not less than one million rubles) to one hundred times the amount offered (but not less than one hundred million rubles) in the case of a very large amount (i.e., exceeding 20 million rubles, as specified in the current version of the Administrative Violations Code).

Other amendments to the Anti-Corruption Law included a new requirement for government officials and civil servants (i.e., persons included in specific lists maintained under federal laws and the regulations of the Russian Central Bank) to provide information about their personal expenditures, thus facilitating efforts to identify suspicious transactions.

Other key amendments to the Anti-Corruption Law include the following:

- Part 2 of Article 235 of the Civil Code now gives Russian authorities the right to expropriate property involved in corrupt activities if the parties cannot show evidence of its lawful acquisition.
- Part 7.1 of Article 81 of the Labor Code now gives employers the express right to dismiss an employee where there has been a "loss of confidence" due to the employee's failure to (1) remedy a conflict of interest or (2) justify certain expenses incurred on behalf of the employer.

It remains to be seen how such compliance rules will work in practice. Nonetheless, companies operating in Russia should consider carefully whether to adopt any corresponding changes in their policies or procedures.

endnotes

1 The amendments were enacted pursuant to Federal Law No. 231-FZ, dated 3 December 2012.

2 For example, Russia is a signatory to the United Nations Convention against Corruption (2003) and the Organisation for Economic Co-operation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (1997).

3 There is no criminal liability for legal entities in Russia. However, since May 2011, under Article 19.28 of the Administrative Violations Code, a company may be fined up to 100 times the amount of any bribe offered, promised, or given.

Disclosure of Beneficial Ownership

In March 2013, the Russian Supreme Commercial Court issued a decision in the case of *Condominium of Skakovaya 5 v. Artex Corporation*, which involved disclosure of the beneficial ownership of foreign companies involved in civil proceedings. This is a sensitive issue since many investments in Russia are currently structured through "offshore" companies whose ownership is confidential.

In this matter, a three-judge panel considered an appeal in a dispute over real property in central Moscow.[1] The case involved a residential condominium at 5 Skakovaya Street. According to the claimants, the building's former management had arranged for the sale of part of the building to a new owner — a Dominican Republic–based company with links to the management. However, the claimants argued that the transaction's real purpose was to conceal the beneficial owner of the property and avoid potential enforcement of court decisions. Other evidence was cited to show that the seller had been engaged in fraudulent activities involving the same property in the past and that the same attorneys represented the seller and the Dominican company.

The court decided in favour of the claimants, holding that the establishment of the offshore entity and the transfer of title to the entity constituted an "abuse of rights" that should not be entitled to legal protection. Accordingly, the transaction could be set aside.

Although the full text of the judgment has not yet been published, certain statements made by the three-judge panel are of interest. For example, the court stated the following:

> Because information on the shareholding structures of offshore companies, including their beneficial owners, is not publicly available under local laws, it may be difficult to establish bad faith in an acquisition of property and to obtain other evidence required for the application of laws relating to protection of interests of third parties. Therefore, in a situation where Russian laws designed to protect third parties are to be applied to an offshore company, the burden of proof in respect of the existence or absence of circumstances that would protect the offshore company as an independent entity in its relations with third parties shall be on the offshore company. Such evidence will primarily be provided by means of a *disclosure of information about its ultimate beneficial owner.* [Emphasis added.]

It will be important to see if the Supreme Commercial Court's published decision adopts the same language, which effectively reverses the normal burden of proof. While the decision is unlikely to be binding precedent in other courts, the decisions of the Supreme Commercial Court are very influential. If other Russian courts take a similar approach, this may affect companies from "offshore" jurisdictions, such as, for example, the Isle of Man, the British Virgin Islands, and the Cayman Islands, when they participate in Russian court proceedings. Potentially, such companies will be required to disclose the identities of their beneficial owners. This would be a distinct change from past practice and could reduce the attractiveness of using such companies as investment vehicles.

endnotes

1 Resolution of the Supreme Commercial Court, No. A40-82045/11-64-444 (9 Jan. 2013).

Amendments to Russian Securities Market Regulations: Depositary Receipt Holders

In late 2012, the Russian State Duma adopted amendments to certain primary legislation[1] (the Amendments), including the Federal Law "On Joint Stock Companies" and the Federal Law "On the Securities Market" (the Securities Market Law). The Amendments aim to further develop and, to some extent, simplify the regulatory framework of the Russian financial markets. The Amendments came into force on 2 January 2013, with some exceptions.

As a result of the Amendments, Russian issuers and foreign depositary banks (issuers of depositary receipts representing rights with respect to the shares of Russian issuers) will not be required to disclose the ultimate beneficial owners of the depositary receipts on a quarterly basis.[2] However, depositary banks will still have to disclose information about the depositary receipt holders for voting purposes.

Disclosure of Depositary Receipt Holders

The obligation to disclose information about the depositary receipt holders first appeared in the Securities Market Law in December 2011. Market participants have since expressed well-grounded concerns with respect to the practical implications of having to comply with such disclosure requirements. As a rule, depositary banks do not hold information about the actual holders of depositary receipts. The banks mainly deal with nominees and brokerage houses holding depositary receipts on behalf of their clients who may, or may not, be the ultimate beneficial owners of such depositary receipts. The Russian financial markets regulator (FSFM) has recently adopted regulations[3] that, to some extent, clarify what documents and information would be sufficient for the purposes of disclosure under the Securities Market Law (the Disclosure Regulations). However, the

Disclosure Regulations are relatively new, and a number of questions remain about how they will be implemented and interpreted in practice by the authorities.

Starting on 6 November 2013 (i.e., one year after the Russian central securities depository started its operations), depositary banks will be required to disclose information about the depositary receipt holders to Russian issuers, as otherwise such banks will not be eligible to vote the underlying shares.

The practical implications of this requirement for depositary banks are as follows:

- A depositary bank (currently holding shares in a "holder" account) should open a special depo account (the so-called "depo account for a depositary program") for the relevant depositary program by 6 November 2013, and the corresponding shares should be transferred to such account by that date.
- The depo account should be opened with a Russian custodian that has a nominee account opened with the National Settlement Depository[4] (the current central securities depository).
- Until 6 November 2013, depositary banks are not required to disclose any information about the depositary receipt holders to be eligible to vote the underlying shares.
- Starting on 6 November 2013, once shares have been transferred to the depo account for the relevant depository program, a depositary bank will be eligible to vote the shares registered in its account provided that the following two requirements are met:

  (i) The holders of depositary receipts (i.e., the legal owners of depositary receipts or persons holding them by virtue of any other proprietary right) and other persons exercising voting rights have provided the depositary bank with clear voting instructions (which implies that the bank may not be entitled to vote the shares in the absence of such instructions).

  (ii) The information about the depositary receipt holders and such other persons, including the number of shares held by them, has been submitted by the depositary (or by the Russian custodian with which the depo account for the depositary program has been opened) to the relevant Russian issuer in accordance with the Disclosure Regulations.

- The FSFM can issue instructions to depositary banks to remedy any failure to provide the required information and, if the breach has not been cured, to suspend all or certain operations in respect of the depo account in question, which may eventually lead to the suspension of the relevant depositary receipts program.

Receiving Dividends

From 1 January 2014, depositary banks will no longer be required to disclose information about the depositary receipt holders to be eligible to receive dividends. However, between 6 November 2013 and 1 January 2014, a depositary bank whose shares have been transferred to the depo account opened for the relevant depositary receipts program will need to disclose a list of the depositary receipt holders to receive dividends.

In addition, starting on 1 January 2014, the so-called "cascade" structure of dividend payments will come into force. Under this structure, Russian issuers will pay dividends not to direct shareholders (as is currently the case) but to nominee holders (custodians) who will then transfer the funds to the shareholders. As a result, agreements with custodians may need to be amended to reflect the new role of the custodians.

Conclusion

Russian issuers and depositary banks have approximately six months to prepare for the new disclosure requirements. Prospectuses and depositary agreements may need to be amended to make sure they (1) cover the risks associated with voting rights and (2) contain obligations for the depositary receipt holders to disclose additional information if and when required by the depositary banks.

endnotes

1 Federal Law No. 282-FZ, On Amendments to the Legal Acts of the Russian Federation and Cancellation of Certain Legal Acts of the Russian Federation (21 Dec. 2012).

2 Technically, the requirement to disclose holders of depositary receipts on a quarterly basis will apply only from 6 November 2013 until 31 December 2013, and it is unlikely that this requirement will have a significant impact on existing depositary receipts programs as most public companies rarely hold shareholders' meetings during that period.

3 FSFM Order No.13/pz-n dated 5 February 2013, registered with the Ministry of Justice on 10 April 2013.

4 See https://www.nsd.ru/en/nsd_dcc/main/.

Amendments to Securities Market Regulation Related to Securities of Foreign Issuers

Securities Market Law

In December 2012, Federal Law No. 282-FZ, "On Amendments to the Legal Acts of the Russian Federation and Cancellation of Certain Legal Acts of the Russian Federation", was adopted. This law introduced a number of amendments to the Federal Law "On the Securities Market" (the Securities Market Law) relating to, among other matters, the ability of non-Russian issuers to place and list their securities in Russia. The amendments to the Securities Market Law came into force on 2 January 2013. The key changes are summarised below.

Issuers

The amendments expanded the circle of issuers whose securities can be admitted to initial placement and public trading in Russia to include, among others, the following:

- Foreign companies registered in the Eurasian Economic Community (EAEC)
- Foreign organizations listed on a foreign exchange that is included on the Federal Service for the Financial Markets (FSFM) list of approved stock exchanges[1] (the Approved Exchanges List), irrespective of the issuer's country of registration

Admission

As a result of the amendments, eligible foreign securities may now be admitted to initial placement in Russia upon a decision of the FSFM and registration by the FSFM of a prospectus. Previously, only the registration of a prospectus was required for admission to initial placement. With respect to public trading, the rule remains unchanged, and the decision for the admission of eligible securities to public trading may be taken by a Russian exchange if such securities have already been listed on a foreign exchange included in the Approved Exchanges List. If the exchange is not included on the Approved Exchanges List, the decision may be taken only by the FSFM.

Prospectus

The amendments have abolished the former requirement that, for admission of a foreign issuer's securities to initial placement and public trading in Russia, the prospectus must be signed by a Russian broker. This is expected to facilitate foreign issuers' access to the Russian securities market.

Depositary Receipts

A new provision has been introduced to the Securities Market Law that now specifically states that eligible foreign securities can be admitted to initial placement and/or public trading in Russia through the admission of foreign depositary receipts representing the foreign securities. In this case, such depositary receipts may be listed in Russia on the basis of an agreement with the issuer of the underlying securities, and the prospectus for the depositary receipts may be signed by the issuer of the underlying securities.

FSFM Trading Regulation

On 20 November 2012, certain amendments relating to securities of foreign issuers were introduced to the Regulation on Organization of Trading Activity on the Securities Market, which was approved by FSFM Order No. 10-78/pz-n (the Trading Regulation). The amendments to the Trading Regulation came into force on 4 January 2013.

The Trading Regulation previously did not provide requirements specific to foreign securities. While it generally did not prohibit their admission to public trading, the absence of such specific eligibility criteria for foreign securities made it difficult for foreign issuers to list their securities on a Russian exchange. The recent amendments addressed this uncertainty by doing the following:

- Introducing specific eligibility criteria for the listing of securities of foreign issuers
- Clarifying that certain listing eligibility criteria apply to both Russian and non-Russian issuers

Moscow Exchange Listing Rules

Following the amendments to the Securities Market Law and the Trading Regulation, the Moscow Exchange adopted a new version of its Listing Rules (the Rules). The Rules were registered by the FSFM on 14 February 2013 and came into force on 21 February 2013. They were revised to comply with the new requirements set out in the Securities Market Law and the Trading Regulation.

endnotes

1 Examples of foreign exchanges on the Approved Exchanges List include the London Stock Exchange, Warsaw Stock Exchange, Stock Exchange of Hong Kong, and Frankfurt Stock Exchange. FSFM Order No. 12-46/pz-n (19 June 2012).

Enhanced Currency Controls and Penalties

In February 2013, amendments to Article 15.25 of the Code on Administrative Offences came into force. These changes in Russian currency controls will have the effect of increasing the penalties for unauthorized transactions.

Under existing currency regulations, "*Russian residents*" are defined as one of the following:

- Legal entities established under Russian law
- Individuals resident in Russia who are Russian citizens or hold a permanent residence permit

Pursuant to Federal Law No. 173-FZ, "On Currency Regulation and Currency Control," dated 10 December 2003 (the Currency Law), *currency transactions* include the following:

- Disposal or acquisition of foreign currency or foreign securities (such as shares in a foreign company) between Russian residents or the use of foreign currency or foreign securities as a means of payment
- Disposal or acquisition of foreign currency, rubles, domestic securities (such as shares in a Russian company), or foreign securities between Russian residents on the one hand, and nonresidents on the other hand, or the use of foreign currency, rubles, domestic securities, or foreign securities as a means of payment
- Disposal or acquisition of foreign currency or foreign securities between nonresidents or the use of foreign currency or foreign securities as a means of payment
- Transfer of foreign currency, rubles, or foreign or domestic securities by a nonresident from an account in Russia to an account abroad (or vice versa)
- Transfer of rubles or foreign or domestic securities by a nonresident from an account in Russia to another account of the same person in Russia

Currency transactions *between Russian residents and nonresidents* may generally be performed freely, subject to certain documentation requirements (i.e., the use of a "transaction passport" that is maintained by the bank of the payor). Conversely, currency transactions *between Russian residents* are generally prohibited.

The latest amendments to the Code on Administrative Offences broaden the definition of "unlawful currency transactions" to include not only those transactions expressly prohibited by the Currency Law, but also any transactions that violate Russian currency regulations. These transactions include the following:

- Transactions not using accounts with Russian or foreign banks, unless expressly permitted by the Currency Law
- Transactions using funds from a foreign bank account, where the deposit of funds into such bank account was not expressly permitted by the Currency Law
- Transactions using foreign bank accounts located in countries that are not members of the Organisation for Economic Co-operation and Development or the Financial Action Task Force on Money Laundering
- Any other transactions that violate Russian currency regulations

The main effect of the new rules is to strengthen the applicable penalties. Under the amended Article 15.25 of the Code on Administrative Offences, the monetary penalty for conducting "unlawful currency transactions" may range from 75% to 100% of the value of the transaction.

Regulation 395-P (Basel III)

On 1 March 2013, the Bank of Russia's Regulation No. 395-P, "On the Methodology of Determination of the Amount and Assessment of Sufficiency of the Capital of Credit Organizations (Basel III)", dated 28 December 2012, became effective. Regulation No. 395-P incorporates the Basel III principles into Russian law with respect to the calculation of regulatory capital of Russian banks.

Among other things, Regulation No. 395-P introduces into Russian banking legislation the concept of equitisation of subordinated debt (while retaining the concept of write-down and cancellation of subordinated debt instruments) and a requirement for banks and other credit organisations to have in place a shareholder assistance commitment. These features have been derived from the Basel III regulations.

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