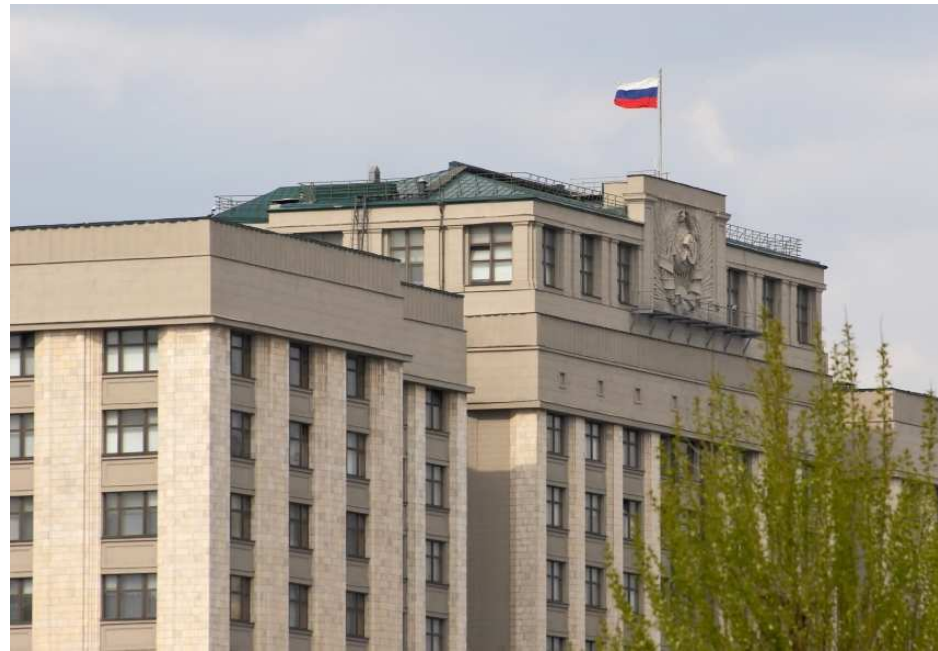




## Doing business, or thinking about investing, in Russia? Recent changes to the Russian Civil Code



14 March 2013

1. Why were changes needed?
2. How are things changing?
3. The process of change
4. Amendments in place now
5. What is still to change?
  - 2<sup>nd</sup> Draft Amendment
  - 3<sup>rd</sup> Draft Amendment
  - 4<sup>th</sup> Draft Amendment
  - others
6. Questions and discussion

# 1. Why were changes needed?

## Why were changes needed?

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### Russian Civil Code:

- adopted originally in 1994 and implemented in 4 stages up until 2006
- no longer meeting the needs of domestic and international business
- lacks key legal concepts including:
  - conditions precedents
  - negative covenants
  - reps and warranties
  - indemnities
  - pledge of accounts
  - escrow arrangement
  - security agent in syndicated loans

## 2. How are things changing?

## How are things changing?

### Changes:

- result of an initiative spearheaded by former Russian President (Mr. Medvedev)
- started April 2012
- expected to impact:
  - banking transactions
  - corporate relationships
  - M&A
  - the real estate market

# 3. The process of change

# The process of change



- Complex – multiple stages and hearings
- First set of amendments adopted in 2012 and effective from 1 March 2013
- Second set of amendments awaiting second hearing
- Timetable for remaining amendments still awaited



## 4. Amendments in place now

## Amendments in force from 1 March 2013

- “good faith” is implied
- evasion of law is prohibited
- information in the real estate register is deemed prima facie evidence of the title

### **Implication for business**

- Principles of Russian civil law will be more in line with other continental European jurisdictions
- Title due diligence will be less cumbersome

## 5. What is still to change ?

# 2nd Draft Amendment: Legal entities

# Legal entities

2<sup>nd</sup> Draft Amendment



- Awaiting timetable for second hearing
- Massive changes to corporate regulations
- Closed joint stock companies (“CJSC” or “ZAO”) are eliminated (to be re-registered in JSC or LLC until 1 January 2014)
- Public joint stock companies introduced:
  - public subscription to the shares
  - must be named as such in the Unified State Register of Legal Entities

# Shareholders agreements

2nd Draft Amendment



Agreement between all or several shareholders/participants or between shareholders/participants and creditors (“corporate agreement”)

- Can provide additional obligations and limitations of right of shareholders (e.g. restrict the right to take certain decisions, option to buy or to sell shares)
- Provisions of the corporate agreement contradicting company’s charter are valid
- Disposal of the shares in the company does not terminate the agreement between remaining shareholders unless the agreement provides otherwise

## Implication for business

- Hope for enforceable shareholders agreements under Russian Law
- If enacted, one less reason for having offshore holding structures

# Reorganization of Russian legal entities

2nd Draft Amendment



- Creditors can demand prepayment - only within 30 days from the date of publication of a notice on the debtor's reorganization
- Secured creditor cannot demand early discharge of obligations
- Unsecured creditor cannot demand early discharge of obligations if provided with sufficient security at a later stage
- In case of unfair allocation of the assets of reorganized company newly created entities may be jointly and severally liable

## Implication for business

- More stability for companies undergoing reorganizations and their shareholders
- But: creditors to monitor their debtors more thoroughly

# And more

2nd Draft Amendment



- Public credibility principle - a good faith person can rely on the information from the Unified State Register of Legal Entities (the “**Register**”)
- Obligation of a legal entity to keep information in the Register up-to-date (damages)
- Obligation of the registration authorities to check the correctness of all information to be included in the Register
- Notification delivered to the address set out in the Register deemed to be received by an addressee

## Implication for business

- Good faith reliance on public register of legal entities should protect creditors



# And more

2nd Draft Amendment



- Exclusion of a legal entity from the Register if it has not submitted financial statements and has not had any money transfers to or from any of its accounts for 12 months
- CEO and the management board of a legal entity are liable if acted unreasonably or in bad faith
- “Matryoshka” (Russian doll) is still prohibited
- Positive net assets confirmed

## Implication for business

- Dormant companies can be forcefully liquidated
- CEOs to bear more liability
- Certain hopes for resolving long standing problems are unlikely to come true

# 3rd Draft Amendment: “Objects” of civil rights

# “Objects” of civil rights

3rd Draft Amendment



- Second hearing is scheduled for April
- New principle – a land plot and a building (or a building in construction) thereon are considered to be one property
- Chapter on securities materially supplemented
- Rights confirmed by securities (e.g. shares) and encumbrances thereto arise upon relevant book entry (e.g. in the shareholders register)

## Implication for business

- Clearer real estate regime
- Clearer regulations on rights to securities

# 4th Draft Amendment: Transactions and invalidation of transactions

# Transactions and invalidation of transactions

4<sup>th</sup> Draft Amendment



- Second hearing scheduled for 19 March
- Consent to the transaction (including corporate approval) can be withdrawn in the same way as it was given before entering into the transaction
- Notarization of the transaction will imply check of the lawfulness of the transaction and capacity of the parties
- “Material” delusion – new grounds for invalidation of the transaction

# Transactions and invalidation of transactions (cont.)

4<sup>th</sup> Draft Amendment



- A person will not be able to claim that a transaction is invalid if such person's actions allowed other parties to rely on the validity of such transaction
- A transaction will be invalidated on the basis of lack of corporate approval only if the other party knew or should have known about the lack of such approval
- If a general director enters into a transaction to the detriment of its company, such transaction may be recognized by court as invalid if the counterparty knew or should have known about such detriment or there are other circumstances confirming collusion of the general director and the counterparty

## Implication for business

- Protection against dishonest counterparties

# 4th Draft Amendment: Representation. Power of Attorney

# Representation. Power of Attorney

4<sup>th</sup> Draft Amendment



- Transaction executed with the lack of authority can be cancelled before its approval
- Unlimited term of the power of attorney (used to be 3 years)
- Irrevocable power of attorney (notarization required)
- No notarization for the power of attorney with the right of substitution issued by a legal entity
- Possibility to incorporate a power of attorney into a contract and a corporate approval

## Implication for business

- Irrevocable PoA for a term exceeding 3 years (current limit) will significantly improve position of secured creditors



# 4th Draft Amendment: Statute of Limitations

# Statute of Limitations

4<sup>th</sup> Draft Amendment



- General term - 3 years
- Maximum term – 10 years starting from the date of violation of rights

## Implication for business

- Clarity with the length of statute of limitations

# More amendments

## More amendments

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- Amendments to other parts and chapters of the Civil Code were approved only in the First Hearing
- Interesting stuff is yet to come

## More amendments

- Concept of “security manager/holder”
- Prior creditor’s consent to a transfer of debt
- Execution of agreements by way of e-mail exchange recognised

### **Implication for business**

- “Security manager” concept will be significant step forward for syndicated loans, both Russian and English law governed

## Russian security: Suretyship and Mortgage

- Suretyship remains in force even if principal obligation is changed
- The German law concept of an independent mortgage:
  - no secured obligation need to be identified
  - the maximum amount to be received in case of enforcement to be set out
  - maximum term - up to 30 years

# Russian security: Pledge



- A reference to the secured agreement is sufficient (no detailed description is formally required)
- A pledge can secure all current and future obligations of the debtor with respect to the creditor, within a certain limited amount
- Potential issues with restrictions of subsequent pledge

## New Types of Security

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- Pledge of Russian Bank Accounts
  - restrictions on a pledgor's ability to control the account
  - enforcement by way of direct debit
- Pledge of corporate rights
  - transfer rights to receive dividends and voting rights (be aware of antimonopoly issues) to the creditor as part of a share pledge
- Independent guarantee
- Option agreement (quasi-security)



# New Types of Security

- Security Deposit:
  - secures monetary obligations (including damages and penalty)
  - secures future obligations
  - in the event of a default the amount of deposit will be applied to discharge the secured obligations

## Implication for business

- Enhancement of secured creditors' position

## New Types of Accounts

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- Escrow Account
- Joint Account – limitation of client’s rights over a bank account by way of sole / joint signing rights
- “Nominal” Account – similar to custody accounts, relevant, *inter alia*, to “Impaired Agent” situations in syndicated lending

## More amendments

- Waivers and condition precedent
- Negative covenants
- Indemnity (an indemnity CAP must be set out in the contract)
- Representations and warranties
- Remedies in case of misrep:
  - damages
  - rescission of contract (in certain cases)
  - invalidation of contract (in certain cases)

### **Implication for business**

- Answers to long standing demands of market participants

# Contact Information



Alexander Janes  
Partner  
+44 20 7862 4643  
[ajanes@orrick.com](mailto:ajanes@orrick.com)



Dmitry Gubarev  
Partner  
+7 495 604 4090  
[dgubarev@orrick.com](mailto:dgubarev@orrick.com)



Victoria Bryxa  
Senior Associate  
+7 495 604 4055  
[vbryxa@orrick.com](mailto:vbryxa@orrick.com)

# 6. Questions and discussion