

Russian Federation

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CORPORATE ENTITIES

The most common forms of legal business entities are:

- **Limited liability companies (*obschestvo s ogranichennoy otvetstvennostiyu*) (LLC).** An LLC has its charter capital divided into participation interests. Participants bear the risk of losses to the extent of their interests in the company's charter capital. The number of participants cannot exceed 50.
- **Joint stock companies (*aktsionernoye obschestvo*) (JSC).** A JSC has its charter capital divided into a defined number of shares. Shareholders bear the risk of losses to the extent of the value of their shares. A JSC whose shareholders can alienate their shares without the consent of the other shareholders is an open JSC. Only an open JSC can offer its shares under an open subscription. Open JSCs are subject to a number of additional disclosure and reporting requirements. A JSC whose shares are distributed only among its founders or another defined group of persons is a closed JSC.

LEGAL FRAMEWORK

1. What is the regulatory framework for corporate governance and directors' duties?

The principal sources of company law and regulation are:

- Civil Code of the Russian Federation (Civil Code). This gives the basic governance framework.
- Federal Law on limited liability companies, No. 14-FZ, 8 February 1998 (as amended) (LLC Law).
- Federal Law on joint stock companies, No. 208-FZ, 26 December 1995 (as amended) (JSC Law).
- Companies' constitutional documents.

In addition, specific legislation applies to companies in the banking, investment and insurance industries, as well as agribusinesses and state- or municipally-owned companies.

Non-binding guidance for JSCs, the Code of Corporate Conduct (CCC), was published by the Federal Commission for the Securities Market (now the Federal Service for the Financial Market (FSFM)) in April 2002. The CCC contains best practices and generally accepted principles of corporate governance, including the OECD Principles of Corporate Governance.

Russian stock exchanges (MICEX and RTS stock exchange) listing requirements require companies listed on Tier A, Level 1 and

Level 2 to confirm their compliance with, respectively, all or part of recommendations contained in the CCC.

BOARD COMPOSITION AND REMUNERATION OF DIRECTORS

2. What is the management/board structure of a company? In particular:

- **Is there a unitary or two-tiered board structure?**
- **Who manages a company and what name is given to these managers?**
- **Who sits on the board(s)?**
- **Do employees have a right to board representation?**
- **Is there a minimum or maximum number of directors or members of the managerial and supervisory bodies?**

- **Structure.** The board structure is unitary.
- **Management.** In addition to general meetings, LLCs and JSCs must have an executive body, that is, either:
 - an individual, such as a general director; or
 - a collective, such as a management board/directorate (board).

LLCs and JSCs can also have a supervisory board while an open JSC with more than 50 shareholders must have a supervisory board.

- **Board members.** A board is comprised of directors elected by participants or shareholders at a general meeting. A legal entity cannot be a director.
- **Employees' representation.** Employees are not entitled to representation on the board.
- **Number of directors or members.** There are no requirements for a minimum number of directors in LLCs. JSCs must have the following minimum number of directors, depending on the number of shareholders (*JSC Law*):
 - companies with up to 1,000 shareholders: at least five directors;
 - companies with between 1,000 and 10,000 shareholders: at least seven directors;
 - companies with more than 10,000 shareholders: at least nine directors.

There is no legal maximum number of directors.

3. Are there any age or nationality restrictions on the identity of directors?

Age restrictions

The general rule requires directors to have "full dispositive capacity". This normally arises at the age of 18.

Nationality restrictions

Directors can be of any nationality.

4. In relation to non-executive, supervisory or independent directors:

- Are they recognised?
- Does a part of the board have to consist of them? If so, what proportion?
- Do non-executive or supervisory directors have to be independent of the company? If so, what is the test for independence or what makes a director not independent?
- What is the scope of their duties and potential liability to the company, shareholders and third parties?

- **Recognition.** The law distinguishes between different categories of directors: between executive and non-executive for the purpose of board composition (*see below*) and between interested and non-interested directors for the purpose of approving an interested director's transaction (*see Question 20*). However, the CCC does recommend that the companies include independent directors in their boards.
- **Board composition.** The maximum number of executive directors on a board is 25% of the total number of the directors (executive directors are members of the collective executive body (management board or directorate)).
- **Independence.** There are no obligatory requirements on directors' independence. The CCC, which recommends including independent directors, gives the following tests for independence:
 - they have not been employees of the company in the past three years;
 - are not affiliated with the company, its affiliates or officers;
 - they are not a major counterparty of the company;
 - the remuneration for sitting on the board does not exceed 10% of the director's income;
 - they do not represent the State.
- **Duties and liabilities.** All board members have the same legal duties and liabilities.

5. Are the roles of individual board members restricted? For example, can one person be the chairman and chief executive?

The roles of directors are restricted, as follows (*LLC Law and JSC Law*):

- Revision committee (*see Question 27*) members cannot be directors.
- Counting committee members cannot be directors.
- Executive board members (*see Question 4*) can account for a maximum of one-quarter of the total number of board members.
- The general director cannot serve concurrently as the chairman of the supervisory board.

6. How are directors appointed and removed? Is shareholder approval required?

Appointment of directors

LLC. Directors are elected by participants at a general meeting. Directors can be elected by cumulative voting if the charter provides for such a procedure.

JSC. Directors must be elected by shareholders at a general meeting.

A shareholder (or a group of shareholders) with at least 2% of voting shares has the right to nominate candidates for the board.

All directors must be elected with cumulative voting.

Removal of directors

LLC. Directors can be removed at any time by participants at a general meeting.

JSC. Directors can be removed at any time by shareholders at a general meeting.

7. Are there any restrictions on a director's term of appointment?

LLC. There are no mandatory restrictions on a director's term of appointment but these may be given by the company charter.

JSC. Shareholders elect directors for a term until the next annual general shareholders meeting. If a new annual general shareholders meeting is not held in the period specified by the JSC law (between 1 March and 30 June each year) the authority of the supervisory board terminates automatically, except for their authority to subsequently prepare, convene, and conduct the shareholders' meeting.

8. Do directors have to be employees of the company? Can shareholders inspect directors' service contracts?

Directors employed by the company

Directors do not have to be employees of the company and commonly do not have contracts related to their duties and liabilities as members of a supervisory board.

Shareholders' inspection

Directors' service agreements are not required to be disclosed by the company to its shareholders.

9. Are directors allowed or required to own shares in the company?

Directors are not required to own participatory interests or shares in the company but this is not prohibited.

10. How is directors' remuneration determined? Is its disclosure necessary? Is shareholder approval required?

Determination of directors' remuneration

Directors can be remunerated for their work. The remuneration amount is determined by the general meeting of participants or shareholders.

Disclosure

There are no requirements for disclosing directors' remuneration.

Shareholder approval

Participants or shareholders decide on directors' remuneration (*see above*).

MANAGEMENT RULES AND AUTHORITY

11. How is a company's internal management regulated? For example, what is the length of notice and quorum for board meetings, and the voting requirements to pass resolutions at them?

LLC. The company charter and internal regulations adopted by participants at the general meeting can specify procedures for internal management.

JSC. The supervisory board operates according to procedures given by the JSC Law, the company charter and internal regulations.

The JSC Law does not specify the notice required for supervisory board meetings. These may be specified by the company charter or internal regulations.

A quorum may be specified in the charter, but cannot be less than one-half of the number of directors.

Supervisory board decisions must be approved by a simple majority vote unless the JSC Law, the charter or internal regulations require a higher percentage of votes. Special rules apply for decisions on interested-party transactions (*see Question 19*).

12. Can directors exercise all the powers of the company or are some powers reserved to the supervisory board (if any) or a general meeting? Can the powers of directors be restricted and are such restrictions enforceable against third parties?

Directors' powers

LLC. A number of matters are reserved for the general meeting of participants and cannot be delegated to a supervisory board or the executive body.

The company charter may specify matters that are reserved for a supervisory board.

JSC. A number of matters are reserved for the general meeting of shareholders and the supervisory board. Matters under the general meeting's authority cannot be extended or delegated to a supervisory board or the executive body. Matters under a supervisory board's authority cannot be delegated to the executive body.

Restrictions

LLC. A decision passed in violation of any of the company charter requirements and infringing the rights or legal interests of a participant can be invalidated by a court action brought by the participant.

JSC. A supervisory board's authority can be restricted by delegation of certain matters to the shareholders' general meeting. A decision passed in violation of any of the company charter requirements and infringing the rights or legal interests of a shareholder can be invalidated by a court action brought by the shareholder.

13. Can the board delegate responsibility for specific issues to individual directors or a committee of directors? Is the board required to delegate some responsibilities, for example for audit, appointment or directors' remuneration?

There is no requirement to delegate responsibilities to committees, although the CCC recommends that companies establish the following committees:

- Audit Committee.
- Strategic Planning and Finance Committee.
- Ethics Committee.
- Nominations and Remuneration Committee.
- Corporate Conflicts Resolution Committee.

DUTIES AND LIABILITIES OF DIRECTORS

14. What is the scope of a director's duties and personal liability to the company, shareholders and third parties? Please distinguish between civil and criminal liability under each of the following (if relevant):

- **General duties.**
 - **Theft and fraud.**
 - **Securities law.**
 - **Insolvency law.**
 - **Health and safety.**
 - **Environment.**
 - **Anti-trust.**
 - **Other.**
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- **General duties.** Directors must act in good faith and in reasonable manner, in the interests of the company.

- **Theft and fraud.** A director can be subject to criminal liability for theft or fraud against the company.
- **Securities law.** A director must not use or provide insider information for any transactions in the company's securities.
- **Insolvency law.** In principle, directors are liable for causing the company's creditors' losses in an insolvency situation (*Article 10.1, Federal Law on bankruptcy, No. 127-FZ, 26 October 2002 (as amended)*). In practice, it is very hard for a plaintiff to provide sufficient evidence against a director to make such a claim.
- **Health and safety.** A director is generally not responsible for health and safety compliance.
- **Environment.** A director is generally not responsible for environmental compliance.
- **Anti-trust.** A director is generally not responsible for anti-trust compliance.
- **Other.** There are no other directors' duties and liabilities.

15. Can a director's liability be restricted or limited? Is it possible for the company to indemnify a director against liabilities?

It is not possible to exempt a director from liability or indemnify a director against liability. Indemnification is difficult as a general matter of Russian law.

16. Can a director obtain insurance against personal liability? If so, can the company pay the insurance premium?

A director can obtain insurance against liabilities to the company and the CCC recommends that they do so.

17. Can a third party (such as a parent company or controlling shareholder) be liable as a de facto director (even though such person has not been formally appointed as a director)?

Under certain circumstances a parent company can be held liable for the losses caused to a company where it is at fault, although this is very rare.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

18. Are there general rules relating to conflicts of interest between a director and the company?

The JSC Law and the LLC Law address conflicts of interest only in the context of interested-party transactions (*see Question 19*).

Directors of JSCs must disclose to the revision commission and the auditor:

- Legal entities in which he, individually or with affiliated parties, possesses at least 20% of the equity.
- Legal entities in which he holds a position in any governing bodies
- Any pending or planned transactions of the company in which he is an interested party.

19. Are there restrictions on particular transactions between a company and its directors?

Any interested-party transaction must receive special approval by non-interested directors or a general meeting of shareholders or participants.

20. Are there restrictions on the purchase or sale by a director of the shares and other securities of the company he is a director of?

A director must not deal with the shares and other securities of the company if he has insider information and must not provide such information to third parties.

DISCLOSURE OF INFORMATION

21. Do directors have to disclose information about the company to shareholders, the public or regulatory bodies?

There is no obligation to disclose information about the company to shareholders, the public or regulatory bodies. However, the minutes of board meetings must be provided to shareholders at their request.

COMPANY MEETINGS

22. Does a company have to hold an annual shareholders' meeting? If so, when? What issues must be discussed and approved?

LLC. A company must hold an annual participants' meeting on a date set by its constituent documents between 1 March and 30 April each year. At the annual meeting, the participants decide on approval of the year-end results.

JSC. A company must hold a shareholders' annual meeting on a date set by its constituent documents between 1 March and 31 June each year. At the annual meeting, the shareholders elect the board of directors, the revision commission, appoint auditors of the company, approve the year-end results and decide on dividends.

23. Can shareholders call a meeting or propose a specific resolution for a meeting? If so, what level of shareholding is required to do this?

LLC. Participants holding together at least 10% of the votes can convene a meeting. Any participant may suggest a specific resolution to be discussed at the meeting.

JSC. Shareholders holding together at least 10% of the shares can convene a meeting. Shareholders holding together at least 2% of the shares can suggest a specific resolution to be discussed at the meeting.

MINORITY SHAREHOLDER ACTION

24. What action, if any, can a minority shareholder take if it believes the company is being mismanaged and what level of shareholding is required to do this?

LLC. A participant can challenge a decision of the participants' general meeting if both:

- The participant was not present at the meeting or voted against the decision.
- The decision breaks the law and violates the participant's rights.

The same applies to the decisions of the supervisory board and executive body. The court can dismiss the claim if it decides that the violations are minor.

JSC. Shareholders holding together at least 1% of the shares can take collateral action against a company's board members or management. In a dispute over compulsory buy-out of shares any shareholder can file such a claim.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

25. Are there any formal requirements or guidelines relating to the internal control of business risks?

Both LLCs and JSCs must annually elect a revision committee. The revision committee reports to the meeting of participants or shareholders on the correctness of the annual statements and accounts. In practice, however, many small and even middle-sized companies neglect these rules, since no liability is attached to them. The revision committee is a weak body not supported by real powers to demand information or to bring management to account.

26. What are the responsibilities and potential liabilities of directors in relation to the company's accounts?

A general director, where he is the sole executive, is responsible for the company's accounts. He is also civilly and criminally liable for the correctness of the company's bookkeeping and tax reporting. The members of the supervisory board are not responsible for the company's accounts.

27. Do a company's accounts have to be audited?

Only open JSC's must have an external audit. Closed JSCs or LLCs may be audited voluntarily.

28. How are the company's auditors appointed? Is there a limit on the length of their appointment?

Both LLCs (voluntarily) and JSCs (either voluntarily or obligatorily) appoint an external auditor by a decision of participants' or shareholders' general meeting, taken by simple majority of votes (an LLC's constituent documents may require a qualified majority). There is no statutory time limit for an auditor's appointment.

29. Are there restrictions on who can be the company's auditors?

Auditors must be members of a self-regulated body, the auditor's chamber. An LLC's auditor must be financially independent from the company and its participants, board members of officers (*LLC law*). This is not a requirement for JSCs, although this has been requested by the industry and is widely anticipated. The Code of Corporate Conduct also suggests that a JSC's auditor be independent, although it does not give an independence test.

The Law on Audit Activity (*No. 307-FZ*) requires an auditor to be independent and gives a lengthy independence test, although the onus to meet this requirement falls on the auditor itself.

30. Are there restrictions on non-audit work that auditors can do for the company that they audit accounts for?

An auditor must not provide any bookkeeping services to the audited company (*Law on Audit Activity*).

31. What is the potential liability of auditors to the company, its shareholders and third parties if the audited accounts are inaccurate? Can their liability be limited or excluded?

An auditor is subject to disciplinary sanctions as a member of the self-regulatory body, the auditors chamber, including exclusion from membership, which would prevent it from providing audit services. Individual auditors found liable for wilful misconduct or gross negligence can be barred from practising. An auditor can be personally liable for damages caused by wilful misconduct or gross negligence. An auditor's civil liability may be covered by a special fund accumulated by the auditor's chamber.

CORPORATE SOCIAL RESPONSIBILITY

32. Is it common for companies to report on social, environmental and ethical issues? Please highlight, where relevant, any legal requirements or non-binding guidance/best practice on corporate social responsibility.

The law does not require disclosure of social, environmental or ethical issues and the CCC does not contain any recommendation to that effect. As a consequence, disclosure of such information is not common. Where such information is disclosed it is generally by international companies under their international guidelines.

ROLE OF COMPANY SECRETARY

33. What is the role of the company secretary in corporate governance?

There is no legal requirement to have a corporate secretary, although the CCC recommends this. A corporate secretary's responsibilities include:

- Complying with statutory and CCC requirements.
- Running shareholders' and board meetings.
- Supervising compliance with information disclosure rules.
- Communicating with the register holder.
- Being a contact for shareholders' requests to the company, including those connected with shareholders' conflicts.

ROLE OF INSTITUTIONAL INVESTORS AND SHAREHOLDER GROUPS

34. How influential are institutional investors and other shareholder groups in monitoring and enforcing good corporate governance? Please list any such groups with significant influence in this area.

Private equity funds holding minority stakes in large Russian companies are often keen to enforce good corporate governance. Among those that have been most notable for using their minority rights are:

- Deutsche UFG Capital Management.
- Hermitage Capital Management.
- Vostok Nafta.
- Prosperity Capital Management.

Recently the activity of these and other groups has been significantly lower.

WHISTLEBLOWING

35. Is there statutory protection for whistleblowers (persons who disclose criminal activity or other serious malpractice within a company)?

Under a recent amendment to the Criminal Code, a person who is a part of a criminal group and who reports a crime to the investigators can ask to enter into a collaboration agreement with the

investigation. Under such an agreement the individual may be protected by the State and the punishment may also be reduced. There is no other statutory protection for whistleblowers.

REFORM

36. Please summarise any impending developments or proposals for reform.

Russian corporate law is in the middle of reform. Many aspects of corporate governance rules are under consideration. The developments that are most likely to take place in the near future are:

- Abolition of the closed JSC form and re-classifying companies into private and public groups, which will be followed by further relaxation of private companies' regulation and new requirements for public companies.
- Refinement of the norms regulating agreements between participants or shareholders.
- Introduction of a statutory concept of independent directors (rather than in non-binding documents) and the introduction of a self-regulating body of independent directors.
- Introduction of a time-limit for being an independent director of a company.
- Refinement of the bankruptcy and liquidation law.
- Registration of off-shore companies as a condition to their legal capacity in Russia.
- Substantial refinement and tightening of the rules on board member and company officers' liabilities.

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