

## **SINO-RUSSIAN BUSINESS: FIVE TIPS ON RUSSIAN COMPANY LAW**

Corporate issues are an important aspect of running a business in Russia. It is essential for foreign businesses that are looking into establishing a company in Russia to understand the corporate aspects of transactions with Russian partners.

The adoption of timely and reasonable precautions will save costs and avoid disputes.

### **Tip 1: Limited Liability and Joint-Stock Companies**

On 1 September 2014 amendments concerning corporate law were made to the Civil Code of the Russian Federation, introducing a new classification of legal entities under which commercial companies are divided into public and private (non-public) companies.

A public company is a joint-stock company:

- (i) whose shares, and securities that are convertible into shares, are placed through a public offering or are publicly traded; or
- (ii) whose charter and corporate name contain an indication that the company is public.

Limited liability companies and joint-stock companies that do not meet at least one of the above characteristics are considered private (non-public).

The law states that a non-public company must have a minimum registered capital of RUR 10,000 (approx. USD 260), while a public company must have a minimum registered capital of RUR 100,000 (approx. USD 2,600).

Non-public companies can have up to 50 shareholders. The company charter is the constituent document of the company; the shareholders may choose to regulate various company matters through it, such as the distribution of voting rights, the establishment of management bodies, the introduction of restrictions and internal procedures, and so on.

Since 1 September 2014, the division of 'closed' and 'open' joint-stock companies has been abolished. Closed joint-stock companies must be transformed into joint stock companies or LLCs. Joint-stock companies (both public and non-public) issue shares and are additionally subject to securities laws and regulations of the Central Bank of Russia, while limited liability companies cannot issue shares and are not so regulated.

Both types of companies may establish any number of subsidiaries. Even though the shareholders enjoy limited liability in the parent company, they can be held jointly liable for transactions concluded by a subsidiary pursuant to the parent company's instructions and with the consent of the parent company.

### **Tip 2: Representative Offices and Branches**

Corporate organization in the form of representative offices and branches in Russia is also an attractive option for foreign investors, as it allows a higher degree of parent company participation, the ability to control local management, and easier financing options (simple cash transfers).

Representative offices and branches do not however enjoy the rights and benefits that are assigned to legal entities, and from a legal point of view they always operate under the name of, and on behalf of their founding companies.

According to Russian law, representative offices can engage in marketing and representation activities. There is a formal prohibition on representative offices engaging in commercial activities.

Branches have a wider permitted scope of activities; they can engage in all or part of the activities carried out by the founding company, including commercial activities and representative functions. In practice however, despite the formal prohibition many representative offices are engaged in commercial activities as well, and this is generally tolerated by state authorities.

Both representative offices and branches operate based on regulations adopted and approved by their parent companies. These regulations perform functions which are similar to those of a company's charter, and they are crucial in establishing the rights and obligations of the managing body, as well as the internal structure and the procedures for protecting the parent company from abuse and misappropriation.

Any company offices or branches set up in Russian territory by foreign legal entities must go through an accreditation process.

### **Tip 3: Corporate (Shareholder) Agreements**

Corporate (shareholder) agreements are a relatively new tool in Russian corporate law and their use by companies is still developing.

Corporate (shareholder) agreements can be adopted by shareholders of both limited liability companies and of joint-stock companies, as stipulated by Russian laws (Federal Laws "On Limited Liability Companies" and "On Joint-Stock Companies", respectively).

These agreements allow shareholders to agree on the manner in which they will exercise or refrain from exercising their rights. In accordance with statutory provisions, the scope of corporate (shareholder) agreements is relatively wide and may extend to an undertaking to vote in a certain manner, sell shares at a certain price, or otherwise coordinate actions in the course of the company's activities, reorganization or liquidation.

Some mechanisms that are integral to any shareholders agreement, such as call and put options, price determination mechanisms, and dead lock solution mechanisms, are difficult to enforce in Russia. Current court practice regards them generally as null and void, contrarily to Russian law.

Therefore, most joint ventures and M&A transactions are structured abroad with a foreign Hold Co and a 100% subsidiary in Russia. Shareholder agreements are usually drafted under English law because of its flexibility.

#### **Tip 4: Considerations on the Protection of Market Competition**

Many corporate decisions and events, such as mergers and acquisitions and, under certain circumstances, the establishment of companies, are sensitive to considerations on the protection of competition in the market.

Having a dominant position in the market depends on the market share of the undertaking or its real market impact. The general dominance rule stipulates that dominance is presumed for companies holding a market share of 50% or more, while with companies holding a market share of more than 35% but less than 50%, dominance is subject to the determination of the Federal Antimonopoly Service of Russia. The 'real market impact' consideration covers companies that do not fall under the general rule: a company whose market share is less than 35% might be regarded as having a dominant position should its real position in the market (as established by the competition authority after conducting a market analysis), be deemed to provide significant influence in the given market. Special rules apply to financial organisations.

Undertakings holding a dominant position are *inter alia* prohibited from: fixing or maintaining "monopolistically" high or low prices, establishing different prices for the same commodity without technological or economic substantiation, establishing discriminatory conditions, restricting the circulation of goods, attempting to restrict other businesses from entering the market or imposing unfair contractual terms and conditions, and so on.

## **Tip 5: Corporate Governance Issues**

Foreign companies with a presence in Russia are often concerned about corporate governance issues.

Generally, the sole executive body (general director) is the central figure for determining both the company's day-to-day activities and its long-term plans. In accordance with the recent amendments to the Civil Code, the powers of the sole executive body can be passed to various company executives, who can act jointly or individually. This passage of powers must be reflected in the Unified State Register of Legal Entities. It is also possible to appoint a natural or a legal person as the sole executive body.

The laws stipulate that certain requirements must be fulfilled regarding the scope of duties of the general director, including in relation to certain restricted economic activities. For example, "major transactions" and "interested party transactions" require the approval of the superior managing bodies unless they are performed in the ordinary course of the company's business.

The company charter should also be regarded as an important tool for imposing additional restrictions on the general director.

The general director is liable to the company for non-performance of decisions taken by the superior managing bodies (decisions taken at a general shareholders' meeting), as well as for any damages and/or losses which result from his actions, if it is proven that, when exercising his or her rights and performing his or her duties, the general director acted in bad faith or unreasonably. A general director may be deemed to have acted in bad faith or unreasonably if his or her actions (or inaction) do not meet the usual conditions of civil relations or the standards of entrepreneurial risk. However, practical difficulties may arise in these circumstances, as such people are protected by a concept similar to the business judgment rule, i.e. they will be presumed to have acted lawfully and at the level of justified risk unless otherwise proven.

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