This Newsletter is the last for this year. Russia is taking a long holiday. The next issue of our Newsletter will be published at the end of January - early February 2011.

This issue contains an article prepared by Violetta Molchanova regarding the amendments to the Russian Civil Code proposed by the Council established by the Russian President and tasked to codify and modernise Russian civil legislation. The article is focussed on those proposals which may limit the operations of newly established Russian subsidiaries of offshore companies. Depending on the list of offshore jurisdictions which the Russian Ministry of Finance was instructed to put together, this proposed change may have a significant impact on the way Russian businessmen organise their holding structures with the use of offshore jurisdictions.

Dmitry Milyutin expands on the subject of possible amendments to the Russian Civil Code and gives a more general overview. The proposed amendments embrace a wide spectrum of provisions of civil legislation and contain a number of novel provisions which will be of interest to practicing lawyers and beyond.

Igor Orlov writes about the new practice of accreditation of rating agencies in Russia. Since the adoption of the rules governing accreditation of rating agencies in May 2010 eight agencies have been accredited in Russia. This is an evidence of high interest that rating agencies have in Russia and the official recognition of this industry by the state.

We take this opportunity to wish our readers a Happy New Year and professional success in the new year.

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Proposed changes to regulation of offshore companies' operations

Violetta Molchanova, Associate

On 14 November 2010 the Supreme Arbitrazh (Commercial) Court published on its website a set of proposed amendments to the Civil Code of the Russian Federation which relate to the legal treatment of foreign legal entities in the Russian Federation. The proposed changes, if adopted, will affect the first three Parts of the Civil Code and limit the ability of offshore companies to operate in Russia.

First of all, we note the proposed changes to Article 21 of the Civil Code (State Registration of Legal Entities). In accordance with the new wording, as published by the Supreme Arbitrazh Court, “a foreign legal entity incorporated in a jurisdiction that has a beneficial tax regime and/or no requirement to disclose its owners or beneficiaries must deposit with the Ministry of Justice ‘true’ information about its founders, shareholders or beneficiaries”.

Under a Russian court order such information may be disclosed to third parties; the legal entity itself is solely liable for any false information deposited with the Ministry of Justice.

It is expected that the Ministry of Justice will be instructed to make a list of such jurisdictions.

Besides it is proposed to amend Article 1202 (International Private Law). In accordance with these amendments, Russian courts will apply Russian law, rather than law of the country of incorporation, to those claims which seek to hold founders, shareholders or management bodies of a foreign company liable for obligations of that foreign company, unless the company’s creditor recognises the law of the country of incorporation as personal law of that company.

It is evident that amendments of this kind will make it more difficult for offshore subsidiaries of Russian companies to operate.

It should be said that such amendments are no surprise for businesses as many legal systems are moving towards greater transparency and regulation in business while disclosure is seen as one of the best tools to achieve those goals.

Proposed amendments to Sections I, III and VI of the Russian Civil Code

Dmitry Milyutin, Senior Associate

The Presidential Council for codification and improvement of civil legislation has published a proposal for amending Sections I, III and VI of the Russian Civil Code. The proposed amendments were prepared in pursuance of Presidential Decree No 1108 of the Russian Federation dated 18 July 2008 “On Improvement of the Civil Code of the Russian Federation” and in accordance with the established Development Concept of the Russian Civil Legislation.
Below is a brief overview of selected legislative changes proposed in the published draft.

**Changes in corporate law**

It is proposed that the Civil Code would include rules regulating corporate relations, i.e. relations arising in connection with a person's participation in the share capital or management of a corporate entity.

It is also proposed that customary business practices be recognized as a source of law, as customs are widely relied on in today's business activities.

It is envisaged that a company should have only one constitutive document, namely the Charter.

The published proposal upholds the existing position in the Civil Code that both for-profit companies, whose main objective is profit-making, and not-for-profit companies which have no such objective and distribute no profit among its shareholders, can be incorporated as legal entities.

It is not allowed to convert a business into a non-profit organisation.

New terminology is introduced to distinguish "corporate" and "unitary" entities.

Legal entities whose founders (shareholders) have the right to participate in the management of the entity (membership right) are called corporate entities (corporations). These include companies and partnerships, industrial and consumers' co-operatives, societies, as well as associations and unions.

Legal entities whose founders do not get the shareholder status and have no membership rights are the so called unitary organisations. These include governmental and municipal unitary enterprises, foundations, governmental agencies and religious organisations.

Companies can be incorporated in the form of a joint stock company or a limited liability company. The proposed amendments suggest that superadded liability company as a type of company should be abolished.

A joint stock company will be seen as a public joint stock company if it places its shares and securities convertible into shares by way of a public offering and they are publically traded in accordance with terms and conditions stipulated in applicable securities legislation.

A number of specific provisions are introduced that apply to public joint stock companies:

- increased minimum charter capital requirements
- a requirement that at least one forth of the board members should be independent directors
- a duty to disclose to the public the information set out in applicable Russian company and securities laws
- a requirement that a public joint stock company maintain a register of shareholders and the company's ballot committee functions be vested in an independent company holding appropriate license
The proposed changes significantly raise the minimum charter capital of legal entities:

- The charter capital of a limited liability company may not be less than RUR 500,000
- The charter capital of a joint stock company may not be less than RUR 5,000,000
- The charter capital of a public joint stock company may not be less than RUR 100,000,000
- The minimum amount of charter capital of a company must be paid in cash. At least three fourths of a company's charter capital must be paid in by its founders prior to state registration of a company

The amendments include a more detailed definition of a contribution into the charter capital of a company or partnership: "A contribution into property of a company can be made in cash, shares (or participation interests) in the charter capital of another company, Russian depositary notes, intellectual property rights as well as those rights arising out of license agreements to which monetary value can be assigned."

Non-profit organisations will fall into two groups: "non-profit corporate organisations" and "non-profit unitary organisations", where the former would include consumers' co-operatives, societies, associations and unions (with their status subject to detailed regulation), and the latter would encompass foundations, governmental agencies and religious organisations.

A non-profit organisation that carries on profit-making activities must have its own separate assets to safeguard the interests of its creditors. The value of its assets should be no less than the minimum charter capital of a limited liability company.

The amended provisions of the Code stipulate that a legal entity registered in a foreign country that has a beneficial tax regime and/or no requirement to disclose information for performing financial transactions would be permitted to operate in Russia on condition that it shall lodge true information about its founders/shareholders and beneficiaries with the authorised justice authority of the Russian Federation.

The list of such foreign countries will be prepared by authorised governmental authority. The information lodged by a company can be disclosed either by the company itself or under a court order. The company shall solely bear the risk of sanctions for lodging false information or operating in Russia without lodging such information.

**Amendments to the law of obligation and contract**

The Civil Code amendments include an article explaining how the general rules of the law of obligations will apply to specific types of obligations including contractual and non-contractual obligations (i.e. obligations out of wrongful damage and out of unjust enrichment), and applicability of these rules to other "relative" legal relations, unless otherwise provided for by legislation or follows from the nature of these legal relations.

The notion of obligation was extended to include (in addition to the existing ones) such acts as provision of services and making a contribution into joint operations.

It is envisaged that Chapter 21 of the Civil Code would include new rules relating to alternative, facultative and natural obligations as described below:

An alternative obligation exists where the debtor is under an obligation to do one of two or
more acts (or refrain from acting) at his own option. By virtue of applicable laws, regulatory
instruments or contract, the right to choose can be vested in the creditor or a third party.
The obligation will cease to be alternative at the time when the debtor (or creditor/third
party, as the case may be) has made his choice;

A facultative obligation exists where the debtor is given the right to substitute the
performance of a principal obligation by another (facultative) performance that is envisaged
in the terms of the obligation. Where the debtor exercises his right to substitute the
performance as envisaged by the terms of the obligation, the creditor will be bound to
accept such performance of the obligation.

A natural obligation is an obligation which can not be enforced by the creditor in a court of
law. The debtor that has performed a natural obligation is not entitled to demand
restitution. In certain circumstances stipulated in a statute or a contract that is connected
with the parties' business activities, the creditor's claim under a natural obligation can be
deemed to be enforceable in a court of law.

Significant amendments were introduced to the provisions of the Civil Code regulating
security for the performance of an obligation.

In particular, the Civil Code provisions on pledge have been overhauled.

The pledgor must own the object of pledge. A person that has a different type of
proprietary interest in the object of pledge may act as a pledgor only to the extent this is
expressly permitted by relevant provisions of the Civil Code.

Next, a new term is introduced in the bill – a co-pledgee. It is provided that, to the extent
permitted by applicable law or contract, the object of the pledge can be held by more than
one person as a security for the pledgor's separate obligations owed to such persons as
independent creditors; all such persons (co-pledgees) will have equal priority rights over
the object of pledge.

The draft contains new rules governing the assessment of the object of pledge and the
priority of creditors' claims; it sets out detailed rules concerning the pledge of a right.

The law of surety was complemented with a new provision to the following effect: in the
event of death of a natural person who is a debtor in an obligation that was created in the
context of his business activities, the person who provided a surety in respect of this
obligation can not invoke the limited liability of the debtor's heirs for his debts.

Where a debtor was notified by the surety about the creditor's claims made against the
surety, or brought into the proceedings by the surety, the debtor shall inform the surety
about all of the objections he may have against this claim and provide the surety with any
available in support of these claims. Failing that, the debtor would be estopped from
objecting against the surety's claim with the objections which could have been raised
against the creditor's claim, (unless the surety and the debtor agreed otherwise).

The proposed amendments lift the restrictions concerning the provision of independent
guarantees (performance bonds) by entities that are not specified in Article 368 of the Civil
Code. The new term for this type of security is an "independent guarantee" rather than the
previously used "bank guarantee".

It is stipulated that the guarantor under an independent guarantee undertakes upon
request of another person (the principal) an obligation to pay a certain amount to an
indicated third party in accordance with the terms of the obligation undertaken by the guarantor, regardless of the validity of the secured obligation.

Material terms of an independent guarantee include the date, the principal, the beneficiary, the guarantor, the principal obligation that is secured by the guarantee, the expiry date of the guarantee and the events triggering the payment of the amount of the guarantee.

A guarantee may include a provision about an increase or decrease of the amount of guarantee upon the occurrence of a certain event or at the end of a certain period of time.

The proposed amendments also concern the provisions of the Civil Code on substitution of parties in an obligation.

The current rules of the Civil Code have been supplemented with provisions regarding assignment of future rights, i.e. the rights that have not yet arisen at the time when the agreement is being made between the initial and the new creditor regarding the transfer of that right.

Transfer of debt from the debtor to another person may be effected upon agreement between the initial debtor and the new debtor.

Where the obligation in point is related to the parties' business activities, debt can be transferred from the old debtor to the new debtor by agreement between the creditor and the new debtor, whereby the new debtor undertakes the obligation of the initial debtor.

Transfer of debt from the debtor to another person requires the creditor's consent and will be void where no such consent was given. Where the creditor gives prior consent to the transfer of debt, the transfer is deemed to be effective at the time when the creditor receives the notice of the transfer.

The Civil Code amendments introduce a new independent type of contract – framework agreement.

Framework agreement (a contract with open terms) is a contract that sets the general terms of the parties' mutual obligations which can be fleshed out and clarified by the parties when further separate contracts are made in pursuance of or under the framework agreement.

Rather than binding parties to enter into a contract in the future (as a preliminary agreement typically would), a framework agreement is a contract which has already been made, although some of its terms are to be applied and specified in the future ('open' terms being the terms that are to be agreed in the future).

In accordance with the Presidential Decree dated 18 June 2008 "On Improvement of the Civil Code of the Russian Federation" the proposed amendments aim to further develop the key principles of the Russian civil legislation to correspond to the new level of development achieved in the market relations; to reflect the experience of Russian courts in application and construction of Russian civil legislation; to bring the provisions of the Code closer to the legal rules regulating similar relations in the European Union; to build on the positive experience gained in some European countries by modernising their civil codes; to maintain consistency with the way civil law relations are regulated in CIS countries; and to ensure stability of civil legislation in the Russian Federation.
Eight accredited rating agencies appeared in Russia since autumn 2010

Igor Orlov, Senior Associate

After approximately a year of work the Russian Ministry of Finance has prepared and enacted (by Order No.37н dated 4 May 2010) the Procedure for Accreditation and Keeping the Register of Accredited Rating Agencies, which statutory instrument was registered by the Ministry of Justice in July 2010 and became effective on 5 August 2010. Already in September – November eight rating agencies were accredited and put on the register in accordance with this procedure, including international (Fitch Ratings and Standard and Poor's, represented by their Russian offices and Moody's Investor Service, represented by two Russian companies affiliated with the agency) and Russian players (such as National Rating Agency, AK&M and others). The list of accredited agencies and the regulatory framework for their accreditation can be seen at the Internet homepage of the Russian Ministry of Justice (www.minfin.ru).

According to experts, the need for some form of regulation of rating agencies’ operations in Russia emerged a few years ago when the market players and investors felt an increased demand for the Russian agencies' ratings as a fully-fledged and popular tool for assessing credit risks. The choice between accreditation, whether formal or functional, and licensing, as a more rigid form of regulation, was discussed in its time. As we can see, eventually the accreditation route was taken in the form of an official recognition of an agency, whereby the Ministry of Finance enters an agency into the relevant register based on certain criteria. It should be stressed that we are taking about a voluntary accreditation.

Both Russian and international rating agencies can apply for an accreditation with the Ministry of Finance, but the latter should be acting strictly via their Russian divisions (representative offices or branches) or via an affiliated Russian company (in other words, to be accredited, a rating agency should be formally present in Russia). The same accreditation procedure applies to both.

In order to obtain an accreditation an agency should submit an application enclosed with a set of documents and materials including its incorporation and registration documents as well as balance sheets and other financial statements for the past two years; the list of its major owners (holding no less than 5% in the applicant); an organisation chart of the applicant's entities; details of the rating scale and methodology used by the agency; the rating process and all of its stages and applicable rules; the list of valid and published credit ratings awarded to Russian companies; a sample rating contract with the rated subject; details of clients who account for more than 10% in the agency's total annual income; details of any ratings awarded to affiliated entities etc etc – the list is quite extensive.

An agency that expects to be accredited should have awarded at least 20 valid “contact” credit ratings (i.e. ratings issued to the rated entity under a contract with that entity, inter alia on the basis of information provided by the latter) including at least 10 ratings awarded to issuers. It is implied that by the time of application the agency would have been in the business of awarding contact credit ratings to Russian companies for 2 years. An agency is supposed to follow its own code of conduct, or one generally accepted in the industry, as well as the credit rating method and process; it is expected to ensure transparency of its operations (by maintaining and publishing relevant
information on the agency’s official website in the Internet) and so on. Judging by the comments in the industry, these requirements and criteria in general did not come as a surprise to the rating agencies as, in one way or another, they are based on the established international and Russian practices in this field.

The Ministry of Finance has 30 days to make a decision regarding accreditation. It has the right to refuse the accreditation of any rating agency that failed to provide the required information in full or does not meet the established criteria.

Once a rating agency is included in the register, it will be further monitored by the Ministry of Finance in accordance with the approved procedure, which includes a set of rules relating to regular disclosure of relevant information (such as financial statements, any change in the foundation documents, management or ownership, the list of major clients etc) to the Ministry of Finance.

An agency’s accreditation can be terminated either at the agency’s own request, in the event of the agency has failed to comply with the established criteria (it is established by way of a separate express provision that accreditation will be terminated where the total number of valid contact ratings issued by an agency goes down to 15 or less or the number of ratings awarded to issuers goes down to 7 or less) or repeatedly violated the rules governing the disclosure of information to the Ministry of Finance.

According to the existing market players, the introduction of the accreditation system in fact can be seen as official recognition of this industry in Russia. Accreditation is meant to imply that the state recognizes a particular agency as competent and its evaluations as correct. This should help resolve the problems of uncertainty that exist in the industry, generally raise the level of trust in rating agencies and change the situation in which companies that issue reliability ratings to market players are not themselves subject to any control. Russian agencies may also expect that the accreditation with the Ministry of Finance would raise their significance and perhaps facilitate their recognition internationally, while possibly reducing to some extent the dependence of Russian businesses on foreign rating agencies.