Our May Newsletter covers a range of topics that have significant practical implications for the business community in Russia.

Yulia Babkina comments on the most recent developments in Russian regulations applying to construction activities in Russia. Russia operates a system whereby nearly every company that proposes to carry out construction works in Russia (both onshore and offshore) must first join a self-regulated organisation. The procedure is not always straightforward, and Yulia's piece is a useful guidance for investors looking to implement construction projects in Russia. Readers interested in this subject should also read our Newsletter for June 2010 which talks about this legal framework which replaced the old licensing regime.

Igor Orlov writes about some newly proposed amendments to the Civil Code which would require for corporate decisions and attendance at general meetings of a Russian joint stock company to be certified either by a Russian notary or in some other way. If adopted, this piece of legislation would further enhance the role of notaries in the corporate life of Russian companies. This is not a development that is universally welcomed by Russian legal practitioners, because in practice Russian notaries already often end up dictating terms of transactions to commercial parties. Further involvement of notaries could cause delays and make decision-making process more expensive for Russian companies.

Dmitry Milyutin discusses the Federal Service for Intellectual Property recently formed by the Presidential order dated 24 May 2011. The main purpose of establishing the Federal Service was to create a comprehensive and efficient mechanism for the management and protection of state-owned intellectual property, based on a clear distribution of functions between public bodies. Hopefully, the creation of this body will assist in the process of fighting intellectual piracy and other infringements of intellectual property rights in Russia.

Finally, our insurance expert, Polina Kondratyuk has written an article with a rather intriguing title “The insured does not always pay”. Read her article to find out if this is indeed the case and what the consequences of such failure to always pay under Russian law are likely to be.

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New regulation liberalised SRO membership criteria in Russia

Yulia Babkina, Associate

On 12 April 2011 Regulation No.207 of the Government of the Russian Federation dated 24 March 2011 became effective. The Regulation is entitled "On minimum eligibility requirements for a self-regulatory organisation to issue competency certificates in respect of highly dangerous and technically complex capital construction projects affecting the safety of said projects". It was issued to replace an earlier regulation of the Government, Regulation No.48 dated 3 February 2010 which is now repealed.

It must be said that this is the first conceptual regulatory act in the short history of Russian self-regulation. This act was initiated by the presidents of three National Associations (construction industry workers, designers and surveyors) and is based on the experience gained by Russian self-regulatory organisations (SROs) over the last year.

This regulation sets out a list of minimum requirements that a company or an individual must meet in order to be eligible for a competency certificate issued by as SRO. A competency certificate serves as a permission to perform work of one or more categories as listed below where such work affects safety of a nuclear energy project or another highly dangerous and technically complex project:

- construction,
- reconstruction,
- overhaul of capital construction projects,
- preparation of design documentation, and
- engineering surveys.

It should be noted that the requirements set out in the regulation represent the minimum standard, and individual SROs are free to issue their own policies to introduce additional eligibility requirements. However in fact Partnership Boards of the majority of SROs have approved the minimum requirements fully in line with the Regulation.

In accordance with the Regulation different criteria apply depending on the type of work which the applicant seeks permission to perform, and on the project whose safety may be affected by this work.

It is interesting that the Regulation applies exclusively to work performed on highly dangerous and technically complex projects, whereas the previous regulation (No.48 dated 3 February 2010) also extended to unique projects. This reflects the changes made to Part 9 Art. 55.5 of the Town Planning Code of the Russian Federation. Thus it is unclear whether any work affecting the safety of a unique project may be carried out under a competency certificate that does not include the "highly hazardous and technically complex" category. Future application of the Regulation may give an answer to this question.

Apart from that, regulation No.48 dated 3 February 2010 established equal minimum requirements for all types of work regardless of the type of highly dangerous, technically complex or unique projects. In contrast, the new Regulation distinguishes between the following:

- capital construction projects which affect the safety of nuclear energy facilities; and
- highly dangerous and technically complex projects (other than nuclear energy projects).
The minimum eligibility requirements for competency certificates vary respectively.

In relation to highly dangerous and technically complex projects (other than nuclear energy projects) the Regulation has relaxed the personnel requirements that must be met by an applicant. Moreover, the required number of employees no longer depends on the number of different types of work the applicant seeks to perform under the competency certificate.

Where the type of work applied for is "the management of the design documentation process", "the management of construction operations" (a general contractor's function), or reconstruction and overhaul in respect of highly dangerous and technically complex projects, the personnel requirements vary depending on the price of a single contract for the performance of such works (the higher is the price, the higher are the qualification requirements and the higher number of appropriately qualified employees must be engaged to do the work). At the same time where an applicant seeks to obtain a certificate that would cover more than one type of work, he may now use one and the same expert for more than one type of work.

When work is performed which affects safety of a nuclear energy facility, the total number of workers still depends, among other things, on the number of types of work the applicant seeks to get a certificate for and the calculation is made on the basis of a special formula.

In general it can be observed that the new Regulation of the Government recognises the trend towards liberalisation of SRO membership requirements and simpler SRO admission procedures in Russia for obtaining competency certificates in relation to various types of works on highly dangerous and technically complex construction projects.

Notaries and corporate practice: new trends

Igor Orlov, Senior Associate

One bill which the president is expected to present to the State Duma is a new edition of the Civil Code, which provides among other things that corporate decisions and attendance at general meetings of a Russian joint stock company must be certified either by notary or in some other way.

This proposal received a great deal of interest from Russian lawyers, in particular, corporate counsel and other legal practitioners who deal, in one way or another, with the practical side of the matters regulated by Russian company law: recently the role of notaries in these matters changed from optional and occasional to mandatory in some cases. For instance, from 1 June 2009 onwards any transaction involving the sale of a participation interest or a part thereof, in a Russian limited liability company, must be notarized, subject to some exceptions expressly permitted in the statute. A notary must be engaged not only to certify the sale and purchase agreement in respect of the participation interest or a part thereof, in a Russian limited liability company, must be notarized, subject to some exceptions expressly permitted in the statute. A notary must be engaged not only to certify the sale and purchase agreement in respect of the participation interest, but also to perform a notarial function of submitting to the relevant registration authority an application (signed by a member of such limited company and enclosed with a copy of the underlying sale and purchase agreement) to make relevant amendments in the trade register (Unified State Register of Legal Entities). Unless otherwise agreed by the parties, the notary shall also notify the company of the fact that the transaction has been made. Since the time when notarial certification became compulsory for such transactions, both lawyers and members of limited liability companies have been able to experience first hand the full extent of the positive and negative consequences of this new rule. It was not without difficulty that this rule came to be applied in actual practice, and its application still remains patchy today (even now one can still meet a notary who prefers to stay away from
certifying this type of transactions). On the one hand, parties involved in these transactions (i.e. former and current members of limited liability companies) feel more secure now and it is notably more difficult to challenge a transaction which was certified by a notary. Moreover, notaries undertake their own due diligence investigation into each such transaction to see if it is legally sound, doing the job of the parties' legal advisers, to an extent. On the other hand, it has become more difficult to prepare and manage a transaction, as time and other costs have increased significantly. Notaries have invoked their statutory liability for notarial actions to assert a position of control over the parties in the course of a transaction, and in practice they have come to determine not only the transaction process, but also in many cases the terms of sale and purchase agreements being made.

Now it seems that joint stock companies, too, will not avoid regular contacts with notaries, albeit for slightly different reasons. The proposed changes are only a part of the envisaged reform that will see notaries' powers grow and their work get more complex, their responsibilities increase and their liability rise. The draft bill was first published in its initial form in November 2010. The proposed amendments to the Civil Code which relate to the status and powers of notaries and their participation in corporate life (by certification of transactions and corporate decisions, and other functions) are connected to each other and rather coherent as they are part of an even more fundamental reform of civil law which aims, among other things, at the harmonisation between the legal systems of the Russian Federation and the European Union.

Currently in fact shareholders are free to invite a notary to their meeting for a notary to perform some notarial acts, however the proposed legislation would make notary's participation a statutory requirement.

The proposed changes are a source of concern for interested public as many share an opinion that they could cause more problems than they solve. To give an example, annual meetings in joint stock companies are usually held at around the same time in the year – between the start of the second and the end of the sixth month following the end of a financial year (i.e. spring to mid-summer, and in practice, from April to June) – it is not difficult to see how much workload the country’s notaries will have during that time, given that they already struggle coping with the vast number of share transfer transactions in limited liability companies, as notaries themselves are first to admit. It may happen that there will be simply not enough notaries: some commentators have made a calculation, based on the number of registered joint stock companies and notaries, that shows that during the "busy season" each notary will have to attend up to eight shareholders' meetings a day.

It is apparent that notaries' services will add substantial extra costs to companies, and not all of joint stock companies are large publically traded corporations for whom such costs will be insignificant. Besides, it is generally believed that the notaries' fees for relevant services are likely to rise as soon as notarisation becomes compulsory. It is not clear how notaries will be dealing in practice with shareholders, corporate management bodies, and, first of all, with corporate ballot committees whose powers and functions are similar to theirs. Finally, some argue, not without some cynicism, that essentially the presence of a notary will not necessarily make a big difference, as shareholders and other interested parties may “come to an arrangement” with the notary.

I would like to believe that in the end the presence of a notary is not the only possible way to confirm the presence of shareholders at and the results of a general meeting. As mentioned above, the draft bill also refers to "other ways" of certifying these facts. No explanation is given as to what "other ways" will be appropriate, but most likely, this would involve video or audio recording – these suggestions have been voiced by members of the government connected to this bill. In general, this approach ties in with the latest trends in the Russian legislation and legal practice (for example, there is a bill the Supreme Court is expected to present to the State Duma proposing to establish a single information space for courts which includes a compulsory video recording of court hearings). An
overwhelming majority of experts believe that notarisation should not become compulsory and companies should have other more accessible alternative courses of action. However, clearly, participation of a notary and the availability of their evidence may be of crucial importance and great benefit to the party seeking to rely on them when a shareholders’ decision is being challenged.


Dmitry Milyutin, Senior Associate

On 24 May 2011 President of the Russian Federation Dmitry Medvedev signed Order No.673 “On the Federal Service for Intellectual Property”. The major purpose for establishing the Federal Service was to create a comprehensive and efficient mechanism for the management and protection of state-owned intellectual property, based on a clear distribution of functions between public bodies.

Pursuant to the Order of the President, the service to be created will become the successor to the Federal Service for Intellectual Property, Patents and Trade Marks (Rospatent) and the Ministry of Justice (to the extent the latter was involved in protecting the interests of the state in the economic and civil-law-regulated movement of intellectual property in the market, inter alia in relation to obligations arising as a result of the enforcement of court judgements) - the new Federal Service will take over the functions currently performed by one of the arms of the Ministry of Justice, the Federal Agency for the Legal Protection of Intellectual Property (FAPRID), that will be dissolved.

Until recently Rospatent, an agency subordinated to the Ministry of Education and Science, was the body overseeing the operation of intellectual property rights in the economic and civil sphere. FAPRID, established in 1998 and subordinated to the Ministry of Justice, was the body responsible for the legal protection of the state’s interests in respect of military, special purpose and dual purpose IP.

In accordance with the Presidential Order the Federal Service for Intellectual Property will be tasked with the following:

• control and supervision in the sphere of legal protection and use of civil, military, special purpose and dual purpose IP that has been created using funds of the federal budget as well as control and supervision over the operations in the said sphere of public sector customers and contractors under public procurement contracts, where such contracts provide for performance of research and development or technological works.
• provision of relevant public services; and
• functions of a regulatory body in relation to matters of control, supervision and provision of public services in the said sphere of activities.

The Order takes effect from the date of signing.

It would be recalled that Russia is on the list of countries with significant difficulties in the area of IP protection and that ensuring compliance with the rules relating to the use of IP is one of the country’s immediate needs.

Dmitry Medvedev has stated on many occasions that the protection of copyright and IP rights is a highest priority for the Russian Federation. In his opinion, no easy answers can
be given in an international discussion to the difficult questions about copyright and IP protection in Russia and this hampers Russia’s WTO accession.

At the end of April 2011 the President already instructed the presidential administration to join forces with the judiciary and the expert community and look into creating a special court for intellectual property matters. It is proposed that such a court could be placed in Skolkovo.

In the beginning of May the USA made a statement in which Russia was named among the 12 countries that offer insufficient protection to intellectual property rights. Russia has been on this list for 14 years now. Inclusion on the list carries no threat of sanctions for the country, but serves to remind the country that a more active approach should be taken in combating intellectual piracy. Thus, on the first days of March the US Trade Representative’s office turned its attention to the social networking site "VKontakte" and included it into the international "black list" of internet resources that provide access to infringing materials.

It should be noted that a number of laws protecting intellectual property has been passed in Russia in the recent years, and Part IV of the Russian Civil Code has taken effect and remains in force since 2008, which governs legal relationships in the sphere of intellectual property.

Experts see the establishment of the Federal Service as a positive development for intellectual property protection in Russia as the Service would consolidate governmental resources in a single public body and is expected to strengthen the state control over the use of intellectual property, including publically funded IP. On the other hand, along with industrial property, there is an urgent need for addressing copyright protection issues as vast numbers of copyright violations are observed in that area. In the opinion of the experts, the efforts of the Ministry of Culture did not bring the expected results. On a more general note, it is observed that Russia needs a coherent public policy in the sphere of intellectual property which the leading countries of the world have developed a long time ago.

The insured does not always pay

Polina Kondratyuk, Advocate

It is common knowledge that insurance is a paid service. In return for an insurance premium paid at the time and in the manner set out in the insurance agreement, the insured or the beneficiary gets peace of mind, having shifted their risks onto the insurer. As for the insurer, he is entitled to a relevant compensation for taking on the risks of the insured. Article 954 of the Russian Civil Code, Insurance Premium and Insurance Fees, provides that the parties are free to choose the manner in which the insurance premium will be paid. Since insurance premiums may be quite substantial, it is not uncommon that parties agree on the payment of insurance premium in instalments.

However, with such a term in their contract, insurers often have to deal with a situation where the insured is unwilling to pay the premium stipulated by the contract. Usually a problem like this occurs closer to the end of the contract.

So there is a paradoxical situation – the insured pays the first part of the premium and then stops paying. If the insured event occurs, the insured makes a claim under the insurance contract, and if the insured event does not occur, the insured then simply chooses to
"forgive" the debt he owes to the insurer and keep the outstanding amounts of the premium. Why pay? The contract has ended, nothing has happened and it may look like there is nothing to pay for.

The statistics show that the insureds underpay 10 to 20% of the total amount of insurance premiums. At the same time insurance companies rarely seek to enforce such contracts in court, for a number of reasons, including the fear of losing a client (where large scale risks are insured) and pragmatic considerations as litigation may not be a cost effective solution for smaller debts.

Therefore even the "strong side", the insurer, needs protection from bad faith conduct of the insured.

The existing legislation and court practice reveal the lack of consistency in the way they determine the consequences of default on the payment of a part of the insurance premium. This gives rise to a vast number of court disputes. In my view the legislator should leave less freedom to the parties and prescribe specific consequences in a statute to eliminate any uncertainty.

As an option, it could be stipulated that a default on a premium instalment constitutes a "unilateral refusal" by the insured to perform under the contract. This would rule out a situation where the premium was not paid but a claim for compensation is made against the insurer.

Currently Art 954(3) of the Russian Civil Code allows the parties to negotiate and agree on the effects of such default on a premium instalment.

It is not uncommon that an insurance contract provides for the termination of the contract in the event of a default on a premium instalment. Penalty provisions are also widely used. An insurance contract may also provide that the period by which the payment is delayed shall be excluded from the insurance coverage.

There are different ways in which courts have dealt with clauses providing that a party's default on a premium instalment terminates an insurance contract.

Supreme Arbitrazh Court in s.16 of its Information Letter No.75 provides that, where the parties have agreed for the insurance premium to be paid in instalments, and the insurance contract purports to terminate automatically as soon as the insured defaults on a due and payable premium instalment, the insurer will not be excused from having to complete his own obligations without notifying the insured of his intention to discontinue performance of the contract.

In the case commented on in the Information Letter, the insurance policy provided that in the event of a late payment of an insurance premium the insurer would be excused from his obligation to pay insurance compensation and the contract would be deemed to have been terminated. The court took the side of the insured and pointed to the fact that the insurer had not exercised his right of "unilateral refusal" to perform the contract and had given no indication to the insured that he was disposed to discontinue performance.

In its determination dated 20 November 2008, case № А43-28038/2007, the Supreme Arbitrazh Court took an altogether different approach and upheld the decision of the lower courts, which had held that the insurer was not liable to pay insurance compensation and accepted that an insurance contract may terminate automatically if the insured failed to pay the next premium instalment on time.
It appears that the Federal Arbitrazh Court of the Central District shares the same view: its decision dated 2 November 2009 in matter No. A36-553/2009 indicates that a "unilateral refusal" to perform a contract, where such refusal is permitted by law or by contract, is an event that may cause the contract to be terminated or varied. Therefore, the insurer does not need to take any additional steps to terminate if it was agreed that a default on the payment of an insurance premium would amount to termination of the contract.

Therefore courts are moving toward recognizing a possibility of automatic termination of insurance contracts, without any additional steps on the part of the insurer, where the contract contains a respective provision and does not require any additional steps to give effect to such termination.

In my opinion such judicial practice improves the transparency of insurance business and the liability of all players as agreements must be kept and it is not only the insurer who must pay (once the insured event occurs); the insured must also pay – for the insurance service.

In the end I would like to discuss a relevant case which I hope would be interesting not only for me to follow as it progresses through the courts.

Arbitration case No. А41-15438/10 involves a discussion of a term frequently found in Russian insurance contracts, the "suspension of insurance coverage" for the period of delay in the payment of insurance contributions.

In this case a court of cassation appeal instructed a lower court to investigate in the new trial the legal effect of "suspending insurance coverage" for the period of default on premium payments. In fact, a court was asked to construe whether the suspension operates to extinguish the insurer's obligation to pay compensation in respect of an insured event that occurred while the insured was in default, or the obligation to pay does arise but the performance is not due until the overdue premium payment is made. The next hearing of this case, at which a decision may be handed down, has been scheduled for 29 June 2011 in the Arbitrazh Court of the Moscow Region.