This edition concentrates on insurance and draft amendments to the Russian Civil Code which will have an impact on corporate entities and developers of unauthorized constructions.

Igor Orlov delves into the draft amendments to the Civil Code and provides a succinct commentary on the proposed substantial alterations and additions to the general provisions on legal entities which, amongst others, will affect registration, corporate governance, shareholder rights, and the redefining of “affiliation” and “controller” for the purpose of anti-monopoly laws, which latter raises the possibility of “piercing the corporate veil” type applications before the courts.

Dmitry Milyutin presents us with a summary of the draft law on mutual insurance for developers involved in participatory construction of apartment blocks (the forward sale of property under construction) which passed its first reading on 4 July 2012. If this law is enacted, it will provide some measure of safeguard to investors in participatory construction.

Yulia Babkina introduces us to the redefining of unauthorized constructions in the draft amendments to Civil Code which may provide some comfort to developers whose right of lease of the land on which a construction is being erected may expire before completion of the construction.

Máire Ní Aodha provides a reminder of the significant provisions of the law on compulsory insurance for civil liability of hazardous objects with the enactment of the provisions relating to professional insurers association on 1 July 2012.

Contents
Commercial legal entities - what’s new? Page 2
Mutual insurance for civil liability of fund raisers for investors in participatory construction of apartment blocks Page 4
Novelties in the field of legal regulation of unauthorized construction Page 6
Compulsory insurance of hazardous objects for civil liability Page 7
Commercial legal entities – what’s new?

Igor Orlov, Senior Associate

The draft Federal Law No. 47538-6 “On Introducing Amendments to Parts One, Two, Three and Four of the Civil Code of the Russian Federation and to some legislative acts of the Russian Federation” (currently with revisions approved by the State Duma of the Federal Assembly of the RF in the first reading on 27.04.2012) (“the Draft”) introduces, inter alia, significant alterations relating to commercial legal entities in Russia.

Commercial legal entities, (i.e. entities, the main objective of which is profit making), can still be established in organizational and legal forms of business partnerships and companies, business associations, producers’ cooperatives, public and municipal unitary enterprises. At first glance there are no fundamental changes in the list (in contrast to non-commercial organizations). However, as the Draft stipulates for the division of legal entities into corporate entities (founders/members of which have a right to take part in the management of their activity (right of membership)) and unitary entities (founders of which do not become their members and do not acquire a right of membership), it is established that business partnerships, business companies and producers’ cooperatives are referred to as corporate commercial entities, or corporations, and public and municipal unitary enterprises as unitary entities (articles 50, 65.1 in the revision of the Draft). That is to say, virtually all commercial entities are considered to be corporations, except for unitary enterprises. Let us consider the main innovations related to corporations.

The Draft introduces substantial alterations and additions to the general provisions on legal entities and introduces many general regulations related to corporations in particular.

Thus, some of the general provisions now regulate, for instance:

• The issues of form and content of a decision to establish a legal entity (new article 50.1 of the Civil Code)
• Liability of a person authorized to act on behalf of a legal entity, members of collegial bodies of a legal entity and persons deciding on the actions of a legal entity (new article 50.3 of the Civil Code) – in the first place, obligation of such persons to act reasonably and in good faith in the interests of a legal entity is set out, and in the second place, liability of such persons to a legal entity if they acted unreasonably or not in good faith is set out in the form of compensation for the respective damages, and it is not possible to exclude or limit such liability
• The Draft also introduces general provisions related to affiliation, control and liability of persons who control a legal entity (new respective articles 53.2, 53.3 and 53.4 of the Civil Code). We note that these provisions are aimed at the introduction of uniform regulation of this issue and, in particular, the replacement of the relevant rules on affiliation of the Law of the Russian Soviet Federative Socialist Republic (RSFSR) dated 22 March 1991 No. 948-1 “On Competition and Restriction of Monopolistic Activity at Product Markets”. The Draft stipulates for a different, presumably more up-to-date, list of grounds for affiliation establishment, and for an opportunity for a court to acknowledge an affiliation between entities, in spite of the lack of above mentioned grounds, if an actual possibility to influence a legal entity as a result of coordinated activities of relevant persons is proved. Furthermore, the Draft determines a notion of “controller” (together with a relevant list of grounds to acquire this status) namely, persons who directly or indirectly (through third parties), independently or together with their associates (affiliates) have an opportunity to determine actions (decisions) of a legal entity, and specifies certain circumstances for both joint liability of a controller for debts of a controlled entity and the right of a controlled entity or its members to claim damages inflicted on the controlled entity by a controller. That it to say, it is an attempt to implement the principle of “piercing the corporate veil” for persons who control the activity of a legal entity – they will have no opportunity at all to refer to autonomy of activities or independence of legal entities.

The Draft changes the regulations related to certain aspects of registration of legal entities and unified state register of legal entities (EGRUL) (new revision of article 51 of the Civil Code. For instance:

• Third parties are now entitled to rely in good faith on the validity of data contained in EGRUL, and a legal entity itself has no right to refer, in relationship with these parties, to circumstances which are not reflected in the register)
• Constituent documents (now it is a charter only, and legal entities can use standard charters elaborated by authorized bodies; only business partnership act on the basis of Foundation Agreement which has the legal force of a charter – article 52 of the Civil Code)
• Name and location (article 54), reorganization and liquidation of legal entities (for instance, now it is allowed to reorganize two or more legal entities at the same time, including those of different organizational and legal forms
• There is a separate regulation on consequences of reorganization invalidation; a list of grounds for liquidation of a legal entity in a judicial proceeding is introduced, etc.)

and many other general regulations.
We would mention that it is proposed to formalize in the Civil Code a regulation similar to the regulation of article 21.1 of the Federal law dated 08.08.2001 No. 129-FZ “On State Registration of Legal Entities and Individual Entrepreneurs” the possibility to exclude from the state register a legal entity that has virtually stopped its activity (i.e. in the last twelve months has not provided tax reporting documents and has not carried out operations at least with one bank account) (new revision of article 61 of the Civil Code).

Finally, in relation to corporations, as a general regulation the Draft stipulates uniform rights and obligations of the members (including, for instance, an obligation not to disclose confidential information on corporation’s activity and not to perform acts that would harm the interests of the corporation) and uniform rules of corporate management (including, inter alia, regulations on corporate management bodies and their types) (articles 65.2 and 65.3 of the Civil Code in revision of the Draft).

On the whole it appears that the proposed changes considerably increase the responsibility of management bodies and members of legal entities, raise and to a degree regularize the grounds for establishment, reorganization and liquidation of Russian legal entities.

In relation to commercial corporate entities, these are divided into business partnerships (which can be established in the form of general partnership or limited partnership), business companies (joint-stock companies or limited liability companies) and producers’ cooperatives (workmen’s cooperative associations) – this is actually the complete list.

As can be seen, it was decided to abandon closed joint-stock companies, the status of which was very similar to the status of a limited liability company (this is, probably, one of the most debated and predictable innovations in terms of organizational and legal forms) and additional liability companies (which almost did not exist).

Instead of open and closed joint-stock companies as separate forms, a status of public and non-public joint-stock companies is introduced together with respective different regulation. Thus, a public company is a joint-stock company, shares and convertible securities of which are publicly placed (by means of public offering) or publicly outstanding on conditions stipulated by the laws on securities. The rules on public companies are also applied to joint-stock companies, charter and company name of which indicate that the company is public. Special regulation is applied to public companies which stipulates for more transparency in company management, public disclosure of information and reports submission (new article 66.3 of the Civil Code).

The amount of the charter capital of commercial corporations was left at the same minimum level – RUB 10 000 – for all corporations except for joint-stock companies, the minimum charter capital of which is set in the amount of RUB 100 000 (paragraph 2 of article 66.2 of the Civil Code in the revision of the Draft).

The Draft considerably changes the general regulations on rights and obligations of members of business partnerships and companies and their management. We would mention, in particular, inter alia, that the Draft provides the members of business partnerships (or some of them) the right to make an agreement with each other on the exercise of their corporate (membership) rights (corporate agreement), in accordance with which they undertake to exercise those rights in a certain way or to abstain (refuse) from exercising them, including voting in a certain way at a general meeting of members of the company, perform in a coordinated fashion other actions connected with company management, acquire or alienate shares in its charter capital (stocks) at a certain price and/or under certain circumstances or to abstain from alienation of share (stocks) until the occurrence of certain circumstances (new article 67.2 of the Civil Code) – as can be seen, the Draft considerably develops and upgrades a quite recently introduced innovation in Russian legislation – shareholders’ agreement / agreement between participants of an LLC.

It is specified that a corporate agreement can, in some cases, determine the structure of a company’s bodies and their competence (where the law permits such amendment by virtue of the company’s charter).

Members who executed a corporate agreement should notify the company about the fact of execution of this agreement, and if they fail to do so, the members which are not parties to this agreement are entitled to claim damages.

It is an important innovation that from now on according to the Draft a violation of a corporate agreement can be a reason to invalidate decisions of the company’s bodies on an action brought by a party to the agreement, on condition that as of the moment of making such decisions all the members were parties to the corporate agreement, and invalidation of the body’s decision does not violate the rights and interests of third parties. It is also specified that a transaction made by a party to the corporate agreement in violation of this agreement can be held invalid by a court on the action brought by a party to the agreement if the other party to this transaction knew or should have known about the restrictions stipulated by the agreement. Finally, parties to a corporate agreement do not have the right to refer to its invalidity connected with its contradiction to the provisions of a company’s charter. Curiously enough, the law will allow company’s creditors and other third parties, in order to secure their legitimate interests, to make with company’s members agreements similar to a corporate agreement.

It appears to us that the indicated regulations and provisions will help, in the long run, to eliminate existing ambiguities on the status of shareholders’ agreements and will allow members of business corporations to use this important instrument to regulate corporate relationships to the full extent.
On 4 July 2012 the State Duma passed the first reading of the draft federal law “On Mutual Insurance of Civil Liability of Entities which Raise Funds for Participatory Construction of Apartment Blocks (Developers) for Non-Fulfillment (Improper Fulfillment) of Obligations under Contracts for Participatory Construction” (“the Draft Law”).

The Draft Law stipulates that the mutual insurance of civil liability of developers shall be provided solely in favor of a beneficiary, even if the mutual insurance policy is issued to another person or it is not indicated in the policy in whose favor it is issued.

A beneficiary can be an individual and / or a legal entity (except for credit institutions) which has a right to demand from a member of the MIC the transfer of ownership of a housing unit (apartment or room) in an apartment block, or a monetary claim in accordance with the law on insolvency and bankruptcy, and which has a right to receive insurance indemnity in accordance with the Draft Law.

The object of mutual insurance of developers is the property interests of a member of a MIC associated with the risk of its civil liability to the beneficiary, which may occur due to the non-fulfillment (improper fulfillment) of an obligation to transfer the ownership of a housing unit to the beneficiary or to fulfill a monetary claim by a MIC as a result of an insured event.

An insured event, in terms of mutual insurance of developers, is the fact of the closing of the register of creditors’ monetary claims in accordance with paragraph 1 of article 142 of the Federal law “On Insolvency (Bankruptcy)”, if the obligations of a member of the MIC have not been fulfilled in accordance with articles 113 and 125 of the insolvency law or if the demands of participants in participatory construction have not been satisfied in accordance with the procedure stipulated by articles 201.10 and 201.11 of the Federal law “On Insolvency (Bankruptcy)”. A payment of an insurance indemnity under mutual insurance of developers is carried out within the limit of a monetary claim of the beneficiary against the developer in accordance with the Federal law “On Insolvency (Bankruptcy)”.

A MIC which pays an insurance indemnity obtains the right to claim, within the limit of amount paid, which the beneficiary had against the developer in relation to the insured event.

Membership in a MIC of developers starts from the moment when a policy of mutual insurance is issued to the developer. In order to become a member of a MIC the entity which intends to raise funds on the basis of a contract for participatory construction should:

- Provide an application for membership
- Pay membership fee
- Provide other documents stipulated by the Draft Law
A member of a MIC of developers is obliged to insure its property interests with the MIC, comply with the MIC’s charter, implement the decisions of general meeting of the MIC, and timely pay the insurance premium (insurance contributions) and other contributions. In general, the rights and obligations of a MIC’s members are determined by the Draft Law, MIC’s charter and Russian legislation.

In accordance with the Draft Law, the source of the MIC assets are:

- Membership fees paid by members
- Insurance premium (insurance contributions) paid by members
- Additional insurance contributions and other contributions for covering expenses connected with company’s charter activity
- Revenue from investment and use of available funds of insurance reserves and other company’s funds
- Revenue received from permitted types of entrepreneurial activity
- Other income that is not forbidden by law

According to the experts, the Draft Law is intended to provide a basis of insurance by establishing a relatively cheap (in comparison to commercial insurance) unified mutual monetary fund, which will exclude the distribution of profit and other revenue, and achieve the main purpose of insurance, thereby creating a more reliable and acceptable financial system managed by mutual insurance participants with safeguards to protect their property interests.
Novelties in the field of legal regulation of unauthorized construction

Yulia Babkina, Associate

The current edition of the Civil Code of the RF stipulates that an unauthorized construction is a residential building, other building, structure or other immovable property erected on a land plot not designated for such purpose in accordance with the procedure prescribed by law or other legislative acts, or erected without obtaining necessary permits, or in material breach of town planning and construction regulations and rules.

Draft amendments to the Civil Code currently under consideration ("the Draft Civil Code") contains a refined definition of unauthorized construction, in that it is defined as a building or a structure erected on a land plot on which the person who performed construction has no right to build, or erected without necessary permits, or in material breach of town planning and construction regulations and rules. Thus, unlike the current edition of the Civil Code, "other immovable property" facilities are not included in the definition of unauthorized construction, even if they are erected without corresponding rights and permits. However, the legal status of such facilities is not regulated by the Draft Civil Code.

Furthermore, in accordance with the current legislation the person who erected such a building ("Developer") does not acquire a right of ownership to it, is deprived of the opportunity to administer it and is obliged, at its own expense, to return the land plot to its original state by the demolition of the unauthorized construction. In cases specifically stipulated by law only the owner of the land plot can acquire the right of ownership to the construction. The Draft Civil Code stipulates when a Developer may acquire the right of ownership to an unauthorized construction.

Firstly, a Developer’s right of ownership will only be recognized if all the following conditions are satisfied:
- The unauthorized construction in question was erected without material breaches of town planning and construction regulations and rules
- The unauthorized construction was erected on a land plot owned by the state or municipal government
- The Developer has the right to the land plot permitting construction on it

Secondly, a Developer can acquire a right of ownership to an unauthorized construction if it is located on a land plot that belongs to the Developer and there are no grounds for its demolition, (for example, material breach of construction regulations and rules in the course of erection of the building/structure).

Another novelty of the Draft Civil Code is the possibility of reimbursement of damages incurred by the Developer (the lessee of the land plot for the purposes of construction), on the acceptance of the unauthorized construction resulting from the lawful acts of the owner of the land plot. In practice it is quite common that in the process of construction on a rented land plot the owner of the land plot ("Lessor") waives the lease contract, or the contract validity period expires and the Lessor refuses to prolong the contractual arrangements while construction is still underway. In this case a Developer is forced to stop the construction because he will have no legal basis (i.e. lease contract) to perform construction on the land plot.

Articles 39 of the Land Code of the RF and article 271 of the Civil Code provides a right to the land plot to the owner of the facility under construction for the purpose of its redevelopment and operation respectively. However, there is no provision in current legislation which provides for a Developer’s right to complete construction in the absence of the right to a land plot. Moreover, continued construction after the Lessor waived the contract can result in the construction facility constituting an unauthorized construction (paragraph 1 of article 222 of the current edition of the Civil Code).

Furthermore, current legislation does not provide for reimbursement of damages incurred by the Developer, as the waiver of a contract is a lawful act and thus rules out the possibility to recover damages.

In order to protect the Developer’s rights, at least in relationship with state bodies which often support the Lessor, the Draft Civil Code provides for the possibility to recover damages inflicted by the lawful acts of public authorities or their officials.

Finally, the Draft Civil Code provides that the limitation period does not cover claims for the demolition of unauthorized constructions which create a threat to the life and health of people or are erected on a land plot where construction is forbidden by law (paragraph 5 of article 208 of the Draft Civil Code of the RF).

Clearly legal regulation of unauthorized constructions requires further development, but in the current revision of the Draft Civil Code the legislators made certain steps towards specifying the legal status of this phenomenon and stabilizing the Developers’ position.
Compulsory insurance of hazardous objects for civil liability

Máire Ní Aodha, Partner


Certain of the provisions of Law 225 came into force on the date of official publication (Articles 17 to 19 and 21 to 23 inclusive). These provisions regulated the establishment of a professional insurers’ association (“PIA”).

Most of the remaining provisions of Law 225 came into force on 01 January 2012. However, the provisions on the right to compensation payments from the PIA and the obligations to pay compensation by the PIA only came into force on 01 July 2012 (Articles 14 to 16 and Article 20).

There are still some provisions yet to come into force on 01 January 2013 (Article 8.3 and 29.8) and 01 January 2016 (Article 7.10).

This article briefly summarises some of the more relevant provisions of Law 225 for the insurer and owner of hazardous objects.

Application of Law 225

Law 225 does not apply to relations arising as a result of, inter alia, the use of nuclear power or damage to the natural environment (Article 1.2).

Additionally, until 01 January 2013, Law 225 will not apply to state or municipal property financed wholly or in part from the budget and lifts and escalators in apartment houses.

Owner

“Owner” includes owner, lessee, operator, licensee and user (Article 2.4).

Hazardous objects:

“Hazardous objects” include (Article 5)

1. Registered hazardous facilities where:
   - hazardous substances are produced, used, stored, processed, transported or destroyed;
   - equipment is operated under a pressure exceeding 0.07 MPa or at a water temperature exceeding 115°C
   - stationary freight lifting mechanisms, escalators, cableways, and funiculars are used
   - metals / non-ferrous metals are melted and alloys used
   - mining works / underground works are carried out
2. Hydraulic engineering structures subject to recording in the Russian Register of Hydraulic Engineering Structures
3. Petrol stations

Claimant

The persons entitled to claim under the compulsory insurance include:

1. Employees and third parties for health, life and property damage (Article 2.1)
2. The property of legal entities which is damaged as a result of an accident at the hazardous facility (Article 2.1)
3. In case of death of a “breadwinner”, the persons identified under Article 1088 of the Civil Code (Article 2.1)
4. A person whose living conditions are due to damage to property or a threat to life or health has arisen as a result of the accident (Article 2.3)

A claimant can present a claim directly to the insurer (Article 8).

Owner’s obligations

The Owner is obliged to maintain the insurance for the entire period of the operation of the hazardous facility (Article 4.1), with minimum period of cover being one year (Article 10.1).

Compulsory insurance must be in place before the commissioning of a hazardous object (Article 4.2).

Owner’s Liability

If the amount of damage exceeds the maximum amount of the insurance payment permitted under Article 6.2 of Law 225, the Owner is liable for the shortfall (Article 8.3).

Amount of cover / insurance payments / insurance premium

The amount of cover, insurance payments and insurance premium are fixed under Law 225.

The amount of cover is calculated on the basis of the number of potential victims from an accident at the hazardous facility.

For facilities which require a declaration of industrial safety or safety of hydrotechnical, the amounts range between 6.5 billion and 10 million rubles (Article 6.1).

For hazardous objects which do not require such declaration, the amount of cover ranges between 50 million (for production facilities in chemical / petrochemical / oil refining industry), 25 million (for gas consumption / supply networks) and 10 million (for other hazardous objects) rubles (Article 6.2).
In respect of insurance payments to claimants (Article 6.2), these are fixed at:

(a) 2 million rubles to persons who sustained losses as a result of the death of each victim (breadwinner)
(b) 25 thousand rubles maximum for burial
(c) 2 million rubles maximum for damage to health;
(d) 200 thousand rubles maximum per person whose residence is affected due to damage to property or threat to health or life
(e) 360 thousand rubles maximum per person for damage to property of natural person, except for damage inflicted in connection with (d) above
(f) 500 thousand rubles maximum per legal entity for damage to property

The premium is calculated by reference to the amount of cover and tariffs established by Federal Law, and takes into account potential harm as a result of an accident, the maximum number of potential victims and any history of incidents (Article 7).

Law 225 includes risks excluded from cover and aggregation of claims (Article 8.8 to 8.11 inclusive).

Time limit for claims
The time limit for claims under Law 225 compulsory insurance is 3 years (Article 10.8).

Insurer’s right against Insured
The Insurer has a right of claim against the insured where the insured failed to comply with an instruction or direction of the Federal Executive Body responsible for control, supervision and security of hazardous objects (i.e. Rostechnadzor) and / or of the Federal Executive Body responsible for the protection of the population / territories from emergency situations and also where the premeditated action or omission of the insurer’s workers caused harm (Article 13).

Insurer’s obligation to report
The insurer must report information on concluded, extended and invalidated contracts of insurance to Rostechnadzor (Article 12.2.4)).

PIA Role
The PIA is essentially a self regulating organization with rules and standards for insurers, which regulates the provision of compulsory insurance (Article 17).

Insurers providing compulsory insurance on hazardous objects must become a member of a PIA. Further the members of the PIA must form a re-insurance pool to reinsure the civil liability risks of the owner of hazardous objects (Article 23.1).

The functions and powers of the PIA are set out in Article 18 of Law 225, with the standard and rules for professional activity specified in Article 19. The principal role of the PIA is to financially maintain and secure the performance of the insurers’ payment obligations by making compensation payments where, for the reasons set out below, an insurance payment is not possible.

The Charter of a PIA must include a provision specifying the PIA’s obligation to pay compensation payments to the insured when the member of the PIA (the insurer) is not in a position to perform its obligation for the reasons listed in the following paragraphs.

A natural person who sustained harm as a result of a hazardous accident may seek compensation from the PIA where payment under the compulsory insurance cannot be made as a result of:
1. Bankruptcy of the insurer
2. Withdrawal of insurance licence
3. Failure to identify the party responsible for the damage
4. Absence of a compulsory insurance contract

However, legal entities are only entitled to compensation from the PIA where the circumstances of 1 and / or 2 are satisfied.

The amount of compensation payments are the same as those for insurance payments under Article 6.2 and are reduced by any partial recompense received from the insurer or insured.

The PIA is entitled to claim regress for compensation paid and outlay expended from the person responsible for the harm and the PIA obtains subrogation rights under the compulsory insurance up to the amount of compensation paid (Article 16).

Consequences of failure to obtain / maintain compulsory insurance for hazardous objects
The owner is not permitted to commission a hazardous object in the absence of compulsory insurance (Article 4.2).
Both owner and officers are personally liable for failure to obtain / maintain compulsory insurance (Article 4.3).

Absence of compulsory insurance for hazardous objects is an offence under Article 19 of the Administrative Offences Code. The penalty for such offence is an administrative fine between 15 thousand and 20 thousand rubles on authorized persons and between 300 thousand and 500 thousand on legal entities.

Additionally, the operation / activity of a hazardous object may be suspended for a period up to 90 days.
Further information
If you would like further information on any issue raised in this newsletter please contact:

Máire Ní Aodha
maire.niaodha@clydeco.ru

Clyde & Co LLP accepts no responsibility for loss occasioned to any person acting or refraining from acting as a result of material contained in this summary.

No part of this summary may be used, reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, reading or otherwise without the prior permission of Clyde & Co LLP.