

CHANGES TO RUSSIAN CORPORATE LAW:
ADDITIONAL PROTECTION OF CREDITORS' RIGHTS
UPON REDUCTION OF CHARTER CAPITAL AND
INTRODUCTION OF NEW FEDERAL REGISTER

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To Our Clients and Friends:

On July 20, 2011 the President of the Russian Federation signed into law Federal Law No. 228-FZ dated July 18, 2011 on Amendment of Certain Legislative Acts of the Russian Federation Revising Methods to Protect Creditors' Rights Upon Reduction of Charter Capital and Requirements to be met by Commercial Entities in the Event of a Disparity Between Charter Capital and Net Asset Value ("Law 228-FZ").

Law 228-FZ is aimed primarily at improving regulation of the procedure for the reduction of the charter capital of limited liability companies ("LLCs") and boosting the protection of creditors' rights upon a reduction in the charter capital of an LLC in the event of a disparity between the level of charter capital and the net asset value of the company. Law 228-FZ essentially introduces for LLCs many of the provisions that already apply for joint stock companies ("JSCs"). Furthermore, there is provision for the introduction of a new Unified Federal Register of Information on the Operations of Legal Entities in addition to the existing Unified State Register of Legal Entities.

Most of the provisions of Law 228-FZ come into effect from January 1, 2012, with the exception of provisions relating to the new Unified Federal Register of Information on the Operations of Legal Entities, which come into effect from January 1, 2013.

Below we provide an overall summary of the provisions of Law 228-FZ.

PROTECTION OF CREDITORS' RIGHTS UPON REDUCTION
OF CHARTER CAPITAL: PRINCIPAL CHANGES

Notification of reduction in the charter capital of an LLC

The procedure for notification by the company of its adoption of a resolution to reduce charter capital by any of the available means has been amended: instead of notifying each known creditor of the LLC personally in writing and publishing an announcement once within 30 days

from adoption of the resolution, Law 228-FZ – by analogy with the procedure applicable for JSCs¹ – provides for notification as follows:

- the company files a notice of the resolution with the authority responsible for state registration of legal entities (the relevant inspectorate of the Federal Tax Service of Russia) within three business days, and
- the company publishes a notice on the reduction of its charter capital in the established print media, publishing information on state registration of legal entities² twice, separated by an interval of one month, with the first announcement published within three business days after adoption of the resolution.

Claims of creditors of an LLC

Upon the reduction of the charter capital of an LLC by any of the available means, the creditors of the company may require acceleration of the obligations of the LLC or the termination thereof and reimbursement for associated losses (in accordance with Law 228-FZ, the latter option becomes available if acceleration is not possible). Law 228-FZ clarifies the procedure by which creditors of an LLC are to pursue their claims against the LLC in connection with a resolution on the reduction of charter capital (by analogy with the procedure in a JSC):

- a creditor may only bring a claim if the basis for the claim arose prior to the (first) publication of the announcement of the reduction of charter capital;
- the claim must be lodged within 30 days of the last publication of such announcement;
- the statute of limitations for creditors' claims is limited to six months³ from the date of the last publication of such announcement.

¹ The relevant changes were introduced by Federal Law No. 352-FZ dated December 27, 2009.

² This information is published in the *Vestnik gosudarstvennoy registratsii* and in part on the Internet web site of the Federal Tax Service of Russia (www.nalog.ru) (see Order No. SAE-3-09/355@ of the Federal Tax Service dated June 16, 2006).

³ Currently, a general statute of limitations of three years applies.

As in the case of a JSC, Law 228-FZ introduces new rules whereby the court hearing the claim of a creditor of an LLC for acceleration of the obligations of the LLC or the termination thereof and reimbursement for associated losses may dismiss the claim if the LLC can prove that:

- creditors' rights are not violated as a result of the reduction of the charter capital of the LLC,
- the security provided is sufficient for the due performance of the relevant obligation.

Reduction of charter capital of an LLC if net asset value falls

Law 228-FZ changes the provisions governing mandatory reduction in the charter capital of an LLC if the net asset value of the LLC falls below charter capital. The new provisions duplicate those established for a JSC.

Thus, the length of time that a company's net asset value may remain below the level of charter capital without the company having to adopt a resolution on the reduction of charter capital to a level not exceeding net asset value, or on liquidation of the company, has been increased. Under Law 228-FZ a resolution on one of the above options must be adopted only if net asset value remains below the level of charter capital upon results of two consecutive financial years (starting from the second year of incorporation of the LLC). In addition, Law 228-FZ establishes a period of six months within which the company must adopt one of the above two resolutions. At present, an LLC is required to reduce its charter capital if the results of any financial year (starting from the second year of incorporation of the LLC) show that net asset value has fallen below the level of charter capital.⁴

At the same time, Law 228-FZ excludes the right of the creditors of an LLC to require acceleration of the obligations of the company or the termination thereof and reimbursement for losses, and excludes the right of the competent governmental authorities are prevented to seek in court a liquidation of the company if the company does not adopt a resolution on the reduction of its charter capital or its liquidation should net asset value fall below the level of charter capital. It is worth noting that these provisions continue to apply in the case of a JSC, which makes good sense (Art. 35.12 of Federal Law No. 208-FZ on Joint Stock Companies dated December 26, 1995).⁵

⁴ Please note that the Civil Code of the Russian Federation (Art. 90.4) has not been amended; in all likelihood, the relevant amendments will be introduced to the Civil Code prior to the entry into force of Law 228-FZ (by January 1, 2012).

⁵ Governmental/ municipal authorities may seek in court a liquidation of an LLC pursuant to Art. 61.2 of the Civil Code of the Russian Federation in connection with a "gross violation of the law", being failure by the LLC to adopt a resolution on the reduction of its charter capital or on its liquidation. The petitioner must prove that the violation is a gross violation; from the standpoint of judicial practice, if a violation can be rectified, the

Net assets: determination and disclosure

While corporate law engages with the concept of “net assets”, the term is defined in subordinate legislation. At the present time criteria defining net asset value exist only for JSCs, and these are applied to LLCs by analogy.

As a general rule, the net asset value of a JSC is understood to mean the difference between the value of balance sheet assets of the JSC (that are taken into account) and the value of balance sheet liabilities of the JSC (that are taken into account).⁶

Law 228-FZ sets forth that the procedure for the determination of the net asset value of JSCs (other than credit institutions) is to be established, as a general rule, by the Ministry of Finance of Russia and the Federal Service for Financial Markets, while the procedure for the determination of the net asset value of LLCs (other than credit institutions) is to be established by the federal executive body empowered to do so by the Russian Government. With due consideration given to established court practice and applicable subordinate legislation, Law 228-FZ clarifies the procedure for the determination of net asset value in a JSC or LLC that is a

court may order that measures be taken to rectify the violation.

As regards the creditors of an LLC, in the event that the LLC fails to obtain corporate approval to reduce its charter capital, the creditors end up unprotected. In the absence of explicit reference to such right in the law, creditors of an LLC no longer have the right to require acceleration of the obligations of the LLC or the termination thereof and reimbursement for associated losses in connection with the LLC's failure to obtain corporate approval for the reduction of its charter capital. Creditors still have the statutory right to require acceleration of the obligations of the LLC or the termination thereof and reimbursement for associated losses upon the LLC obtaining corporate approval for the reduction of its charter capital; however, if an LLC fails to obtain such corporate approval, then any claim against the LLC seeking such corporate approval in order that a creditor may be legally entitled to require termination of the obligations of the LLC (or acceleration of its obligations and reimbursement for associated losses) is unlikely to be supported by the court: court practice indicates that courts are unwilling to force companies to hold general meetings of participants so that they can adopt a corporate resolution.

⁶ Order No. 10n, 03-6/pz of the Ministry of Finance of Russia and the Federal Commission on the Securities Market on Approval of the Procedure for the Determination of the Net Asset Value of Joint Stock Companies dated January 29, 2003. There are particular rules laid down for the determination of net asset value for certain industries, e.g., for insurance companies see Order No. 7n/07-10/pz-n of the Ministry of Finance of Russia and the Federal Service for Financial Markets on Approval of the Procedure for the Determination of the Net Asset Value of Insurance Companies Incorporated as Joint Stock Companies dated February 1, 2007.

credit institution. Instead of net asset value, for a credit institution equity capital value is calculated as prescribed by the Central Bank of Russia.⁷

Law 228-FZ abolishes the recently introduced⁸ rule whereby all JSCs must file quarterly reports with the Unified State Register of Legal Entities (“USRLE”) on their net asset value; in practice the provision of such information gives rise to additional expenses (including notary fees) and administrative formalities (including the need to obtain a new extract from the USRLE). We note, however, that as issuers of securities that have registered a securities prospectus, JSCs and LLCs must disclose their net asset value in quarterly issuer’s reports in accordance with securities law.⁹

At the same time, Law 228-FZ provides that both JSCs and LLCs must provide access to information on their net asset value to any interested party in the manner prescribed for the provision of documents to JSC shareholders/LLC participants. Law 228-FZ does not specify how often a company must calculate its net asset value. Until the new rules come into effect, we believe that it should be calculated every quarter and at year-end.¹⁰

Law 228-FZ also introduces the requirement that an LLC include in its annual report a section on the state of the company’s net assets. We note that given a literal interpretation of the provisions of Law 228-FZ, this requirement applies in all cases, in contrast to JSCs, where this requirement applies only if the net asset value of a JSC at the end of the second or each succeeding financial year is less than its charter capital.¹¹ However, based on the content requirements for this section, it appears feasible that this section should only be included in the

⁷ The Central Bank of Russia has long established that for credit institutions the equivalent of the term “net assets” is “equity capital” (see Letter of the CBR No. 350 dated October 28, 1996). The method of calculation is set forth in CBR Regulations No. 215-P on the Method for Determining the Equity Capital of Credit Institutions, dated February 10, 2003.

⁸ The rule was introduced by Federal Law No. 352-FZ dated December 27, 2009.

⁹ Art. 30 of Federal Law No. 39-FZ dated April 22, 1996 on the Securities Market; Order No. 06-117/pz-n of the Federal Service for Financial Markets on Approval of the Regulations on Disclosure by Issuers of Equity Securities, dated October 10, 2006.

¹⁰ This is based on the provisions of Order 10n, 03-6/pz of the Ministry of Finance of Russia and the Federal Commission on the Securities Market on Approval of the Procedure for the Determination of the Net Asset Value of Joint Stock Companies dated January 29, 2003 (Clause 5 of the Procedure), which is applicable to JSCs. We believe that here also these Rules may be applied similarly as for LLCs. However, it also cannot be ruled out that the calculation must be made monthly based on the monthly account reporting of the company.

¹¹ Art. 35.4 of Federal Law No. 208-FZ on Joint Stock Companies dated December 26, 1995.

annual report of an LLC in a situation similar to that for JSCs. Thus, such section of the annual report of an LLC should contain:

- data on dynamics of changes in the net asset value and charter capital of the company for the three most recent complete financial years;
- analysis of the causes and factors which, in the opinion of the sole executive body of the company or the board of directors (as applicable), have led to the net asset value of the company falling below its charter capital;
- list of measures to bring the net asset value of the company into line with its charter capital.

In addition, information on the net asset value of a JSC and, in certain cases, of an LLC, should be entered in the new public register: the Unified Federal Register of Information on the Operations of Legal Entities.

UNIFIED FEDERAL REGISTER OF INFORMATION ON THE OPERATIONS OF LEGAL ENTITIES

Law 228-FZ provides for the creation of a new Unified Federal Register of Information on the Operations of Legal Entities (the “Unified Register”), an information resource that will essentially be open and freely accessible on the Internet (with the exception of information to which access is restricted under Russian law, such as personal data). At the same time, the existing USRLE at this point remains effectively as is, and much publicly available information will be duplicated to a great extent.¹²

The Unified Register will contain information that is required to be published in accordance with the law on state registration of legal entities, as well as other information contemplated by Law 228-FZ. It is also envisaged that the Unified Register will include the Unified Federal Bankruptcy Register, as provided for in Federal Law No. 127-FZ on Insolvency (Bankruptcy) dated October 26, 2002.

The formation and maintenance of the Unified Register will be the responsibility of a special operator: a Russian legal entity to be selected in the manner and according to the criteria to be established by the federal executive body empowered to do so by the Russian Government. The

¹² Information from the USRLE is published in the *Vestnik gosudarstvennoy registratsii* and in part on the Internet web site of the Federal Tax Service of Russia (www.nalog.ru) (see Order No. SAE-3-09/355@ of the Federal Tax Service dated June 16, 2006).

procedure for the formation and maintenance of the Unified Register will also be established by the competent federal executive body with a view to ensuring that any interested party has fast, free access to information contained in the Unified Register. Until the operator of the Unified Register is determined, this function will be handled by the operator of the Unified Federal Bankruptcy Register. At present this function is temporarily being handled by CJSC Interfax.¹³

A fee will be charged for publication on the Internet of information entered in the Unified Register for legal entities required to include such information in the Unified Register, but not for governmental or municipal bodies. The amount of such fee will be set by the competent governmental authority.

The following information will be entered in the Unified Register:

- data entered by the competent authority responsible for state registration of legal entities (the Federal Tax Service of Russia) – within five days after such data are entered in the USRLE:
 - general corporate data: establishment of the legal entity, pending reorganization, liquidation/pending liquidation, completed/pending de-registration from the USRLE, change of address, reduction or increase in charter capital, appointment or termination of the powers of the sole executive body, termination of a unitary enterprise;
 - other information envisaged in Russian law;
- data entered by the party responsible for publishing such information (the relevant legal entity) – within three business days of the respective event:
 - financial data: net asset value of a JSC as of the most recent reporting date¹⁴, net asset value of an LLC in cases provided for by Federal Law No. 14-FZ on Limited Liability Companies dated February 8, 1998¹⁵, start of the bankruptcy supervision procedure;

¹³ Order No. 121 of the Ministry of Economic Development of Russia on Selection of the Operator of the Unified Federal Bankruptcy Register, dated March 21, 2011.

¹⁴ It cannot be ruled out that such information will have to be provided on a monthly, quarterly and annual basis, to reflect the monthly, quarterly and annual reported accounts.

¹⁵ It is worth noting that this law does not at present provide for any such special cases (even as amended by Law 228-FZ).

- operational data: obtaining a license, suspension/renewal of a license, re-issuance, cancellation, or termination of a license;
- optional data: information entered in the Unified Register at the discretion of the legal entity.

The party that entered the information in the Unified Register is responsible for the authenticity and accuracy of such information entered in the Unified Register and posted on the Internet.¹⁶

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We would be happy to answer any questions you may have regarding the above.

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¹⁶ We note, however, that the authenticity of information included in the USRLE must be confirmed by the applicant (see Federal Law No. 129-FZ on State Registration of Legal Entities and Individual Entrepreneurs dated August 8, 2001). Consequently, the Federal Tax Service, in providing information to the Unified Register, is relying on the confirmation of authenticity provided by the applicant.