Debevoise In Depth

Top 10 Legal Developments in Russian M&A in 2018

January 31, 2019

This Debevoise In Depth outlines the most significant developments in Russian legal regulation and court practice in M&A and corporate legislation in 2018.

Key legislative changes include the following:

- extension of restrictions on investment in strategic companies[1] to all foreign organizations (regardless of the country of their incorporation) that do not provide information on their beneficiaries, beneficial owners and controlling persons to the Federal Antimonopoly Service of the Russian Federation (the "FAS Russia");

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- vesting the Russian President with discretionary powers to regulate corporate relations;

- adoption of procedure for redomiciliation of foreign companies in Russia;

- developments in corporate governance of joint stock companies;

- issuance of model charters for Russian limited liability companies; and

- change of approach to forming a list of inside information and change of insiders' duties.

In addition to legislative changes, the following practice of the Russian Supreme Court (the "Supreme Court") deserves attention:

- clarifications on disputing major transactions and interested-party transactions;

- clarifications on issues related to assurances about circumstances (analogous to *representations and warranties* in English law);

[1] A strategic company is a Russian company conducting activities of strategic importance for national defense and security as defined in Article 6 of the Strategic Investments Law (as this term is defined in Section 1).

- use of recovery of lost profits as a measure of liability in the event of failure to make a mandatory tender offer; and

- finding that an arbitration clause providing for dispute resolution at the International Court of Arbitration of the International Chamber of Commerce (*ICC International Court of Arbitration*) in a particular case is ambiguous and unenforceable.

Amendments to Regulation of Foreign Investments in Strategic Companies

On June 12, 2018, amendments to Federal Law No. 57-FZ on Foreign Investments in Companies of Strategic Importance for the Defense and Security of the State dated April 29, 2008 (the "Strategic Investments Law") and some other legislative acts came into force.

Introduction of Restrictions for Foreign Investors That Do Not Disclose Information About Their Beneficiaries and Other Persons

Until June 12, 2018, the Strategic Investments Law provided for a number of restrictions on the participation in strategic companies by foreign investors established in certain offshore jurisdictions, regardless of their ultimate beneficiary status.[2]

Since June 12, 2018, instead of these restrictions, new requirements have been introduced for any foreign investors (regardless of the country of their incorporation) that do not provide information on their beneficiaries, beneficial owners and controlling persons to the FAS Russia.

This information is provided to the FAS Russia in any form:

- as part of an application for preliminary approval of the transaction (for example, in the event of acquiring of more than 50% of the votes in a strategic company);

- as part of a notice of a completed transaction (for example, in the event of acquiring from 25% to 50% of the votes in a strategic company);

- as part of a request for the need to approve a transaction in the event that the fact of a foreign investor's control over a strategic company is not obvious; or

[2] For more details, see our client update, "Top-10 Legal Developments in Russian M&A for 2017," dated February 15, 2018.

- as a separate document if this document is required by the FAS Russia for making a decision that the transaction is not subject to prior approval (for example, when a foreign investor is acquiring from 25% to 50% of the votes in a strategic company or when a foreign investor who is under the control of a Russian citizen who is a Russian tax resident and does not have any other citizenship is acquiring more than 50% of the votes).

Foreign investors that do not disclose the above information are barred from:

- acquiring 25% or more of the total votes in the users of subsoil sites of federal significance ("strategic subsoil users");
- acquiring more than 50% of the total votes in other strategic companies;
- obtaining control over a strategic company by any other means; or
- acquiring fixed production assets of a strategic company the value of which represents 25% or more of the balance sheet value of its assets.

In addition, such foreign investors are required to obtain prior approval of the Governmental Commission for Control over Foreign Investments in the Russian Federation to acquire:

- the right to directly or indirectly dispose of more than 5% of the total votes in a strategic subsoil user, or
- the right to directly or indirectly dispose of more than 25% of the total votes in another strategic company or other options for blocking the decisions of its governing bodies.

Aggregate Control

To determine control over a strategic company, one takes into account the aggregate share of all: (i) foreign investors that do not disclose their beneficiaries, beneficial owners and controlling persons; (ii) foreign states; (iii) international organizations; and (iv) persons under their control, even if not within the same group.

An exception is provided for foreign investors that are shareholders of a public company within the meaning of Art. 11 of the Russian Tax Code[3] (apart from international

[3] The public companies are Russian and foreign entities that are issuers of securities (or depositary receipts) listed and/or admitted to trading on Russian exchanges with an appropriate license (Moscow Exchange, St. Petersburg Stock Exchange) or exchanges included in the list of foreign financial intermediaries.

organizations, foreign states and entities under their control). In determining whether such a foreign investor has control over a strategic company, only the votes owned by its group of persons will be taken into account.

Applicability of Foreign Investor Benefits

Entities controlled by Russian persons and foreign nationals who are also Russian citizens are no longer considered foreign investors and may not claim any benefits granted by the laws on foreign investments.

Authority of FAS Russia

The FAS Russia, as the body authorized to monitor the implementation of foreign investments in strategic companies, received the right to provide guidance on the application of the Strategic Investments Law, as it previously used to do without legislative authorization.

Vesting the Russian President with Discretionary Powers to Regulate Corporate Relations

On June 4, 2018, the provisions of Federal Law No. 133-FZ dated June 4, 2018 came into force, which give the Russian president the right to set, in exceptional cases and in certain areas, the "*peculiarities*" of:

- creation, reorganization, liquidation and legal status of business companies (including the fulfillment of the obligation to keep, disclose or provide information about their activities);
- making transactions (including their notarization and accounting);
- legal status of issuers and professional participants of the securities market; and
- accounting of information about securities.

The law does not specify what is meant by "*exceptional cases*" and "*certain areas of activity*." Equally, the law does not provide for the purposes or nature of such possible "*peculiarities*," the timing and order of their introduction and application, or the groups of entities with respect to whom they can be applied.

Since these provisions are too general, it is not possible to assess the degree of their influence on the regulation of corporate relations. At the same time, such broad powers

will allow the Russian president to align civil and corporate legislation, as well as the legislation on the securities market, with certain cases. This may lead to the creation of different legal regimes for initially equal companies and, as a result, to heterogeneous law enforcement practice and potential legal uncertainty.

Adoption of Law on Redomiciliation of Foreign Companies in Russia

On August 3, 2018, the Federal Law on International Companies took effect, making Russia one of the first CIS countries to adopt laws on the redomiciliation (reregistration) of foreign companies.

This law allows foreign companies to be registered in the Unified Russian State Register of Legal Entities (the "EGRUL") as a limited liability company or joint stock company with the status of an international company. Upon registration in Russia, an international company is removed from the register of legal entities in the country of its initial registration, but it retains all of the rights and obligations it previously held and is considered to be created not from the date of entry into the EGRUL, but from the date of its initial registration in the foreign country. This is a core distinction between the procedure of redomiciliation of a foreign company and its liquidation in the country of the initial incorporation and the subsequent incorporation of a new company in Russia.

Upon the registration of an international company in the EGRUL, Russian law becomes its *lex societatis*.[4] However, during the transition period which will last until January 1, 2029, the charter of such international company may provide that it will be subject to foreign law governing relations of its members and the rules of foreign stock exchanges. If so, the charter must contain an arbitration clause that all corporate disputes related to the participation in such international company will be referred to arbitration. The list of disputes subject to arbitration set forth in the Russian *Arbitrazh* Procedure Code will be amended to this extent.

The Law on International Companies was adopted as part of a general package of laws that established special administrative zones (the "SAZ") on Russky Island (Primorsky Region) and Oktyabrsky Island (Kaliningrad Region)[5] as an alternative to foreign offshore zones. The redomiciliation of foreign companies is only allowed in these two regions. From a practical point of view, this means that the sole executive body ("CEO") of a re-domiciliated company must be located in these zones, since the location of the

[4] *Lex societatis* governs, in particular, (i) the status of the company as a legal entity; (ii) the matters relating to its reorganization and liquidation; (iii) the procedure in which the company accrues its rights and obligations; (iv) corporate relations, including those of the company with its members; and (v) the liability of the members.

[5] Oktyabrsky Island is a historical name of a district in Kaliningrad.

international company, as well as location of any other company, is determined by the location of its CEO.

The ability of a foreign company to re-domicile will depend not only on the existence of the technical procedure for reregistration in Russia but also on whether the law of the country of initial registration allows such redomiciliation. If the local law does not recognize redomiciliation, a number of risks may occur, including:

- risks connected with a parallel existence of two companies during the transition period;
- risks of unforeseen obligations (including early performance or termination of existing obligations);
- risks of loss of assets held by the re-domiciled company; and
- risks of loss of corporate rights by its participants.

Particular attention during redomiciliation should be paid to continuing contractual obligations that are governed by foreign law. The Law on International Companies expressly provides that redomiciliation of a foreign company does not negatively affect its obligations. However, applicability of the above provisions to legal relations governed by foreign law may be disputable. Moreover, loans, options, joint venture agreements and other contracts entered into under a foreign law may contain fairly broad language concerning events of default, material adverse change, reorganization or liquidation, the scope of which may also extend to redomiciliation. Some agreements may even restrict redomiciliation or give rise to additional rights or obligations in the event of redomiciliation (e.g., the right to sell or buy out shares).[6]

An international company is considered a non-resident for the purposes of currency-control regulation.

Despite the rather active interest shown by foreign companies in redomiciliation procedure, as of the end of 2018, only one case of redomiciliation of a foreign company, incorporated in Cyprus, was announced on September 11, 2018 at the Eastern Economic Forum. In addition, on December 20, 2018, EN+ GROUP PLC announced that its

[6] For more details, see our client update, "New Law on the Redomiciliation of Foreign Companies in Russia," dated October 9, 2018.

shareholders approved reregistration (continuance) in Oktyabrsky Island (Kaliningrad Region).[7]

Pursuant to the amendments to the Law on International Companies which took effect on December 25, 2018, redomiciliation will be available (subject to a number of conditions) to foreign companies incorporated prior to January 1, 2018 only.

Developments in Corporate Governance of Russian Joint Stock Companies

On July 19, 2018, amendments to Federal Law No. 208-FZ on Joint Stock Companies dated December 26, 1995 (the "JSC Law") came into force. According to the drafters, the amendments are aimed to increase (i) the level of protection of minority shareholders and (ii) the quality of corporate governance in joint stock companies. Key changes are given below.

Audit Commission

Mandatory establishment of an audit commission in joint stock companies is no longer required: (i) in *public* companies, an audit commission is not created, unless its establishment is set forth in the company's charter; and (ii) in private companies, an audit commission, on the contrary, is created by default, unless the company's charter provides otherwise. The Law also prohibits joint stock companies from having a sole auditor, save for those companies in which the sole auditor was appointed prior to July 19, 2018.

Risk Management, Internal Controls, Internal Audit

Starting on September 1, 2018, *public* joint stock companies are obliged to introduce risk management and internal control systems and, from July 1, 2020, to arrange for an internal audit to assess the reliability and effectiveness of risk management and internal controls. In addition, from July 1, 2020, the board of directors (the "Board") of a *public* company will be required to establish a special audit committee for preliminary consideration of issues relating to the company's business controls.[8]

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[7] http://www.enplus.ru/upload/iblock/052/05216a9376a3904905fa8e103517e7e0.pdf.

[8] Such an obligation is currently set forth in the Bank of Russia Regulation on the Admission of Securities to Organized Trading and in the listing rules for the companies that list their shares on the first (highest) and second level.

Right of the Board to Propose Candidates to Governing Bodies of the Company

Starting on September 1, 2018, the Board is entitled, in its own discretion, to propose candidates to the governing bodies of the company, including the Board itself, for election at the general shareholders' meeting (the "GSM"). Previously, this right was granted to the Board only when the shareholders had not provided candidates, or had provided an insufficient number of candidates.

Quorum for Approving Interested-Party Transactions

A general shareholders' meeting approving an interested-party transaction will be quorate independent of the number of disinterested shareholders participating in the meeting.

Voting Rights of Holders of Preferred Shares

The Law provides that holders of preferred shares have voting rights at the GSM in respect of questions which require the unanimous vote of all shareholders in accordance with applicable law. In addition, holders of a certain type of preferred shares now have voting rights on matters relating to charter amendments introducing provisions on authorized preferred shares of the same or another type if their issuance may reduce the amount of dividends and/or liquidation value to be paid on preferred shares of the relevant type.

Dividends on Preferred Shares

The recurrent issue of how to determine the amount of dividends on preferred shares in the company's charter has been clarified. The amount of dividends is considered to be determined if the charter sets forth the minimum amount of dividends, including by reference to a percentage of the net profit of the company. The amount of dividends is not considered to be determined if the charter provides only for the maximum amount of dividends.

Right to Require Redemption of Shares

It is provided that shareholders do not have the right to request redemption of their shares by the company if, in accordance with the JSC Law, items falling within the competence of the GSM are transferred to the competence of the Board (previously, there was a position according to which an introduction of such amendments to the

charter could be considered as an amendment limiting the rights of shareholders and, therefore, falling under Art. 75 of the JSC Law).[9]

Issuance of Model Charters for Russian Limited Liability Companies

On September 24, 2018, the Russian Ministry of Economic Development published Order No. 411, dated August 1, 2018, approving 36 model charters for limited liability companies. The Order enters into force on June 24, 2019.

The model charters have been approved pursuant to Art. 12 of Federal Law No. 14-FZ on Limited Liability Companies, dated February 8, 1998 (the "LLC Law"), which provides that a company may operate on the basis of either (i) a charter approved by the members of the company or (ii) a model charter approved by the Ministry of Economic Development.

All 36 model charters are extremely concise (less than two pages each). Meanwhile, many of the provisions of the model charters contain only references to the relevant provisions of the LLC Law.

The model charter forms vary in the regulation of certain matters on which the LLC Law allows members to independently determine their position, as follows: (i) transfer by a member of its interest (or part thereof), (ii) preemptive right of members to acquire the interest (or part thereof), (iii) passing of a member's interest to its heirs/successors, (iv) exit of a member from the company, (v) control over the day-to-day operations of the company and (vi) endorsement of resolutions of the general meeting of members.

The model charter forms are aimed at simplifying the process of preparing the charter and, as a result, reducing the relevant costs of members. However, given the extremely limited set of available corporate mechanisms and possible options, as well as a partial inconsistency of 26 out of the 36 model forms with the current legislation (regarding exclusion of the preemptive right or exercise of powers of the CEO), it appears that the use of current model forms will be limited.[10]

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[9] For more details, see our client update, "Important Developments in Corporate Governance of Russian Joint Stock Companies," dated July 25, 2018.

[10] For more details, see our Debevoise in Depth, "Model Charters Issued for Russian Limited Liability Companies," dated November 1, 2018.

Changes in Regulation of Inside Information and Market Manipulation

On August 3, 2018, the amendments[11] providing for a number of significant changes affecting all persons whose activities involve access to inside information were published. Most of these amendments enter into force on May 1, 2019.

List of Inside Information

The List of Inside Information Approved by the Bank of Russia[12] will no longer be considered exhaustive. Legal entities covered by the Insider Trading Law (issuers of securities, trading institutions, etc.) will be required to make their own lists of inside information subject to the specifics of their businesses. Such lists will have to include, *inter alia*, information contained on the above List of Inside Information Approved by the Bank of Russia. However, issuers, their officers or their employees will not be responsible for the absence of any information not included on the List of Inside Information Approved by the Bank of Russia, in their own lists of inside information.

List of Insiders

The following persons are added to the list of insiders set forth in the Insider Trading Law:

- persons holding shares indirectly entitling them to 25% or more of the votes in the highest governing body of certain entities, including issuers; and

- persons having access to information regarding preparation and/or sending of (i) a voluntary, mandatory or competitive tender offer; (ii) a notice of the right to request stock repurchase; or (iii) a stock repurchase request pursuant to Chapter XI.1 of the Joint Stock Company Law, including persons who submitted any such offer, notice or request to the joint stock company; appraisers; and banks that issued a bank guarantee.

New By-Laws of Issuers and Insiders

Legal entities indicated by the law, including issuers (also foreign), their counterparties and advisers on the insider list, will be required to approve a number of new by-laws, in particular:

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[11] Federal Law No. 310-FZ on Amendments to the Federal Law on Countering the Unlawful Use of Inside Information and Market Manipulation (the "Insider Trading Law") and on Amendment to Certain Legislative Acts of the Russian Federation dated August 3, 2018.

[12] *See* List of inside information approved by the Bank of Russia under Instruction No. 3379-U dated September 11, 2014 (the "List of Inside Information Approved by the Bank of Russia").

- internal audit rules for preventing, detecting and eliminating unlawful use of inside information and/or market manipulation; and

- terms and conditions for dealing with financial instruments by members of the Board, management board, the CEO, members of the audit commission, individuals having access to inside information on the basis of employment or civil law contracts or persons related to them.

In addition, while under the previous regime the insider was advised on the requirements of the Insider Trading Law and liability for its violation only upon being included in the insider list, starting from May 1, 2019, the Law requires that the insider be informed of the above (and of the fact that the insider will be included in the insider list) also upon the execution of an agreement with a legal entity receiving access to inside information.

Trade Reporting Requirements

The insiders will no longer be required to notify the company and the Bank of Russia of any transactions involving securities, financial instruments, foreign currency, etc. Instead, companies will have the right to request a report from their insiders of transactions undertaken by them.

Expansion of Powers of the Bank of Russia Regarding Compliance Review

The Bank of Russia, when conducting reviews for compliance with inside information laws, will receive additional powers to access the property and premises of the entities subject to review and necessary documents or information, including access to electronic storage devices.

Definition of Market Manipulation

The Bank of Russia will be authorized to supplement the market manipulation practices listed in the Insider Trading Law.

Restrictions on Disclosure of Inside Information

The Russian Government will be entitled to determine whether inside information is not subject to disclosure or delivery and/or is subject to limited disclosure or delivery.[13]

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[13] For more details see our client update, "Regulation of Inside Information in Russia: What Will Change in 2019," dated September 10, 2018.

A New Ruling of the Supreme Court on Disputing Major and Interested-Party Transactions

In Ruling No. 27, dated June 26, 2018, the Supreme Court provided guidance on certain issues regarding the application of new regulations to major and interested-party transactions. Below we briefly review the most significant clarifications.

Procedure for Disputing Transactions

When considering a claim for the invalidation of a transaction as performed in breach of the procedure for its consummation set forth in the JSC Law or LLC Law, Art. 173.1 of the Civil Code should be applied in respect of major transactions[14] and Art. 174(2) in respect of interested-party transactions,[15] subject to specific requirements set forth in the above laws. It can be assumed that this guidance of the Supreme Court seeks to prevent the courts from applying other provisions of the Civil Code when major and interested-party transactions are challenged based on the breach of procedure for the consummation thereof, in particular, to prevent the application of Art. 168 of the Civil Code[16] and to specify that the grounds for disputing set forth in the JSC Law and LLC Law are not self-sufficient, but rather such transactions should be challenged pursuant to Art. 173.1 and 174(2) of the Civil Code subject to specific requirements set forth in such laws.

Limitations Period

The limitations period for challenging major and interested-party transactions is determined pursuant to the rules of Art. 181(2) of the Civil Code and is one year. The Ruling of the Plenary Session of the Supreme Court also contains explanations regarding the moment of commencement and termination of the limitations period, including taking into account when a conscientious CEO, a member of the Board or a shareholder/participant (the "shareholder") became aware or should have become aware of the disputed transaction.

Right of Action of a New Shareholder

A claim for invalidation of a transaction cannot be dismissed on the grounds that the shareholder commencing the action was not a shareholder of the company at the time

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[14] Art. 173.1 of the Russian Civil Code contains provisions on the invalidity of transactions concluded without the consent of a third party, a body of a legal entity, or a state body or a local government that is required by law.

[15] Art. 174(2) of the Russian Civil Code contains provisions on the invalidity of transactions concluded by a representative or an agent of a legal entity acting on behalf of a legal entity without a power of attorney to the detriment of the interests of the representee or a legal entity.

[16] Art. 168 of the Russian Civil Code contains provisions on the invalidity of transactions that violate the requirements of the law or another legal act.

when such transaction was made. Transfer of share to another party does not affect the limitations period with respect to the claim for invalidation of a transaction and enforcement of consequences of an invalidated transaction.

Scope of the Ordinary Course of Business

A transaction will fall beyond the scope of the ordinary course of business, in particular, in the event of sale/lease of the fixed production assets of the company or if such transaction results in a significant change of the region of its operations or its sales markets.

Determination of the Amount of a Major Transaction

The amount/sum of a major transaction will be determined without regard to the claims that may be made against the respective party for the failure to perform or improper performance of its obligations (e.g., penalties), unless it is established that the company did not originally intend to perform or properly perform such transaction.

The price of a contract providing for regular payments (e.g., lease, services, storage, agency, trust, insurance, franchise, licensing agreement, etc.) for a person required to make such regular payments should be determined on the basis of the total amount of such payments for its entire term (if it is a contract for an indefinite period, for one year; if payments vary, the greatest amount of payments for one year should be used).

It can be assumed that the above approaches for determining the contract price will be applied to interested-party transactions as well.

Conclusion on a Major Transaction

The conclusion of the Board or CEO on a major transaction may contain a recommendation to enter into or not to enter into such transaction. The fact that no conclusion was issued does not serve as a ground for disputing such transaction as performed in breach of the approval procedure. However, it makes it possible to advance claims for damages caused to the company by such transaction against persons who failed to perform the obligation to prepare a conclusion.

Retired Board Member

A member of the Board will be deemed to have retired, in particular, in the event of his/her death, if he/she has been declared legally incompetent or as having limited legal capacity or disqualified by order of the court or if he/she has notified the company of his/her resignation (such resignation must be made in writing in advance of the Board meeting).

Approval of a Major Transaction That Is Simultaneously an Interested-Party Transaction

Any major transaction that is simultaneously an interested-party transaction is subject to approval both as a major transaction and an interested-party transaction. However, according to the rules of approval of interested-party transactions, such a transaction is subject to approval only if expressly demanded.

If the amount/sum of the transaction is from 25% to 50% of the book value of the company's assets, then it is approved by (i) the Board according to the rules of approval of major transactions and (ii) the GSM according to the rules of approval of interested-party transactions. However, the literal reading of Art. 79(5) of the JSC Law may lead to a conclusion that in this situation, if it is demanded that a transaction is approved as an interested-party transaction, such transaction is subject to approval by the GSM according to the rules of approval of interested-party transactions only and no approval by the Board according to the rules of approval of major transactions is required.

Standards of Good Faith

Generally, the law does not require any third party to verify prior to making a transaction whether such transaction is a major transaction or an interested-party transaction for its counterparty and whether it has been properly approved. Third parties relying on the information contained in the EGRUL as to the persons authorized to represent a legal entity may generally assume that such persons are authorized to enter into any such transactions. However, a representation/warranty by a person who entered into a transaction that all necessary corporate procedures and other requirements have been complied with does not itself prove that the counterparty acted in good faith.

Voting by Persons Controlled by an Interested Party

It is not only interested parties that are not entitled to vote for the approval of an interested-party transaction, but also corporate shareholders that are not formally interested in a transaction but rather are under control of interested parties (controlled entities).

Requirements for Approval of Interested-Party Transactions

The Supreme Court clarified that a GSM or a Board meeting for approval of an interested-party transaction may be requested at any time both prior to and after the

consummation of a transaction (in the latter case, the corporate body of the company should decide on a subsequent approval of such transaction).[17]

Clarification of the Supreme Court on Issues Related to Assurances About Circumstances

On December 25, 2018, Ruling No. 49 of the Plenary Session of the Supreme Court was adopted. In addition to the clarifications directly related to the conclusion and interpretation of contracts, the Ruling also provides guidance on certain issues related to public, preliminary, framework and subscription contracts.

Of particular interest with regards to M&A transactions are clarifications of the Supreme Court concerning assurances about circumstances (Art. 431.2 of the Civil Code). The institution of assurances about circumstances (analogous to *representations and warranties* in English law) was first introduced into Russia in 2015 as part of a civil law reform. This guidance is the first attempt of the Supreme Court to summarize the court practice in this area. The clarifications include:

- Assurances of relevance to the contract may or may not be directly related to the subject matter of the contract.

- Assurances impose additional liability on the party in addition to the liability specified by the law for the relevant type of obligations. Meanwhile, according to the general principle of civil law (Art. 307.1 of the Civil Code), if the assurances are related to the subject of the contract, then the liability of the party for the inaccuracy of the assurances is determined by special rules on certain types of contracts, as well as by the provisions of Art. 431.2 of the Civil Code and other general provisions of the Civil Code. Essentially, the point is that, for example, under a sale and purchase agreement (including in relation to shares), the object of sale and purchase must comply with both the legislatively established quality rules and the characteristics and requirements specified in the assurances (for example, in relation to the acquired company and the composition of its assets).

- Assurances may be made by a third party with a legitimate interest in the contract. The presence of a legitimate interest is assumed, unless proved otherwise. In the event of inaccuracy of assurances, the third party is liable to the party to the contract in whose favor the assurances are provided.

[17] For more details, see our client update, "The Supreme Court of Russia Issued a New Ruling on Disputing Major and Interested-Party Transactions," dated July 23, 2018.

- To prove assurances, a party may not refer to witness testimony.

- As a consequence of inaccuracy of assurances, both the damages and agreed penalty can be provided for (although it follows from the literal reading of Art. 431.2 of the Civil Code that either compensation for damages or payment of penalty is allowed).

- A person who provided a deliberately inaccurate assurance cannot, as a ground for exemption from liability, refer to the fact that the party relying on the assurance acted imprudently and did not independently verify its accuracy.

- As a general rule, declaring a contract null and void does not in itself exempt the respective party from liability for inaccuracy of assurances (for example, regarding the authority to enter into a contract or its compliance with the applicable law), even if such assurances are contained in the contract itself. However, this does not exclude the possibility of recognizing assurances invalid in a general manner according to the rules on the invalidity of transactions if there are appropriate grounds.

The above clarifications of the Supreme Court are aimed at ensuring the uniformity of law enforcement practice and should contribute to increasing legal certainty. However, many issues that arise in practice in the provision of assurances have been ignored. In particular:

- Can assurances be provided for a future date? Is an automatic repetition of assurances allowed on a certain date or upon the occurrence of certain circumstances?

- Is it possible to limit assurances to the seller's knowledge using the "*to the best of the seller's knowledge*" clause? Is it possible under the contract to determine a specific group of persons whose knowledge equates the knowledge of the seller?

- Can the standard of *disclosure* be applied against assurances and how will it be applied?[18] Is a general reference to any information, which, for example, is disclosed as part of a legal review, allowed, or can the disclosure be made only by providing an exhaustive document? What is the legal status of such a document: an additional agreement, a disclosure letter, etc.?

- Is the buyer deprived of the right to refer to the assurances if he/she knew or should have known about the *unintended* inaccuracy of such assurances on the part of the seller (analogous to the *anti-sandbagging rule*)? Is it possible, on the contrary, to

[18] As an example, English law uses the "fairly disclosed" standard, which provides that the seller discloses all circumstances in a sufficient manner so that the buyer can determine the nature and extent of such disclosure.

directly stipulate that such a right is retained in the contract, despite the knowledge of the buyer?

Recovery of Lost Profits by a Minority Shareholder from the Majority Shareholder Who Failed to Make MTO

On May 24, 2018, the Supreme Court for the first time confirmed compensation of lost profits of a minority shareholder caused by failure of the majority shareholder to make a mandatory tender offer for the acquisition of shares (Case No. A19-17165/2016).

LLC Telmanskaya HEPS (defendant) acquired shares of PJSC IrkutskEnergo at a price that was significantly higher than the average weighted price per share on the Moscow Exchange. As a result of the transaction, the shareholding of the defendant (together with its affiliates) in the company exceeded 75% of the total company shares. In violation of Art. 84.2 of the JSC Law, the defendant failed to make a public offer to other shareholders for the acquisition of shares (mandatory tender offer).

The minority shareholder (an individual) attempted to sell his shares to the defendant, but it refused to purchase them. In light of this, the minority shareholder sold his shares to a third person on the Moscow Exchange at a price that was significantly lower than the transaction price paid by the defendant and filed a claim in court for compensation of lost profits equal to the difference between the price at which he sold his shares on the Moscow Exchange and the price paid by the defendant.

The courts satisfied the plaintiff's claim, stating the following:

- due to the defendant's fault, the plaintiff could not return his investments in full, whereas the defendant and its affiliates had expanded their corporate control; and

- the compensation of damages will (i) protect the rights of the plaintiff who intended to accept the public offer and sell shares and took measures to require the defendant to make a mandatory tender offer, and (ii) the plaintiff will be put in the position he would have been in had the defendant properly performed its obligation to acquire the plaintiff's securities at a fair price.[19]

[19] For more details, see our client update, "Russian Supreme Court Rules in Favor of Minority Shareholder's Claim for Lost Profits Caused by Majority Shareholder's Failure to Make MTO," dated July 24, 2018.

Arbitration Clause Found Ambiguous and Unenforceable by Supreme Court

On September 26, 2018, the Supreme Court upheld decisions of the lower courts that the International Court of Arbitration at the International Chamber of Commerce (*ICC International Court of Arbitration*) (the "ICA") had no jurisdiction over the dispute between a foreign company and a Russian entity, since the arbitration clause in the agreement did not meet the principles of certainty and enforceability.[20]

Dredging and Maritime Management SA (Luxembourg) filed an application with the Russian court to recognize and enforce an ICA award, which provided for the collection of damages and interest on the agreement from JSC InzhTransStroy (Russia). The courts concluded that the parties did not identify a specific arbitral institution to resolve their dispute under the agreement. This served as one of the grounds for the refusal to recognize and enforce the ICA award in Russia.

As follows from the judicial decisions, the parties provided in their agreement that, unless the parties agree otherwise, any dispute which has not been amicably settled shall be finally settled in international arbitration in accordance with the Rules of Arbitration of the International Chamber of Commerce in Geneva (Switzerland). According to the courts, the language of the arbitration clause is ambiguous and does not evince the direct consent of the parties to submit all their disputes to the ICA since, despite the reference to the arbitration rules, a specific arbitral institution has not been named.

The conclusions of the courts in this case are disputable, but since they have been endorsed by the Supreme Court, they should be taken into account when drafting arbitration clauses (including those in stock purchase agreements and corporate agreements).

Given the approach of the courts, the following recommendations will help reduce the risk of finding that the arbitration clause is ambiguous and, consequently, that the arbitral institution lacks jurisdiction to resolve a dispute:

- The consent of the parties to dispute resolution in the relevant arbitral institution must directly and clearly follow from the agreement.

- An arbitral institution must be expressly and clearly identified in the agreement indicating, in particular, the specific name and location of the institution, as well as the rules on the basis of which it operates.

[20] Case No. A40-176466/2017. See our discussion in more detail in the Client Update of January 7, 2019, "ICC Arbitration Clause Found Unenforceable in Russia: Potential Risks and Drafting Considerations."

- Leading arbitral institutions develop and publish their own standard arbitration clauses, and in preparing and negotiating an arbitration clause, it is necessary to use a standard clause recommended by the respective arbitral institution or at least follow it.

The standard arbitration clause of the ICA is available on its website. Recently, the International Chamber of Commerce has developed an additional version of its standard arbitration clause, which not only refers to the ICC Rules of Arbitration, but also explicitly names the ICA as the institution for the dispute resolution.[21]

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Please do not hesitate to contact us with any questions.

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[21] https://iccwbo.org/dispute-resolution-services/arbitration/arbitration-clause/.