Doing Business in Russia

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Hogan Lovells

Contents

Introduction

This note provides an overview of the legal framework in Russia. It is designed for businesses looking to invest in the jurisdiction, and it deals with common legal issues that foreign investors have to deal with in Russia.

By way of background, Russia operates under a civil law system and business activities are primarily governed by the Civil Code and applicable federal laws. The system is still evolving and legislation is frequently modified in an attempt to improve the business environment and legal landscape. The latest 2014 and 2015 reforms included significant investor-friendly amendments to the Civil Code.

Welcome to legal Russia, we hope you enjoy the ride.

Legal Forms of Companies and Incorporation

Russia has two principal forms of legal entities; corporations and unitary enterprises. A corporation is a company in which shareholders (or participants) hold shares (or participation interests) and have the rights to attend general shareholders' or participants' meetings. Corporations include, amongst other things, joint-stock companies and limited liability companies.

Joint-stock companies and limited liability companies can either be public or non-public companies.

Public companies must have a board of directors or another board consisting of at least five members and its commercial name must include a reference to its public status. Public companies are not allowed to offer pre-emption rights to shareholders.

Non-public companies enjoy more flexible corporate governance rules. In particular, non-public companies do not need to form an internal audit committee; they may transfer shareholders' decisions to the board of directors; and they can establish their own rules for preparing, convening, and holding general shareholders' or participants' meetings.

Shares in joint-stock companies, both public and non-public, are considered securities and share issues must be registered with the Central Bank of Russia. Joint-stock companies may place ordinary and preferred shares. Participation interests in limited liability companies are not considered securities.

A unitary enterprise is an entity whose founders or participants do not have a share or participation interest in its capital and do not acquire any shareholders' or participants' rights. These include, for example, state unitary enterprises, religious organizations and certain other entities.

Newly incorporated companies must be registered with the official companies register (the Unified State Register of Legal Entities, commonly known as the "EGRUL"). The registration takes five business days from a date of filing of application documents. A legal entity is registered for an indefinite period.

Documents required for a company's incorporation that are issued or signed abroad need to be notarized and apostilled (legalized) in the country of issuance or signing. They must also be translated into Russian, and the translation must be notarized.

It is important to note that a Russian legal entity may require having two shareholders either Russian or foreign as so called "one-one-one" structure is prohibited under Russian law, i.e. a legal entity may not have as its sole shareholder another business entity having one shareholder only.

Corporate Governance

Russian companies must have at least one general director (chief executive officer). It is also possible for a Russian company to have two or more single management bodies (general directors, chief executive officers etc.). In this case they act jointly or separately in accordance with the company's charter. The director of a Russian company can be either a Russian individual or a management company or a foreign individual holding a work permit.

Public companies must have a board of directors. Members of the management body are prohibited from chairing the board of directors.

General shareholders' or participants' meetings must be held annually not earlier than two months and not later than four months for a limited liability company and not later than six months for a joint-stock company after the end of preceding financial year. Private companies are permitted to set their own rules on convening and holding general meetings.

Decisions taken at the general shareholders' or participants' meetings must be certified by a registrar (in the case of a public joint-stock company), a registrar or notary (in the case of a non-public joint-stock company), or a notary or otherwise, e.g. by participants themselves (in the case of a limited liability company).

It is possible for shareholders and participants of a non-public company to have a number of rights that disproportionate to the percentage of their shareholding or participation interests (any such rights would be provided for under the company's charter and in shareholders' / participants' agreements). The rights would apply so long as information on the rights is recorded in the state companies register.

Shareholders' Liabilities

In general, shareholders of a joint-stock company or a limited liability company will not be liable for a company's obligations to its creditors. The company itself bears sole responsibility for such obligations.

However, this will not be the case where shareholders hold share that are not fully paid up. Company law also provides for further exceptions to shareholders' limited liability.

In particular, a parent company may be held liable for any transaction of its Russian subsidiary, if the subsidiary followed the instructions given by its parent or acted with the consent of the parent.

Any liability to counterparty is joint and several. This means that the counterparty may pursue an obligation against either the parent company or its subsidiary. However, this will not be the case if transactions were approved by the parent at the subsidiary's shareholders' or participant's meetings where such approval was required by law or the company's charter.

Other restrictions on a shareholder's ability to limit its liability are rare. Nevertheless, a person who exercises control over a Russian subsidiary may be held liable for damage caused to that subsidiary due to this person's fault. For these purposes, control means a right to give binding instructions, or otherwise determine the business of a company. A majority shareholder may be considered controlling persons.

Importantly, it is only the subsidiary itself or the other shareholders who can claim damages in this way. This makes the risk that a majority shareholder may be liable relatively remote. Shareholders may also incur secondary liability for obligations of its insolvent subsidiary if the subsidiary became insolvent because of willful acts (or omissions) of the shareholders.

Directors' and Officers' Liabilities

In certain circumstances, directors and officers may be liable for damage caused to a company, its shareholders, or third parties.

Directors have a duty to act in good faith, act reasonably and act in the company's best interests. In addition to these general heads of liability, more specific grounds of liability exist. For example, directors may be held liable if they failed to file an application for insolvency of the company at a court within the one month period following the occurrence of an event triggering the company's insolvency as defined by Russian bankruptcy law.

Where a director breaches the general principle or a specific law, damage and causation should normally be proved by the person filing a claim against the director. Once damage and causation have been proved, the burden of proof with respect to guilt lies with the director. In other words, if the claimant proves the director's violation of the principle of good faith and prudence, damage and causation, the onus is then on the director to prove that she or he is not guilty.

Investors' Issues

Russian businesses can, in general, be acquired by way of: share purchase, asset purchase, statutory merger, or, in the case of public companies, tender offer.

Share purchases are carried out by way of an agreement between the acquiring entity and the target's shareholders to purchase the target's holding company or to buy its shares in the target.

As a matter of practice, many buyers prefer to purchase a special purpose vehicle which has been created for the purposes of an acquisition or joint venture. Special purpose vehicles are generally established abroad, (most frequently in a country with flexible corporate governance legislation). The vehicle helps to protect the buyer's rights (particularly in relation to the seller's warranties and representations).

Generally, a share purchase would be carried out under a foreign law agreement (typical choices of governing law include for English law or New York law). Pursuant to that agreement, the purchaser would acquire the special purchase vehicle which held the shares in the Russian target.

Alternatively, share purchases can be carried out pursuant to Russian law agreements. This is generally the case where key assets of the seller are located in Russia as enforcement against Russian assets is likely to be easier where contracts are governed by Russian law.

Asset sales in Russia are structured by way of separate transfers of core assets of the business. In practice, tangible assets and relevant IP rights, trademarks, patents and domains are transferred under specific sale and purchase or assignment agreements whereby existing contracts are terminated and simultaneously re-executed with the new owner of the business.

Normally, employees are transferred by terminating their employment with the target employer and entering into new contracts with the new owner.

It should be noted that an asset deal would be subject to Russian VAT where it involves an actual purchase of assets.

Typically, a share deal is easier to structure in terms of both timing and implementation. The buyer should also take a cautious approach where the whole business is acquired via an asset deal as any acquisition of assets without a corresponding assumption of liabilities may be invalidated in court.

A statutory merger is carried out by way of a merger agreement between the merging entities. The merger requires corporate consents to approve the merger agreement, asset transfer plan and the make-up of the newly established corporate bodies. The merging parties must file a merger notice with the Unified State Register of Legal Entities (known in Russia as the "EGRUL") and then monthly publish merger related information in the media for their creditors.

In practice, actual merger transactions are rare due to as the completion process is long and complicated, largely due to tax investigations which can look into activities of both business for the three years preceding the merger.

Finally, the tender offer option is available only for the acquisition of a public joint-stock company. In order to implement a tender offer, shareholders holding on its own or together with their affiliates more than 95% of the share capital acquired as a result of share purchase offers made in compliance with Russian takeover regulations acquire the remaining shares in the company. Offers preceding the tender may be voluntary where the shareholder together with his affiliates intends to acquire more than 30% of the share capital and may submit an offer; or mandatory where such a shareholder has acquired the shares in a company as a result of which the aggregate amount of the shares held by him then exceeds 30%, or 50% if already higher than 30%, or 75% if already higher than 50% and must submit an offer.

Foreign Investments

Foreign investment is not generally restricted by Russian law, except where foreign investors wish to engage in so-called "strategic" activities (e.g. natural monopolies, subsoil use, nuclear energy, military and defense, TV and broadcasting, transport safety services, aviation, cosmic, cryptographic, printing and publishing, fisheries etc.) where investments from foreign state-controlled entities and international organizations are generally limited to 50%. This limit is reduced to 25% minus one share for investments in companies engaged in mining exploration activities.

Subject to the above limits, foreign investment in companies engaged in strategic activities (as well as investments made by foreign state-controlled entities and international organizations in other, not necessarily strategic companies) may have to be cleared by a special governmental commission headed by the Russian Prime Minister.

In certain market sectors, further restrictions also apply. For example, foreign ownership of media organizations is currently restricted to 20%.

Merger Control

Russian merger control regulates the acquisition of shares, participation interests, operational and/or intangible assets or rights to use them; and rights to determine a Russian company's business.

These regulations may extend to acquisitions of a foreign company having Russian-based revenues. Reorganization transactions in the form of merger or accession and establishment of a company may also trigger the merger control. Intra-group transactions as soon as they concern the above-mentioned acquisitions normally require prior clearance from Russian antimonopoly authorities save for some exceptions and relaxations.

The merger control regulations apply only where certain financial revenue and assets based thresholds are met.

Anti-Bribery and Corruption

Russia ratified the United Nations Convention against Corruption and has adopted its key principles in national laws. Bribery is a criminal offence. The term has a wide meaning and includes giving of anything of value (for example, in the form of giving gifts, making promises, providing services, facilitation payments, corporate hospitality, promotional expenses, hiring decisions, political and charitable donations) to a state official (public bribery) or a person carrying out managerial functions in a legal entity (private/commercial bribery) with the purpose to influence the use or misuse of the recipient's powers as well as for general patronage or connivance. Only individuals can be criminally liable. The maximum punishment for bribe giving is a fine of 70 to 90 times the amount of bribe or seven to twelve years imprisonment with or without a fine of seventy times the amount of bribe.

Russian law also establishes an administrative liability for companies found to have committed bribery in the form of fines. The entity on behalf, or in the interests, of which the public or private bribe was given shall be liable in addition to criminal liability for the individual bribe giver. The maximum fine for bribery on behalf or in the interests of a legal entity is up to 100 times the amount of bribe.

Apart from the Russian legislation on anti-bribery, it is possible that foreign legislation, in particular the UK Bribery Act 2010 or the US Foreign Corrupt Practices Act ("FCPA"), would apply exterritorialy in Russia, in certain circumstances. Implementation of certain provisions of these acts may cause issues in terms of competition regulations in Russia. In particular, it may be difficult to avoid contracting certain counterparties with reference to compliance concerns based on a foreign legal act as it may be seen an unfair restriction of competition, especially if a refusal comes from a company holding a considerable share or a dominant position in the market. Enforcement of exterritorial regulations in Russia should be carried out cautiously and based on explicit and transparent contracting policies and rules with consultations with regulatory authorities if required.

Furthermore, as a matter of Russian anticorruption laws, all companies operating in Russia must take measures to prevent corruption and develop specific measures to prevent corruption. The suggested measures include designation of departments and officials responsible for implementation of preventive policies against corruption and other offences, development and introduction into practice of standards and procedures aimed to ensure the company's work in good faith, adoption of the code of ethics and office conduct for the company's employees etc.

Sanctions

Since 2014 several countries, including EU member-states, the USA, Canada, Australia and Japan, have enforced economic sanctions

against certain Russian nationals. These sanctions prohibit persons originated from these countries engaging in certain dealings with specified Russian individuals and entities. The sanctions also restrict specific activities in certain market sectors in Russia, most commonly such as financial services, natural resources and technology.

For example, the sectoral sanctions imposed by the USA prohibit US persons transacting in new debt with a maturity of longer than 30 days or new equity issued by the entities operating in the Russian financial sector listed by the US Department of the Treasury. Both debt and equity are broadly defined and include in the case of debt bonds, loans, extensions of credit including deferred payments under agreements; and in the case of equity stocks, shares depositary receipts or any other evidence of title or ownership. These prohibitions apply equally to any subsidiaries owned 50 per cent or more by one or more of the identified sanctioned individuals and entities.

Employment Laws

As a matter of Russian law, employers must enter into a formal employment contract, made in written form, with each of their employees. The majority of the terms and conditions of the employment contract are prescribed by law. In general, employers / employees cannot contract out of labor law regulations. These regulations will apply even if there is no formal contract between employer and employee, provided there is proof of actual employment.

There is an important distinction between the employment relationship between an employer and his/her employee, and the relationship between businesses and independent contractors. The former is governed by labor law, the latter by general contract law.

This distinction is not always easy to draw, but it has far-reaching consequences as employees enjoy a variety of rights under labor law regulations which are not extended to independent contractors. The distinction is also important as it affects tax and social insurance, as well as other matters such as pensions. It is important to note that, an independent contractor who actually performs a labor function for her/his counterparty may claim for qualification of her/his services agreement as an employment contract by applying to court.

The normal working week is 40 hours and, unless internal work regulations and the employment contract provide for irregular working hours, overtime must be paid by the employer where the working week exceed this. There are a number of restrictions on working outside normal working hours.

Russian law does, however, have an irregular working hours regime. In case of irregular working an employee has specific working hours but can be from time to time be required to work outside of these hours. Employees with irregular working regime according to their internal work regulations and their employment contracts are entitled to additional paid holiday, which cannot be less than three calendar days per year.

An employee is entitled to cancel her/his employment contract at her/his own discretion by giving two weeks' prior notice.

An employee can be only dismissed without her/his consent based on the exhaustive list of grounds including, inter alia, liquidation of the company, redundancy or disciplinary termination due to lack of qualification, repeated misconduct and certain other grounds listed by the Russian Labor Code. As a matter of practice, many employers prefer to enter into a mutual termination agreement providing compensation in the amount of two to four month salaries where the termination ground is difficult to formally confirm.

Termination provisions for directors of a company are more employer-friendly. In particular, a director must give a month notice of termination. In addition to this, her/his employment agreement may be terminated in a result of a relevant decision taken by the company’s corporate bodies or on specific grounds agreed in the agreement by the parties with no mandatory reference to the Labor Code.

Foreign employees must have a valid working visa issued on the basis of the permit obtained by the employer. Granting permits is subject to a quota established by authorities. The rules on quotas do not apply to the so called highly

qualified specialists, which are foreign citizens with relevant working experience, skills and achievements and whose annual remuneration exceeds certain threshold. It is an employer's responsibility to decide whether a relevant individual meets the criteria of a highly qualified specialist (i.e. whether he or she has relevant working experience and skills etc.) Residence permits and work permits for such specialists are issued for a period of up to three years.

Personal Data and Privacy

Personal data is defined as any information that directly or indirectly relates to an identified or identifiable individual. With a few exceptions, personal data may only be processed upon a clear and informative consent obtained from the relevant individual. There are no strict requirements as to the form of the consent. Depending on the circumstances a click on a website or communication by telephone or e-mail may be sufficient.

Generally, a cross-border transfer of personal data to a foreign jurisdiction requires formal written consent of the individual unless the transfer is necessary for entering into an agreement with the respective individual or there are certain other circumstances.

In certain circumstances, cross-border transfers are exempted from this regulation. For example, if the transfer occurs within the countries that are members of the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data.

Under the so called data localization requirement, personal data of Russian citizens must be stored and be retrievable in the territory of the Russian Federation if it is used in connection with business activities directly conducted in Russia.

Intellectual Property

Russian intellectual property laws recognize patents, trademarks (service marks), company names, trade names, copyrights (which include software and databases), know-how and trade secrets, etc. In general, infringement of intellectual property rights may entail administrative and criminal liability.

The assignment and/or licensing of registered intellectual property objects (such as patents, trademarks) are subject to registration with the Russian Patent and Trademark Office. Failure to register the assignment / licensing agreement renders the transfer invalid under Russian law.

As a general rule, the exclusive rights to the copyright works and/or a patentable objects created or developed by employees belong to the employer, unless otherwise provided for by the labor agreement by the parties.

There is an exemption for inventions, utility models and industrial designs developed by employees (using their employer's equipment) outside of their employment. In such a situation, the right to file a patent application belongs to the employee. The employer retains a right to the invention by way of a non-exclusive royalty-free license. Alternatively, the employer can claim damages if any are incurred as a result of the invention.

Infrastructure and Public-Private Partnership

The Russian legal framework on infrastructure development has benefited significantly from a number of amendments over the last two years, which have improved the bankability of Russian projects and opened up new possibilities for Russian and foreign investors.

There are a number of ways to structure infrastructure projects in Russia which involve public-private partnership ("PPP").

A concession agreement is one of better-regulated and more reliable instruments for implementing an infrastructure project involving public and private financing. Various projects ranging from large-scale mega-projects (e.g. the Central Ring Road, Moscow – St. Petersburg highway) all the way to smaller municipal infrastructure projects (e.g. municipal heating, water, waste projects) have already benefited from the use of concession agreements. The relevant legal framework applies to such sectors as transport (roads, bridges, tunnels, airports, etc.), social infrastructure (healthcare, kindergartens, schools, etc.), utilities (waste, water, heating facilities, etc.), defense, tourism, and agriculture.

Generally, there are two ways to conclude the concession agreement: either by way of tender, or following an unsolicited proposal from a private investor. The parties to concession agreement are a grantor (the Russian Federation or a constituent entity or a municipality) and a concessionaire (the private investor).

BTO (RTO) (build-transfer-operate (rehabilitate-transfer-operate)) is the only model available for a concession agreement. The ownership title to a concession facility always remains vested in the grantor.

The law on concession agreements sets out various types and mechanisms of state support and provides for standard guarantees to private investors in line with best international PPP practices. Following a number of amendments introduced between 2012 and 2014, the market consensus is that the law on concession agreements meets most of sponsors' and financiers' requirements and facilitates structuring bankable projects.

The concept of PPP appeared first in regional laws and only recently made its way up to the federal level. The federal law on PPP entered into force on 1 January 2016. In many respects a PPP agreement is very similar to the concession agreement. One of the key specific features of PPP is availability of private ownership to the PPP facility. It is possible to structure a PPP project as BOT (build-operate-transfer), BOOT (build-own-operate-transfer), BOO (build-own-operate), etc. There are also some differences in terms of project preparation and approval, as well as tender procedures.

The law on PPP also contains a numbers of provisions protecting the rights of sponsors and financiers and thus facilitating the bankability of PPP projects.

The other possible contractual options for infrastructure development projects include: long-term investment agreements, "conventional" investment agreements and lease agreements with investment obligations.

Developing the infrastructure of the Far East of Russia has recently become a new trend supported by the Russian Government. Federal Law 'On Priority Developments Areas' was adopted 29 December 2014 and entered into force on 30 March 2015. More than a dozen priority development areas have already been established. The law provides for a solid stimulus package, including reduced taxation, reduced land lease rates, simplified procedure for attraction of foreign staff, reduced customs duties, free land plots and infrastructure provision, duty-free zone, simplified state control, accelerated and simplified administrative procedures etc.

Court Proceedings and Arbitration

Notwithstanding the Constitutional Court of the Russian Federation, which adjudicates on Constitutional matters, Russia has two types of state courts. The first type is known as "arbitrazh" (or commercial) courts, and the second is known as an ordinary Courts.

Arbitrazh courts are concerned with business disputes and generally hear cases on the creation, re-organization, liquidation and bankruptcy of companies. They also adjudicate on disputes between companies and their shareholders. The arbitrazh courts also have a separate division, which hears disputes as to intellectual property rights and IP regulatory matters.

Ordinary courts hear disputes on all other legal issues. These courts generally deal with civil disputes between individuals, usually linked to employment, family and inheritance issues. They also have the exclusive function of undertaking criminal cases.

Russia also has arbitration tribunals. As usual, use of an arbitral tribunal depends on the prior agreement of the parties.

A foreign judgment obtained from a state court of a foreign jurisdiction may be enforced in Russia if there is an international treaty, most common a bilateral treaty, on mutual recognition of judgments.

Foreign arbitral awards are generally enforceable in Russia in accordance with procedures and rules of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to which Russia is a party. These awards will be recognized and enforced by Russian courts

without reviewing them on its merits unless they contradict the concept of public order.

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Key contacts

Further information

If you would like further information on any aspect of the issues described in this note please contact a person mentioned below or the person with whom you usually deal.

Oxana Balayan

Managing Partner, Moscow
T +7 495 9333000
Oxana.Balayan@hoganlovells.com

Svetlana Fedkova

Head of PR and Marketing, Moscow
T +7 495 9333000
Svetlana.Fedkova@hoganlovells.com

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