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RECENT UPDATES IN RUSSIAN LAW (1 QUARTER 2017)

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1. CORPORATE LAW

1.1. The Bank of Russia defined thresholds for related party transactions

According to the recent amendments to the Federal Law "On Joint Stock Companies" and the Federal Law "On Limited Liability Companies" [1], a transaction is exempted from related party transactions regime if both following conditions are fulfilled:

1) value of the transaction amounts less than 0.1% of the book value of the company's assets;

2) value of the transaction does not exceed the limit established by the Bank of Russia.

On 31 March 2017 the Bank of Russia set the following related party limits based on book value of company's assets [2]:

- for companies with book value of assets not exceeding 25 billion rubles – 20 million rubles;
- for companies with book value of assets from 25 billion to 100 billion rubles – 50 million rubles;
- for companies with book value of assets from 100 billion to 1 trillion rubles – 500 million rubles;
- for companies with book value of assets from 1 trillion to 2 trillion rubles – 1 billion rubles;
- for companies with book value of assets exceeding 2 trillion rubles – 2 billion rubles.

The Order comes into force on 13 May 2017.

[1] Federal law dated 3 July 2016 No. 343-FZ "On amending Federal law "On Joint Stock Companies" and Federal law "On Limited Liability Companies" in part of regulation of major transactions and interested party transactions"

[2] Order of the Bank of Russia dated 31 March 2017 N 4335-O "On establishing limit values for transactions of Joint Stock Companies and Limited Liability Companies where value exceeding transactions may be recognized as related party transactions" ("the Order")

1.2. Arbitrability of corporate disputes

Starting from 1 February 2017 most corporate disputes may be referred to arbitration by concluding corresponding arbitration agreement set forth by the Federal law № 382-FZ "On the arbitration (arbitral proceedings) in the Russian Federation" [1] (hereafter – "the Law"). Previously such disputes were to be reviewed by state commercial (arbitrazh) courts only.

Some disputes may not be referred to arbitration.

Arbitration agreement may be concluded in relation to various corporate disputes, however, the Commercial Procedural Code of the Russian Federation establishes an exhaustive list of exclusions. Following disputes may not be referred to arbitration and shall be considered by state commercial courts:

- on convening of a general shareholders meeting;
- regarding notarization of transactions with shares in the charter capital of limited liability companies;
- on challenging of non-regulatory legal acts, decisions and acts (omissions) of the state bodies, local self-government bodies and their officials;
- involving legal entities of strategic importance for the national defense and state security;
- addressing buy-back of shares by a joint stock company and acquisition of more than 30% shares of a public company;
- on expulsion of participants from limited liability companies.

Some disputes require special procedure of referring to arbitration:

- on establishment, reorganization and liquidation;
- on legal actions of shareholders seeking compensation of losses incurred by the company;
- on invalidation of transactions of a legal entity;
- on formation of corporate management bodies;
- arising from shareholders` agreements;
- regarding securities' issues;
- on challenging decisions of company's management bodies.

Such disputes may be referred to arbitration only upon fulfillment of the following conditions:

- the company itself, all shareholders and other persons, acting as defendants or claimants in such disputes, have entered into an arbitration agreement;
- permanent arbitral institution [2] is specified as an arbitration forum;
- place of arbitration is the Russian Federation.

Apart from the standard methods (arbitration clause, separate agreement in writing, exchange of electronic documents), the Law provides for two new methods of entering into arbitration agreements on corporate disputes:

- exchange of service documents (including statement of claim and defense statement), where one of the parties confirms the agreement and the other party does not oppose to it;

- inclusion of an arbitration agreement in a company's charter of (with the exception of public joint stock companies and companies with 1,000 or more voting shareholders). However, in this case the place of arbitration is limited to the territory of the Russian Federation.

The arbitration agreement may be concluded starting from 1 February 2017. All agreements concluded before this date are deemed unenforceable.

New rules for arbitrability of corporate disputes in Russia are generally aimed at increasing its investment appeal and popularity of Russian arbitration institutions. On the other hand, the Law de facto limits opportunity of referring corporate disputes between Russian companies to international arbitrations. Foreign arbitrations shall obtain a status of permanent arbitral institution in accordance with the Law to handle corporate disputes involving Russian parties and requiring special procedure of referring to arbitration.

[1] Federal law dated 29 December 2015 № 382-FZ "On the arbitration (arbitral proceedings) in the Russian Federation"

[2] Permanent arbitral institution – subdivision of a non-commercial organization performing arbitration on a permanent basis, acting pursuant to the Law and under authorization from the Government of the Russian Federation. After 1 December 2017 arbitrations having not obtained the above status will cease to exist

1.3. New regulation of requirements to eligible director in the boards of directors of companies with public ownership

The requirements to persons nominated as eligible director in the boards of directors of publicly owned joint stock companies are clarified by Russian Government Decree [1].

It had previously been established that a person nominated by the Russian Federation as a shareholder for election to the board of directors as an independent director should not, among other things, for the past 5 years be a continuous member of the board of directors (supervisory board) of the company, which he is electing to.

The Decree has extended this term to 12 years.

[1] Russian Government Decree dated 28 January 2017 № 94 "On amending par. 8 (1) of the Regulation on the management of federally owned shares of JSC and the use of the special right to participate in the management of joint stock companies ("golden shares") of the Russian Federation" (hereafter – "the Decree")

2. CIVIL LAW

2.1. Recovering companies' reputational damages

In the past, recovering companies' reputational damages in Russia used to be rather challenging, if not impossible. According to the recent case law, one may note that the situation has begun gradually changing.

Initially, the Russian Civil Code contained only general terms on recovery of non-pecuniary damages by individuals and provided for application of the provisions on individuals' business reputation protection to legal entities. The Code did not stipulate specific remedies for compensation of legal entities reputational harm. That is why Russian courts often refused to recover such damages.

The practice substantially changed in 2003. The Constitutional Court ruled that legal entities are entitled to claim damages for reputational harm regardless the absence of such remedies in the

Civil Code.

The Court also stated that compensation of harm caused by depreciation of goodwill has its own legal nature that it is different from non-pecuniary damages awarded to individuals. Despite that, other Russian courts developed completely different approaches regarding the nature of such compensation:

- some courts considered monetary compensation of harm to business reputation of legal entity being similar to compensation of non-pecuniary damages;
- other courts, including the former Supreme Commercial Court, outlined the special nature of compensation of harm to business reputation as reputational damages.

Thus, Russian courts often handed down contradictory decisions in similar cases.

In 2013, amendments to the Civil Code stipulated that the rules on compensation of non-pecuniary damages cannot be applied to legal entities. This brought up a question whether a legal entity may claim reputational damages at all.

In 2016, the Supreme Court held that legal entities can protect their reputation through:

- compensation of loss (requires proving measure of damages, cause and causal link as elements of the wrongdoing);
- refutation of the published information.

Non-material nature of goodwill determines the difficulty of proving the amount of actual loss incurred by spread of defamatory statements using general rules of damages' recovery. At the same time refutation as de facto standard and straightforward remedy in some cases may be not enough to compensate non-material damages and to prosecute the wrongdoer.

The latest ruling № 307-ES16-8923 passed in November 2016 by the Supreme Court is likely to organize the judicial practice and to ensure its uniformity by distinguishing between legal entities' compensable reputational damages and non-pecuniary damages available for individuals' award only.

In order to recover reputational damages a legal entity shall prove:

- the fact of distribution of defamatory information depreciating business reputation (publication of defamatory information in the media);
- formation of certain reputation in the relevant field (rankings showing leading position of the company);
- adverse effects as a result of distribution of defamatory information, including the loss of confidence in the reputation (company's expulsion from the ranking).

The Supreme Court introduced potential adverse effects, presence of which denotes possible compensation of reputational harm. Prior to that the question whether a certain adverse effect was sufficient for compensation used to be the cause of much debate.

Compensation of damages caused to the business reputation gives plaintiffs a real possibility of protection in a situation where it is impossible to prove the fact and the actual amount of damages. The main feature of this method of protection is that there is no need to prove damages.

Nevertheless, there are still several unresolved questions about:

(1) Criteria used by the court to determine the exact amount of compensation: the amount of compensation depends solely on the judge's belief and is often determined on the basis of circumstances not related to the business reputation of the legal entity (for example, the circulation of the publication spreading defamatory information, the area of publications' circulation etc.). Moreover, it is inherent for Russian courts to underestimate the amount of compensation to be

awarded in such cases.

(2) Evidence that is enough to prove the loss of confidence in plaintiff's reputation: it is difficult to prove loss of confidence in the company's reputation due to absence in the law and practice of the illustrative evidence list, which could confirm such loss.

Both of these problems were clearly manifested in the decision of the Commercial Court of Moscow dated 19 December 2016 on the case number A40-97503/16 regarding PJSC "Oil Company Rosneft": while the claimed compensation amounted to 3.179 billion rubles, the actual award was only 390 thousand rubles. Moreover, a report on business reputation evaluation was provided as evidence to prove the amount of compensation. However it was concluded that the report did not meet the requirements of relevance and admissibility of evidence amid the absence of information required by the law on the persons responsible for its preparation.

Hopefully, these issues will be further clarified in the upcoming case law.

3. TAX LAW

3.1. Latest initiatives on promoting production localization in Russia

The Ministry of Economic Development of the Russian Federation has prepared a draft law [1] introducing 0% value added tax (VAT) rate on re-export of goods produced by foreign companies in Russia in processing regime or using foreign components.

Currently there are certain practical problems related to taxation of goods' re-export in Russia, namely:

1) on the one hand, according to Russian tax legislation re-export is not subject to VAT. That's why foreign companies importing goods to Russia for manufacturing or processing and further re-exporting of the end product may not recover VAT paid to their Russian suppliers (for example, in case of purchasing Russian components required for processing). This results in increase of the cost of produced goods;

2) on the other hand, according to the position of Russian financial authorities [2], 18% VAT shall be paid on sale of re-exported goods, which leads to further increase of the end products' costs.

The draft law deals with both problems by introducing 0% VAT rate on realization of re-exported goods, thus enabling foreign companies re-exporting goods processed in Russia to reduce the expenses on their production.

The draft law also provides for a list of documents to be submitted with tax authorities to confirm the relevant tax benefit.

Consequently, in case of its adoption, the law is planned to facilitate local production of goods by foreign companies in Russia.

According to the current status of the draft law review, it is published on the federal portal of draft legal acts [3] and an independent anti-corruption monitoring is carried out in relation thereto.

Notably, production localization in Russia means placing part of foreign manufacturing process at the territory of the Russian Federation (for example, by importing foreign parts and assembling them at a local plant).

The criteria for local products differ widely for each industry and product. It might be the percentage of share of the cost of foreign raw material and components in the price of the final product, performance of certain production operations in Russia, and the availability of after sales services in the Eurasian Economic Union.

Localization provides a number of advantages: tax benefits, government subsidies and state and local procurement preferences.

Localization in Russia can be carried out by different ways: entering into special investment contract; locating plant in a special economic zone.

[1] Draft Federal law "On amending chapter 21 of part II of the Tax Code of the Russian Federation"

[2] The Letter of the Ministry of Economic Development of the Russian Federation dated 21 July 2016 № 03-07-08/42825

[3] Official website for publication of information about draft laws and regulations prepared by the federal executive bodies can be found at http://regulation.gov.ru