

## Changing landscape of risk in Russia

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The life of the directors and officers of a Russian company may soon become less comfortable than before. A number of amendments to Russian corporate laws are pending and, if enacted, they will bring significant changes to the current risk landscape of the Russian corporate world. The proposed changes to the Law on Joint Stock Companies and the Law on Limited Liability Companies amount to a fundamental shift — for the worse — when it comes to personal liability for Russian directors. The good news is that certain provisions governing directors and officers insurance may be clarified. Therefore, the directors will at least have a chance to better protect themselves in the rising tide of liability.

### Overview of Russian Legal System

Participants in civil law transactions in Russia are generally governed by a uniform collection of regulations set out in the Civil Code of the Russian Federation. Civil Code sections dealing with legal entities set out the general principles of organisation, regulation and management of Russian companies. More specific federal laws, such as the Law on Joint Stock Companies and the Law on Limited Liability Companies, develop and explicate the Civil Code principles in detail. Any amendments to federal laws must be made by a separate amending legislation which, before coming into force, is required to pass through readings in the State Duma, the federal legislative body of the Russian Federation.

### Amendments to Law on Joint Stock Companies and Law on Limited Liability Companies

Currently pending before the State Duma is legislation with a cumbersome title "On Amending Certain Regulatory Acts of the Russian Federation in the Parts Applicable to Holding Liable Members of Management Bodies of Business Companies". It proposes a number of changes to the Law on Joint Stock Companies and the Law on Limited Liability Companies which could potentially implicate every joint stock company and every limited liability company in Russia.

The changes offered by the amending law are of particular interest to directors and officers because they purport to widen the basis for potential director and officer liability. The changes provide that the management bodies shall be liable not only to the company, but they could bear secondary liability to the shareholders or participants of the company and the third parties such as holders of securities issued by the company (e.g., corporate bonds). This would significantly expand the class of the potential claimants able to sue a director or officer.

The amending law sets out what actions could give rise to secondary liability. The examples for the management bodies of the joint stock companies include acquisition of securities in violation of the existing procedures, failure to grant the right of first refusal or violations of the existing rights, violations of dividend payment procedures, setting the price for securities offering in violation of the federal laws, and violation of the legal procedures for buyout or acquisition of securities. For limited liability companies the examples include violations of the procedures established by law for contributions to the charter capital of the company, missing registration deadlines, violations in purchasing interests by the company itself and failure to follow the procedures established for appraisal of in-kind contributions to the charter capital of the company.

The amending law restates a requirement for the officers and directors to act reasonably and in good faith. Rather than leaving it up to the courts to interpret the meaning, the amending law seeks to establish what means to act unreasonably or in bad faith. For example, the officer would be presumed to have acted unreasonably if he made a decision without taking into account the information at his disposal or he did not act to obtain the necessary information prior to making the decision.

The presumption of acting in bad faith would apply in the situations where there was a conflict of interest. This includes situations where the officer had a personal interest in a transaction entered into by the company and he failed to inform the board. Other scenarios when the presumption of bad faith would exist is where he knew or should have known that a particular action, decision or an omission to act for which he voted were not in the interests of the company, or where he failed to perform his duties without a solid justification. It also includes situations where his actions or decisions were made in violation of the laws or internal by-laws of the company.

The drafters of the amending law did not establish a closed list of examples of unreasonable or bad faith actions, but rather point to circumstances where the burden of proving reasonableness or good faith would be shifted to the officer in question. In the other circumstances where the claimant would seek to establish unreasonable or bad faith actions, the burden of proof is borne by the claimant. A number of other significant changes are offered by the amending law, going hand in hand with the proposed increased basis of liability for directors and officers. Notably, the proposed changes in the area of the D&O insurance introduce the concept of indemnification and liability insurance for directors and officers.

The amending law passed the first reading in October of 2010 and is due for the second reading this summer. The outlined changes are likely to be altered further by the second reading. Between the second and the third reading of the draft law, mostly technical changes would be made.

### **Insider trading**

Another revolutionary, albeit long overdue, addition is the Law on Prevention of Illegal Use of Insider Information and Manipulation of the Market (the Law on Insider Trading) which came into force at the end of January 2011 (except for certain provisions which will take effect in July 2011 and July 2013). Similar to other laws on insider trading in Europe

and the United States, its main purpose is to prevent the illegal use of the insider information and manipulation of the market. The law includes a list of insiders, including members of the board of directors, the management boards, chief executive officers, and members of the audit committee. The Law on Insider Trading is another new area where the Russian director or officer could face liability. These pending or actual amendments to the Russian corporate environment are only a few examples of how the risk landscape in Russia is changing. Russia was once a territory where suing a director or an officer was difficult, if not impossible. It is turning into a culture where the managers need to be fully aware of the possible risks and take all necessary precautions to safeguard against them.

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