The Corporate Governance Review

Ninth Edition

Editor
Willem J L Calkoen

The Law Reviews

THE CORPORATE GOVERNANCE REVIEW

NINTH EDITION

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Willem J L Calkoen

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PREFACE

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this ninth edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society, and they very often do. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management, and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in better corporate governance: parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working diligently, many with even more diligence. Nevertheless, there have been failures in some sectors, so trust has to be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most non-executive directors understand the business? How much time should they spend on their function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans and takeover defences?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on norms by codes and influential investor groups.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, far-sighted boards have 'selected engagements' with stewardship shareholders to create trust.

What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better tone from the top? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code, and many countries produced national versions along the lines of the Cadbury comply or explain model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs have gradually amassed too much power, or companies have not developed new strategies and have produced bad results – and sometimes even failure. More are failing since the global financial crisis than previously, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing a regulation for this area as well. Recently, we see that governments want to involve themselves in defending national companies against takeovers by foreign enterprises. We also see a strong movement of green investors, which often is well appreciated by directors. There is a move to corporate citizenship.

This all implies that executive and non-executive directors should work harder and more as a team on long-term policy, strategy, entrepreneurship and investment in R&D. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management with new risks entering such as a digitalised world and cybercrime is an essential part of directors' responsibilities, as is the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders, regulations and the press?

Each country has its own measures; however, the chapters of this book also show a convergence. Understanding differences leads to harmony. The concept underlying the book is of a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that permit convenient comparisons, where a quick first look at key issues would be helpful to general counsel and their clients.

My aim as editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen as an essential reference work in our field. To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law and best practice by reading about the laws and practices of others. Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

Willem J L Calkoen
NautaDutilh
Rotterdam
March 2019

Chapter 22

RUSSIA

Danil Guryanov, Denis Morozov and Bogdana Shtoma[1]

I OVERVIEW OF GOVERNANCE REGIME

i Legal and institutional framework

The core statute setting forth the general framework for the Russian governance regime is the Russian Civil Code (RCC).[2] The RCC outlines the basic available corporate forms, including the most commonly used forms: the limited liability company (LLC) and the joint-stock company (JSC); the structure and powers of the various corporate bodies; the rules on representation; the statutory duties and the matters of civil liability of a company's management and controlling persons; and the procedure for bringing derivative actions.

The JSC Law[3] and the LLC Law[4] each expand upon and supplement the RCC provisions. Importantly, the JSC Law also specifies takeover procedures in respect of public JSCs. The provisions of those laws are primarily enforced by shareholders through Russian commercial (or arbitrazh) courts.[5]

Another statutory framework is the Securities Market Law.[6] This lays out the operational rules for all securities market participants in relation to the offering of securities, the marketing of financial products and the disclosure of information. Regulatory and interpretative acts of Russian regulatory and enforcement agencies (such as the Standards for Issuance of Securities[7] and the Disclosure Rules[8]) expand upon and supplement the provisions of the Securities Market Law.

Both public and non-public corporations active in certain highly regulated sectors of the Russian economy (such as banks, insurers, non-state pension funds and professional securities market participants) are bound by industry-specific legislation. This legislation specifies management qualification and reputation requirements, liquidity and financial stability standards, risk management and compliance procedures, and, in certain cases,

1 Danil Guryanov and Denis Morozov are senior associates and Bogdana Shtoma is an associate at Herbert Smith Freehills CIS LLP.

2 Civil Code of the Russian Federation (Part 1) (Federal Law No. 51-FZ dated 30 November 1994).

3 Federal Law No. 208-FZ On Joint-Stock Companies dated 26 December 1995.

4 Federal Law No. 14-FZ On Limited Liability Companies dated 8 February 1998.

5 For ease of reference, Russian arbitrazh courts are referred to as commercial courts in this chapter.

6 Federal Law No. 39-FZ On the Securities Market dated 22 April 1996.

7 Regulation No. 428-P On Securities Issuance Standards, the Procedure of State Registration of Issuance (Additional Issuance) of Securities, the Procedure of State Registration of Securities Issuance Reports and the Registration of Securities Prospectuses approved by the Central Bank of the Russian Federation on 11 August 2014.

8 Regulations on Disclosure of Information by the Issuers of Securities No. 454-P approved by the Central Bank of the Russian Federation on 30 December 2014.

specific requirements in relation to the structure of the governing bodies of the regulated companies. Industry-specific legislation is primarily enforced by Russian regulators. The Russian Central Bank (CBR) is the key regulator: it is in charge of the listed companies' regime, and is generally responsible for the prudential regulation and supervision of Russia's financial services industry.

Best practice provisions for listed companies are set out in the Corporate Governance Code (CGC)[9] and the listing rules of licensed stock exchanges.[10] Listed companies are expected to comply with the CGC or disclose and explain non-compliance in their annual reports. Companies must comply with the listing rules requirements to obtain and maintain premium or standard listings (rather than mere quotations) at the stock exchange. Best practice provisions for certain regulated companies are determined and enforced by self-regulatory organisations (SROs) in each sector. For example, the law on self-regulation of financial markets[11] requires the SROs for professional security markets participants to agree with the CBR the corporate governance standards for their members, which will then be mandatory.

ii Corporate governance regime: latest developments

Virtually non-existent in the early 1990s following Russia's abrupt transition to a market economy and privatisation, corporate governance standards have gained more significance over the years and became one of the top policy issues in 2010, when the government launched an initiative to transform Moscow into an international financial centre and channel investments in Russian assets from foreign jurisdictions onshore.

Of all the steps taken to achieve this ambitious goal, those intended to improve the quality of capital markets' infrastructure and financial services' regulatory framework were the most successful. For example, the government has successfully completed reforms of netting and clearing arrangements on organised markets, stock exchanges and custodian activities; self-regulation of financial markets; facilitated the access of foreign investors to Russian markets through international clearing systems; and implemented measures against the abuse of inside information and market manipulation. In a further attempt to improve its stability, the government has begun to regulate the financial services industry more closely. Since concentrating the regulatory functions for that sector under the auspices of the CBR in 2013, the CBR has been waging a large-scale campaign against financial institutions and their management involved in bad faith or suspicious transactions or practices detrimental to their clients (e.g., money laundering, asset dissipation and write-offs, misstatements of financial reports, excessive risk assumption). According to the CBR's official statistics, as at 1 July 2018 there were around 100 cases pending before Russian courts regarding the personal liability of the management and controlling persons of insolvent credit organisations.[12] The CBR's continued efforts to remove financially unstable and non-compliant participants from the financial services market have enjoyed continued public support from the highest-level Russian officials.

As part of broader reforms of Russian civil law, in 2014 the RCC was amended to distinguish between public and non-public companies (with non-public companies having

9 Corporate Governance Code, published in the Official Journal of the CBR No. 40 (1518) (18 April 2014).

10 Each stock exchange develops a set of rules for access to public trading in securities that in turn are based on the benchmark approved by the regulators.

11 Federal Law No. 223-FZ On Self-Regulatory Organisations on Financial Markets dated 13 July 2015.

12 http://cbr.ru/Content/FileDocument/File/47615/involvement.pdf.

significantly greater flexibility in their governance arrangements). A company is deemed to be public if it has a registered prospectus in respect of its shares or instruments convertible into shares and has entered into a listing agreement with a licensed stock exchange.[13]

In further corporate governance reforms, the government concentrated on the two principal conflict areas common in virtually any corporate governance regime: conflicts between the interests of the majority and minority shareholders, and the shareholders in general and the management of the company. In assessing how regulation of the first of those conflict areas was addressed, it is important to remember that the Russian economy is characterised by a high concentration of ownership and control, in both public and non-public companies, and a very significant government footprint (with the government holding controlling stakes in key players in the banking, energy, transport, machinery, telecoms and various other sectors).[14] The majority shareholders are often perceived by Russian policymakers as being in the business for the long run, and taking a strategic interest in its development. While recognising the importance of attracting financial investors into Russian businesses, policymakers often see financial investors as having a more speculative interest in obtaining a short-term return on their investment. The key concern of Russian policymakers in respect of minority shareholder protection matters was, therefore, to avoid the overextension of the powers of minority shareholders, and so prevent a significant rise in shareholder activism by short-term speculative investors (or their nominees to the supervisory board, now that they are entitled to bring derivative actions) to the detriment of the company's long-term stability and development. To try to find the balance between the various conflicting interests in this area, the government retained very low thresholds for shareholders to bring derivative actions (1 per cent for derivative actions concerning management liability or to challenge some *ultra vires* transactions of management). At the same time, to limit the room for potential abuse of the right to bring derivative actions, a more complicated procedure for bringing those actions was introduced to the JSC Law. This procedure requires the claimant shareholder or the claimant supervisory board member to notify all the shareholders in the company of his or her intention to bring a derivative action (by submitting the notice to the company, which then forwards it to the shareholders), and contemplates a cut-off time for all shareholders to join derivative actions initiated by a shareholder or by a supervisory board member. Shareholders who do not join the action lose their right to bring any action in connection with the same matter in the future. On the other hand, Russian corporate law has been supplemented with a concept of liability of controlling persons[15] of the corporation to enhance both the accountability of such controlling persons and the protection of minority shareholders against controlling persons' bad-faith actions.

13 This definition was introduced in 2015. However, immediately following the 2014 reform of the RCC, a different definition of a public company applied, which allowed a company simply to opt to acquire public status without arranging for the public trading of its shares. Simultaneously with the introduction of new requirements for acquiring public status, for those companies that had previously opted in favour of public status but do not satisfy the new criteria, the law established a transition period up to 2020, during which those companies should either apply for termination of their public status or register a prospectus for their shares or securities convertible into shares.

14 OECD, 'OECD Economic surveys: Russian Federation: January 2014: Overview', p. 9 (www.oecd.org/eco/surveys/Overview_RUSIA_2013.pdf).

15 A controlling person of a company is a person having actual ability to determine how the affairs of the company are run (in particular by giving instructions to the members of the governing bodies of the company).

In addressing the second set of conflicting interests of various stakeholders in a corporation, the government concentrated on closing the previous regulatory loopholes, which, until recently, provided very limited legal instruments for shareholder and supervisory board oversight of the exercise by management of their widely formulated powers.

To enhance the accountability of the management of both public and non-public companies, the RCC expressly sets out an overriding duty of the members of governing bodies of companies and their controlling persons: to act in the company's best interests reasonably and in good faith, subject to an obligation to indemnify the company for damage resulting from a breach of that duty. To improve the quality of board oversight, the government has significantly expanded the powers and information rights of supervisory boards and, therefore, their independence from management. Most importantly, supervisory board members have been given the power to bring derivative actions.

The government is continuing its efforts to find an appropriate degree of balance between the interests of various stakeholders in Russian corporations. There are a number of legislative initiatives proposed by Russian ministries seeking to address sensitive issues such as the information rights of supervisory board members, the takeover rules in relation to public companies, derivative actions and the liability of controlling persons. These proposed amendments are now mostly at the consultative stage of the legislative process.

II CORPORATE LEADERSHIP

i Board structure and practices

Russian law provides for a two-tier board structure in public companies, including a supervisory board (also referred to as the board of directors) and the executive bodies. The two-tier structure is also mandatory for non-public companies that have more than 50 shareholders or that are subject to a specific regulatory regime (e.g., credit institutions).

The executive bodies of a company include the CEO (or several joint CEOs) and the management board. The formation of a management board is optional, except for those companies that are subject to special regulatory regimes (such as credit institutions).

Supervisory board and management board

Functions and formation

The functions of the supervisory and management boards are to supervise and advise CEOs (or joint CEOs) and limit their discretion on matters that are crucial for the stability and sustainable development of the company. The supervisory and management boards are not responsible for the day-to-day management of the company, and therefore do not have authority to enter binding contracts with third parties on behalf of the company.

The supervisory board is responsible for determining the company's long-term strategy and deciding on matters that affect key aspects of that strategy (e.g, the acquisition or disposal of major assets or the entry into a joint venture). Supervisory board members are usually nominated by the shareholders and rarely include representatives of the company's management – in particular, there is a statutory limitation on the representation of members of the management board on the supervisory board.[16] Additionally, the CEO, if elected to the supervisory board, may not serve as its chair. The supervisory board may not delegate matters within its competence to the management board or the CEO (or joint CEOs).

The information rights granted to the supervisory board were reinforced in 2014. Despite these improvements, the scope of information rights is not broad enough to ensure an appropriate level of transparency. For example, some Russian listed companies are only holding companies, while the key assets of the group are held by their operational subsidiaries. Russian law views these subsidiaries as separate legal entities (rather than as part of a single economic unit); therefore, supervisory board members and shareholders of the holding company are not entitled to request information about the activities of key subsidiaries bypassing the management of the holding company (however, an obligation of the management of the holding company to request and share information on the key subsidiaries if requested by the shareholders or supervisory board members of the holding company may be set out in the company's internal regulations). However, as mentioned above, a draft law was proposed in 2016 to fill in this gap and to grant supervisory board members access to the documents, books and records of the company on whose board they serve and its subsidiaries. The draft law also proposes to subject the management of the company to administrative liability for failure to provide this information upon the supervisory board members' request. The draft law has not been introduced to the Parliament and is still under discussion.

The management board usually includes the company's senior management and is subordinate to the supervisory board. Its primary function is to advise the CEO on the implementation of the strategy approved by the supervisory board and the most important matters of the company's day-to-day activities. The CEO is vested with the office of the chair of the management board by operation of law.

The minimum competence of the supervisory board is specified by the RCC and the JSC Law. The competence of the management board is determined wholly by the company's charter.[17]

Decision-making procedures

With few exceptions, the law does not regulate the decision-making procedures of the supervisory board or the management board, so that shareholders are free to specify the relevant procedures in the charter. The CGC urges the procedures for the supervisory board to be set out in a way that allows the supervisory board members to have appropriate time to prepare for meetings of the supervisory board and to engage in meaningful discussions on the matters in question. The CGC also recommends that important matters are decided by supermajority or unanimous voting.

Committees

Until recently, the formation of supervisory board committees was generally discretionary. However, from July 2018 public corporations are required to form an audit committee in

16 The members of the management board may not fill more than 25 per cent of the seats on the supervisory board.

17 The charter is the analogue of the memorandum and articles in Western jurisdictions.

their supervisory boards and implement risk management and internal control functions in general (July 2018 Amendments). There is no such statutory requirement for non-public companies.

A recommendation that such committees be formed was historically included in the CGC, which specifically refers to an audit committee (the formation of which has now been put on a statutory footing), compensation committee and human resources (HR) committee. The CGC urges that each of these committees, either entirely (audit and compensation) or predominantly (HR), comprise independent directors.[18] The supervisory board is urged to form other committees that are necessary based on the scale of the company's business (e.g., a strategy committee, corporate governance committee or ethics committee may be appropriate). Those recommendations continue to apply following the adoption of the July 2018 Amendments.

Additional requirements regarding the formation of supervisory board committees are included in the stock exchange rules. Compliance with such additional requirements is often a condition for a company to be included in certain quotation lists. For example, the MOEX Rules[19] require that companies with securities included in the first quotation level have audit, compensation and HR committees, and that companies with securities included in the second quotation level have an audit committee.

CEO (or joint CEOs)

The CEO (or joint CEOs) (referred to in law as the sole executive body) has the duty of managing the company (with assistance from, and supervision by, the supervisory and management boards). The CEO is held accountable by Russian law for the company's overall compliance with the applicable law. The CEO is vested with the power to enter binding contracts with third parties on behalf of the company. Additionally, the CEO may issue powers of attorney to other individuals or legal entities to allow them to represent the company.

18 There is no statutory definition of an independent director. However, the regulations on related-party transactions in effect from 1 January 2017 provide a number of additional criteria that members of the supervisory board of a public company need to satisfy to be able to participate in the approval of company related-party transactions. While the law does not expressly use the term independent directors when setting out those criteria, they aim to enhance the independence of the supervisory board members approving potentially sensitive transactions in which management or the controlling persons of the company have a personal interest. Namely, the supervisory board member in question shall not be, and shall not have been within one year prior to the date the related-related party transaction is approved by the supervisory board: the CEO of the company or a member of the management board, or otherwise involved in the management of the activities of the company; related to a person holding a managerial position in the company; or a *de facto* controlling person of the company.

In accordance with the CGC, an independent director should mean any person who has the required professional skills and expertise and is sufficiently able to have his or her own position and make objective and *bona fide* judgements, free from the influence of the company's executive bodies, any individual group of its shareholders or other stakeholders. It should be noted that, under normal circumstances, a candidate (or an elected director) may not be deemed to be independent if he or she is associated with the company, any of its substantial shareholders, material trading partners or competitors, or the government.

19 Listing Rules of Public Joint-Stock Company 'Moscow Exchange MICEX-RTS' adopted by the board of directors on 10 September 2018 and registered by the CBR on 2 February 2018 (http://fs.moex.com/files/257).

The scope of powers of each of the joint CEOs may differ depending on the provisions of a company's charter. The powers vested in the office of the CEO by the applicable law and the charter (in particular, the representative powers) may be performed by each of them individually and independently from each other or by all (or some) of them acting jointly. The functions of the CEO may alternatively be performed by a specialised management company on the basis of a management services agreement with the company.

Any action of the CEOs that is taken without due authorisation from the supervisory board, the management board and, in certain cases, the general shareholders' meeting, may be open to challenge by shareholders or supervisory board members, and be a basis for the CEOs to be liable to the company.

ii Directors

Appointment and removal

Supervisory board

Supervisory board members of a public JSC are elected annually by the general shareholders' meeting[20] (meaning that the maximum term is one year). Members may be re-elected for an unlimited number of terms. The supervisory board in a public JSC is elected by cumulative voting. Each shareholder receives a number of votes equal to the product of the number of shares held by the shareholder by the number of seats on the supervisory board, and may distribute these votes among the nominees as desired. The supervisory board is then composed of the candidates who receive the largest number of votes. Cumulative voting is an important element of the minority protection system in Russia, allowing minority shareholders to be represented on the supervisory board, which would not have been possible had those matters been decided upon by simple or qualified majority of votes.

As a general rule, the general shareholders' meeting may dismiss the supervisory board (as a group rather than any member individually) at any time prior to the expiration of its term of office.

Management board and the CEO (or joint CEOs)

Statute does not prescribe the term or procedure for the appointment of members of the executive bodies. In view of this, the matter is governed by the company's charter.

Independence, expertise and reputation

The professional suitability of supervisory board members and executive body members is becoming increasingly important in Russia. Under Russian law, no person disqualified by a court for an administrative or criminal offence (e.g., the falsification of financial and accounting reports, money laundering or insider trading) can serve as a CEO or a member of the management or supervisory boards of a public or non-public company for the term of their disqualification.

There are further reputational and qualification requirements for supervisory board members and executive body members of regulated companies. For example, a CEO of a

20 Since July 2018, the competence of the supervisory board has been broadened, empowering its members to propose candidates for the CEO (or joint CEOs), the supervisory board itself and the audit committee at their own discretion; however, the number of such candidates shall not exceed the overall number of board members.

bank must have a higher education degree and relevant managerial experience of at least two years. Similarly, a person who heads a financial organisation during a period in which its licence is withdrawn cannot serve as the CEO of an insurance company for three years from the date the licence was withdrawn.

In the absence of limitations in the charter, supervisory board members are generally free to simultaneously hold managerial and supervisory positions in other companies. The approach is entirely different for executive body members, which require an express authorisation from the supervisory board to be able to combine more than one office. Additionally, there are certain specific restrictions for regulated companies. For example, the CEO of a bank cannot simultaneously hold the CEO or chief accountant position in another bank, insurance company, non-state pension fund and certain other financial organisations (or their affiliates).

Remuneration of directors and senior management

Membership of the supervisory board does not result in employment by the company *per se*. In view of this, the basic position is that membership of the supervisory board is unpaid. However, the general shareholders' meeting may decide to remunerate or compensate the supervisory board members.

Executive body members are company employees and their salary is stipulated in their employment contracts. The CEO is responsible for implementing the company's employment policies by operation of law and, therefore, whether the executive bodies' compensation package (or that of any other key employees) requires special approval from the supervisory board or the general shareholders' meeting depends on the provisions of the charter. In practice, the compensation of key managers is usually made subject to the consent of the supervisory board.

In accordance with Russian employment law, there is no upper limit on the amount of severance payments to the CEO of a non-state-owned company – it all depends on the terms of the CEO's employment agreed with the company. However, following a high-profile case in 2013 where courts invalidated a multimillion dollar severance payment to the former CEO of a state-controlled and significantly leveraged telecoms major, the severance payments to CEOs of state-controlled companies were capped at the level of three months' salary.

Conflicts of interest

Russian law contains the principle that supervisory board members and executive body members should act in the absence of conflicts of interest. To enforce this principle, supervisory board members and executive body members are required to provide to the company the information necessary to determine whether a transaction undertaken by the company qualifies as a related-party transaction – that is, a transaction in which an executive body member or supervisory board member or a controlling person[21] of the company is interested personally or through companies under their control or their respective relatives.[22] With effect from 1 January 2017, related-party transactions are not subject to mandatory

21 The definition of a controlling person for the purposes of related-party transactions includes the persons holding, directly or indirectly, a controlling stake in the capital of the company, the persons vested with power to appoint its CEO or to elect more than 50 per cent of supervisory board members, or both.

22 The information undertakings imposed on those persons by the JSC Law are expanded and supplemented by the regulations of the CBR.

prior approval by the supervisory board or the general shareholders' meeting. Instead, the management of the company is under an obligation to notify the supervisory board and, in certain circumstances, the shareholders of the intention to proceed with a related-party transaction. The supervisory board members and more than 1 per cent of shareholders in the company are then entitled to request that the transaction be postponed until the approval of a competent management body of the company is obtained. If no such request is made, the management is free to proceed with the transaction. The management may request an approval from the competent bodies of the company even in the absence of a request from the supervisory board members or the shareholders (e.g., to enhance the legitimacy of the transaction). At the same time, as clarified by the Supreme Court of the Russian Federation,[23] even if the corporate approval of a transaction is in place, the transaction can nevertheless be invalidated if it is clearly detrimental to the company and the other side has been or should have been aware of that.

A transaction made or approved in the presence of a conflict of interest (unless it was properly disclosed and the interested persons refrained from participating in the approval process) or resulting in a loss to the company, or both, may trigger an obligation for the conflicted persons to indemnify the company for the loss. This obligation can be enforced through a derivative action by the supervisory board members or shareholders.

Following a number of high-profile cases involving major credit institutions becoming insolvent as a result of significant financing having been extended to persons connected with management and major shareholders, the CBR has sought to put an end to such practices. In particular, the CBR has introduced and continues consistently to enforce more rigid standards on the level of risk that can be assumed by a bank with respect to a single borrower and its affiliates and on the value of transactions with the bank's connected persons. Another example of the regulation aimed at elimination of a conflict of interest is a statutory prohibition on a non-state pension fund to become a shareholder of the management company that manages its assets.

Liability

Internal liability

In the event that a supervisory board members or executive body, or a company's controlling persons, are in breach of their duties to the company, they are under an obligation to indemnify the company (rather than its shareholders) for the damage (both direct loss and loss of profit) resulting from the breach. There is a statutory restriction on the ability to limit management's liability in relation to bad faith (all companies) and unreasonable conduct (public companies), and the liability of controlling persons. There are several exemptions from liability: for example, if the action in question, although detrimental to the company, qualifies as a reasonable commercial risk.

The CEO is not exculpated from liability merely because he or she obtained all requisite corporate approvals for an action – if the action caused damage to the company and none of the exemptions from liability apply, all persons who voted in favour of that action (or abstained from participation in the voting in bad faith) may be held jointly and severally liable. In assessing the scope of liability of the members of the supervisory board and the

23 Paragraph 24 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 27 dated 26 June 2018 'On challenging major transactions and interested party transactions'.

management board, courts will take into account the scope of their information rights and, in certain cases, their dependency on the CEO in terms of the information required for their decision making.

As executive body members are in an employment relationship with a company, they can be sanctioned in accordance with employment law for any breach of their duties to the company.

External liability

The general position under Russian law is that executive body members, supervisory board members and a company's controlling persons are not liable to parties who contract with the company for the company's debts. However, there are several exemptions to this principle.

One exception is that management and the controlling persons are liable in the event that the company is declared insolvent. The controlling persons of the company[24] are subject to secondary liability to the company's creditors if the insolvency is the result of their actions or omissions. In the case of the controlling persons, there is a presumption in favour of liability if the creditors' interests have been prejudiced as a result of a transaction made by, in favour of or with the approval of the controlling person. In the case of the CEO, the presumption also applies if the accounting documents are misleading, omitted or missing, which complicates the course of the insolvency proceedings.

Another exception is set out in the Securities Market Law, which provides that any person who has signed or approved a prospectus (i.e., the CEO, the chief accountant and the supervisory board members) is subject to secondary liability for losses caused to investors as a result of inaccurate, misleading or incomplete information being contained in the prospectus.

III DISCLOSURE

The JSC Law and the Securities Market Law are the key statutes establishing disclosure obligations. The JSC Law requires all public companies (including those public companies that have not arranged for the registration of a prospectus or listing of their securities) to disclose annual reports, annual accounts (including an auditor's opinion), lists of affiliates and corporate documents. The composition of the annual accounts is set out in the Accounting Law[25] and the requirements for the auditor's opinion are set out in the Auditors Law.[26] In general, the auditor is required to be independent from the company and its major shareholders. Annual reports and annual accounts are subject to review and approval by the internal audit commission, the supervisory board and the external auditor before they are submitted to the general shareholders' meeting for approval. The Securities Market Law sets out wider disclosure obligations that are triggered by the company registering a prospectus of its securities. The registration of a prospectus is not tantamount to the admission of securities to trading on an organised market. The prospectus requirements apply in most cases where

24 The definition of a controlling person for the purposes of insolvency laws, includes the CEO (or joint CEOs), the persons holding a controlling stake in the capital of the company, the persons vested with representative authority on behalf of the company and the persons exercising *de facto* control over its activities. The definition and criteria of a controlling person have been summarised in Resolution of the Plenum of the Supreme Court of the Russian Federation No. 53 dated 21 December 2017.

25 Federal Law No. 402-FZ On Accounting dated 6 December 2011.

26 Federal Law No. 307-FZ On Audit Activity dated 30 December 2008.

securities are issued to a large number of subscribers through an open subscription (even without the involvement of stock exchange infrastructure). As a result, the disclosure obligations apply to public companies (other than those that only opted for public status without offering their securities to the public). The disclosure obligations may also apply to non-public companies (such as LLCs and non-public JSCs) that have issued securities (such as bonds)[27] to the public and that were required to register a prospectus. The Disclosure Rules provide further detail to supplement the Securities Market Law.

The Securities Market Law disclosure requirements can be classified as periodic and one-off disclosure obligations. The periodic disclosure obligations include the publication of quarterly reports, which primarily include quarterly financial statements. One-off disclosures relate to material facts. Material facts are price-sensitive information concerning the reporting company, which may, for example, include information about meetings of the supervisory board or the general shareholders' meeting; changes of control of the company; or information on the acquisition by a single shareholder or a group of shareholders of a stake exceeding 5, 10, 15, 20 25, 30, 50, 75 or 95 per cent of voting shares in the company.

A complex procedure applies if a reporting company wishes to terminate (or become exempt) from its disclosure obligations. This procedure involves a super-majority vote by the shareholders and a special authorisation from the CBR. The reporting company is primarily liable to its shareholders for damage caused by untimely, incomplete or misleading disclosure. The management of the reporting company may be subject to administrative or criminal sanctions for any failure to comply with the disclosure regime.

Additional disclosure obligations may apply to regulated companies. Credit institutions are subject to the highest level of transparency. In particular, banks are required to disclose information on their ownership structure and the qualification and reputation of their management. Credit institutions are also subject to numerous reporting requirements to the CBR (and in particular are required to disclose to the CBR their annual and quarterly accounts, details of their risk management and risk assessment systems, and an outline of the level of risk they have assumed). The CBR encourages banks to agree that part of the information submitted to the CBR to be disclosed on its official website for the public, and in practice, a large number of banks follow this recommendation.

In light of the continuing geopolitical unrest and the ongoing 'war of sanctions', amendments to the JSC Law and the Securities Market Law were introduced in December 2018 to empower the government to determine instances where a company may become exempt from some of the disclosure requirements that would otherwise have been applicable to it. Those instances include, in particular, major or related-party transactions made in connection with the performance of government defence orders or made with companies that are subject to sanctions imposed by foreign states.

IV CORPORATE RESPONSIBILITY

i General

The CGC defines corporate governance as 'a system of relationships between the executive bodies of a company, its board of directors, its shareholders and other stakeholders'. The CGC

27 Non-public companies may not issue shares and instruments convertible into shares to the public: this right belongs to public companies only.

recommends that supervisory boards take into account both financial and non-financial risks affecting a company's activities (including ethical, social, ecological and operational risks), the interests of all external stakeholders (including employees), and applicable social and ecological standards. The CGC also recommends that the annual report contain a section on human resources and social policy, healthcare and protection, workplace safety and social policy.

The obligation of the management to take into account the interests of all of the company's stakeholders is not expressly set out in a specific piece of legislation, but is rather derived from a range of general legislative provisions. Thus, the obligation to act in the best interests of the company makes it the managers' responsibility to build and maintain an efficient interaction system with key contributors to and stakeholders in the company. Additionally, CEOs are held personally responsible by the government for ensuring companies' compliance with the applicable laws. Some of those laws establish minimum statutory comfort for the various stakeholders in the company (e.g., its employees, creditors and clients).

The government has been promoting the idea of companies engaging in corporate social responsibility beyond the minimum benchmark standards for some time now. However, it has failed to provide an appropriate regulatory framework to incentivise companies to engage in charitable activities or other additional social responsibility measures. Despite this, many major companies tend to assume broad social responsibility undertakings in implementing their internal ethics codes and, on certain occasions, as part of their government-relations strategy.

ii Employees

All Russian companies are subject to social obligations, such as ensuring minimum salary levels for employees, making contributions to social and pension funds for employees, conducting assessments of workplace conditions, and introducing additional benefits and regimes if necessary based on these assessments. Companies with a significant number of employees must also employ a minimum percentage of disabled people. Separate benefit regimes are also established for different categories of employees (such as women with family responsibilities and rotational system employees). Breaches of these obligations can result in fines and other kinds of liability for a company.

However, the above is only a benchmark level of comfort for employees. In practice, companies tend to assume a wider range of social responsibilities and reflect them either in their internal regulations or in agreements with their employees or trade unions. Those documents usually address issues such as: increases to the minimum amount of salary and the period of annual leave, additional allowances for employees under certain circumstances, additional medical and life insurance, employees' discounts for certain services, compensation of travelling costs during employees' holidays, and protection and additional support to former employees and retired employees.

iii Small and medium-sized businesses

The government is seeking to support Russian small and medium-sized businesses (SME). Given the significant footprint that the government has on the Russian economy, one of the support measures it has proposed is ensuring SMEs' access to the government and state company procurement systems.

Russian law sets mandatory provisions for state agencies and state-owned companies to purchase a specified amount of goods and services from SMEs. The general rule is that companies that are within the scope of the Procurement Law[28] must procure at least 18 per cent (as measured in terms of value) of the total amount of their contracts from SMEs.

To increase the transparency of procurement processes, companies must disclose information about their procurement policy, procurement plans and information on tenders in a publicly available information system.

iv Anticorruption

In an effort to improve the investment climate in Russia and to advance its transition to an international financial centre, the government has launched a number of anti-bribery and corruption initiatives. Commercial bribery is a criminal offence under Russian law, and an offender can be sentenced to a period of imprisonment. Although Russian anticorruption legislation is mainly focused on governmental authorities and state-owned companies, there are still some broadly stated rules requiring companies with no state participation to take measures to prevent corruption. These measures may include adopting a corporate ethics code and anti-bribery policies, procedures preventing conflicts of interest, or appointing an officer with controlling powers in this area. Internal anti-bribery policies and codes have become common in large Russian companies but remain rare for smaller privately held companies. Companies with significant foreign participation tend to follow the anticorruption standards applicable to their overseas parent undertakings (e.g., the UK Bribery Act or US Foreign Corrupt Practices Act).

v Currency control and anti-money laundering

Russian financial institutions have a number of supervisory functions in relation to currency control and anti-money laundering (AML). Russian residents are required to collect all foreign currency export proceeds in their bank accounts in Russia (mandatory repatriation of currency proceeds). The purpose of this regulation is to prevent capital flight from Russia. Controlling functions are mainly delegated to Russian banks. Until 28 February 2018, when making overseas contracts, Russian residents were required to report this to their bank and open a transaction passport outlining basic information about the contract, including the amount and time frames for delivery and payments. Subsequently all payments under the relevant transaction should be made through the passport bank (unless the passport bank is replaced, in which case payments should be made through the new passport bank). The requirement to open and maintain a transaction passport was replaced with a requirement to register the relevant contract with an authorised bank with effect from 1 March 2018.

The AML laws require that companies operating with money – banks and other credit institutions, securities market participants, insurance companies, investment fund management companies, realtors, pawnshops and others – to monitor and, if necessary, report their clients' transactions the value of which exceeds the threshold set out in law. Reporting obligations are triggered irrespective of the value of the transaction if it qualifies

28 Federal Law No. 223-FZ on Procurement of Goods and Services by Certain Types of Legal Entities dated 18 July 2011.

as a suspicious transaction. Suspicious transactions include extraordinary transactions with no clear commercial purpose, transactions not consistent with a client's business, and other transactions that raise a reasonable suspicion of money laundering or financing of terrorism.

vi Compliance

To ensure their stability and protect their clients, credit institutions and professional participants of securities markets are required to maintain an internal compliance function. Other companies are not required to organise a compliance function (although, as mentioned above, the implementation of risk management and internal control mechanisms generally is now mandatory for public corporations). Nevertheless, even where there is no specific legislative requirement regarding the maintenance of a compliance function, in practice, this function is usually fulfilled by various departments within the relevant company's corporate structure.

The requirement for credit institutions and professional participants to organise a compliance function is enforced predominantly by the CBR. Credit institutions should also refer to the principles of the Basel Committee on Banking Supervision's 'Compliance and the compliance function in banks' of 2005.

Russian law requires that the internal compliance policies of credit institutions and professional securities market participants specify, inter alia, the structure of the compliance function, its activities, main responsibilities, allocation of duties and internal compliance procedures (such as compliance risk assessment and coordination). The compliance function in these institutions must be carried out on a regular basis.

V SHAREHOLDERS

i Shareholder rights and powers

Russian policymakers have adopted a restrictive approach towards the powers of the general shareholders' meeting in public companies. The scope of these powers is determined by the JSC Law only and may not be extended (but, conversely, may be further limited in favour of the supervisory board) by the charter. Unlike some jurisdictions, where residual powers falling outside the competence of other governing bodies are attributed to the general shareholders' meeting, in Russia those residual powers would be assumed by the CEO or CEOs. It is, therefore, the supervisory board (and not the general shareholders' meeting) that plays a key role in the system of oversight over the managerial activities of a public company.

The general shareholders' meeting is still vested with important powers within the company (in particular, the power to amend its charter, to elect the supervisory board members, to approve dissolution or reorganisation of the company, its exemption from the disclosure obligations,[29] and major acquisitions or disposals involving more than 50 per cent of the balance sheet value of its assets). The matters attributed to the competence of the general shareholders' meeting by the JSC Law, are, therefore, limited to those that are likely to result in a fundamental change to the nature of the business of the company or the composition of its assets, and the balance of powers between the various governing bodies set out in the charter.

29 See Section III.

As stated above, the regulation is more flexible for non-public companies (i.e., non-public JSCs and LLCs). For example, the competence of the general shareholders' meeting in a non-public company may be extended compared to the one set forth by the statute (making, in the absence of a statutory requirement, the formation of the supervisory board and the management board redundant).

The key statutory rights of the shareholders include:

a their rights on participation in the management of the company (i.e., voting rights, information rights and rights to put items on the agenda of the general shareholders' meeting);

b their economic rights (i.e., rights to receive dividends and other distributions from the company);

c the rights to protect the interests of the company (i.e., the right to bring derivative actions); and

d the rights to protect the shareholders' own interests (in particular, the rights for a dissenting shareholder to put its shares to the company in a limited number of circumstances).

The rights of the holders of the preference shares are determined either by the charter or the preference shares issuance documents.

Russian law establishes the following ownership thresholds for the exercise of the management rights by the shareholders of public companies: the right to request the convocation of the general shareholders' meeting is granted to shareholders individually or collectively holding at least 10 per cent of voting shares in the company, and the right to put an item on the agenda to holders of at least 2 per cent of the voting shares. The list of shareholders entitled to vote at the general shareholders' meeting is set up as at the record date (which, subject to a few exceptions, may not be more than 25 days prior to the date of the general shareholders' meeting). In the event of the transfer of the shares following the record date, the shareholder appearing on the register will have to grant a voting power of attorney to the transferee or vote at the general shareholders' meeting in accordance with the instructions of the transferee.

Equality of voting rights

Russian law establishes the principle of equality of voting rights: all ordinary shares and all preference shares of a single issue provide equal rights in proportion to their nominal value. For the ordinary shares, the JSC Law sets forth the one share-one vote principle. The voting rights are usually carried by ordinary shares only. The preference shares in public JSCs become voting shares in certain exceptional circumstances only (most commonly in the event of non-payment of dividends in respect of the non-voting, non-cumulative preference shares or if the general shareholders' meeting is considering winding up the company). Non-public JSCs may issue voting preference shares granting voting rights on all or some of the matters on the agenda of the general shareholders' meeting. LLCs do not issue shares, and as a general rule provide a percentage of votes determined as the ratio between the nominal value of the participatory interests held by the shareholder and the aggregate amount of the charter capital of the LLC. Disproportionate voting arrangements may be set out in the charter of an LLC or a non-public JSC (but not a public JSC).

Rights of dissenting shareholders

Apart from the general protections available to all shareholders, the law contains specific protections for shareholders who attended a general shareholders' meeting and voted against a resolution or did not participate in the relevant general shareholders' meeting (dissenting shareholders).

A dissenting shareholder can challenge such a resolution of the general shareholders' meeting. If, pursuant to the resolution, the company entered into a transaction, the dissenting shareholder can also challenge the transaction. For the resolution or transaction to be invalidated, the dissenting shareholder needs to establish grounds for its invalidity (most commonly, the transaction having been made without proper authorisation from the competent governing bodies of the company, the lack of proper authorisation having been known to the other party and the transaction in question being prejudicial to the interests of the company).

Additionally, the law permits dissenting shareholders of JSCs to request that the company buys out all or a part of their shareholding, if the resolution in question concerns the following fundamental matters:

a reorganisation of the company;

b approval of a major transaction of the company with a value exceeding 50 per cent of the company's asset value;

c the introduction of amendments to the company's charter that restrict the rights of the dissenting shareholders; or

d delisting of the company's shares.

ii Shareholders' duties and responsibilities

The most important statutory obligations of shareholders include:

a the obligation to participate in the formation of the capital and assets of the company (by way of paying up their share in the charter capital in the course of the company's incorporation and, if explicitly provided by the charter, by making other mandatory contributions to the capital or assets of the company (or both));

b the obligation to refrain from disclosing confidential information relating to the activities of the company;

c the obligation to participate in the adoption of decisions required for the company to continue to exist (where such participation is necessary); and

d the obligation to refrain from knowingly causing damage to the company, and otherwise significantly complicating or rendering impossible the pursuit of the company's fundamental goals.

Subject to the above obligations, shareholders are generally free to act in their own discretion and in their own interests. A higher standard of conduct is set forth for the controlling persons of a company. As stated above, the RCC imposes on them a duty to act reasonably and in good faith in the best interests of the company. Therefore, as is the case with managers, controlling persons who cause damage to the company may be liable to reimburse the company for the damage.

iii Shareholder activism

Say on pay

The general shareholders' meeting is the competent body to decide on the timing and amount of the distribution of dividends to shareholders. However, the supervisory board, assessing the results of the company's activity for the relevant period and its financial status, may issue a recommendation to the general shareholders' meeting on the amount of dividends (in which case the general shareholders' meeting cannot decide to distribute a larger amount) or a recommendation not to distribute the dividends at all (in which case the general shareholders' meeting cannot decide otherwise).

As best practice, the CGC recommends that companies adopt an internal dividend policy, and that they explain to shareholders the reasons for any change to, or deviation from, that policy.

Derivative actions

Shareholders can sue members of the executive bodies and the supervisory board, as well as persons exercising *de facto* control over the company, for damage caused to the company by those persons. Guidance for assessing the unreasonable and bad faith behaviour of managers is provided in Resolution of the Supreme Commercial Court of the Russian Federation No. 62 of 30 July 2013 (Resolution).[30]

The Resolution clarifies that the obligation to act reasonably and in good faith shall be construed to mean that managers must take necessary and sufficient actions for the achievement of a company's objectives, including due performance by the company of any public liabilities imposed by the applicable law (such as the payment of taxes). The Resolution gives a number of examples of when managers are presumed to be acting in bad faith and unreasonably, and when transactions are considered to be evidently unfavourable to the company.

The Resolution was passed prior to the RCC being amended to impose the duty to act in the interests of the company reasonably and in good faith. It is sensible to assume that the guidance in the Resolution is equally applicable to the liability of controlling persons.

Proxy battles and proxy solicitation

As noted in Section I, the share capital of Russian companies, including listed companies, is typically concentrated in the hands of one or a few large shareholders, who can procure decisions at the general shareholders' meeting. Therefore, unlike in some Western jurisdictions, the issues of proxy fights and proxy solicitation are not typical in Russia. In view of this, there are no special regulations in this respect.

Shareholder campaigns

Large shareholder campaigns are not very common in Russia; however, there have been some notable cases. Recent examples of shareholder activism include the campaigns of Alexey Navalny, a minority shareholder in 20 Russian companies, including the state-owned Rosneft, Gazprom, Transneft and VTB. Navalny has filed numerous lawsuits and petitions

30 The Supreme Commercial Court was abolished and merged with the Supreme Court in 2014. Upon completion of the merger, the Supreme Commercial Court's previous guidance was expressly said to continue to stand until the Supreme Court has expressly ruled otherwise on the relevant subject.

to regulatory authorities in relation to non-transparent transaction structures, suspicious expenses and failure to provide information to him as a shareholder. Some of the institutional minority investors (particularly portfolio companies) in Russian public corporations have been increasingly active in bringing derivative actions against controlling shareholders in the public corporations for losses caused by their actions.

Long-term shareholder value

Simply put, traditionally the shareholder value denotes the increase of wealth in the hands of the company's owners in a number of ways, in particular through an increase of its market capitalisation, the paying of dividends or ensuring that the company generates returns higher than the cost of capital employed by the company to generate them.

In assessing the application of the shareholder value concept in the context of Russian corporations, it is worth always taking into account the fact that, while the creation of additional wealth for a company's owners may be, as a matter of practice, the key motivating factor of the company's management and a decisive factor in determining their compensation package and the set of the relevant key performance indicators, the management is under no legal obligation to manage the company for the benefit of its ultimate owners. Their legal obligation is to act reasonably and in good faith to ensure that the company continues as a going concern with a view to profit. As discussed above, any failure on the part of the management to comply with that overriding obligation exposes them to liability to the company (rather than its shareholders).

The way the policymakers have formulated the key obligation of the management of Russian companies corresponds with the concept of the shareholder value in its proper sense. The premise here is that if the company is properly managed with sufficient regard to the interest of its key stakeholders and with an appropriate allocation of resources, it would be able to generate a sufficient level of return on capital and have sufficient funds to declare and pay dividends. Insofar as public corporations are concerned, the market capitalisation would, in those circumstances (in the absence of extraordinary black swan-type events), necessarily go up.

The management is, therefore, encouraged by the Russian legislators to try to work towards an increase of the shareholder value long-term. Recognising that in certain circumstances the management may be tempted or pressured to prioritise short-term (and sometimes speculative) goals by some of the shareholders (particularly controlling shareholders), a number of checks and balances to enable the management to follow a proper course of action have been put in place in Russian legislative acts. In addition to the overall obligation to act in the best interests of the company itself, the law prohibits all security market participants from engineering any short-term price increases in the company's stock (market manipulation) and reserves (at least for public companies) – a key role in deciding whether a public company should declare dividends to the management and the supervisory board members (with shareholders being unable to circumvent the relevant decision). Insofar as dividends are concerned, there are a number of other statutory restrictions on their payment that target instances where the payment of dividends would jeopardise the stability of a company as a going concern (e.g., in relation to the amount of net assets of the company, or if the company may become insolvent as a result of any such payment).

iv Takeover defences

Takeover Rules

Russian law does not generally prohibit acquisitions of significant stakes in public JSCs on the basis of private bilateral deals between the purchaser and the selling shareholder or shareholders. That said, as mentioned above, the JSC Law contains a number of provisions addressing the procedure for acquisition of more than 30 per cent stake in public JSCs (Takeover Rules).

The Takeover Rules:

a require a shareholder (that on its own or together with such shareholder's affiliates) consolidated a more than 30, 50 or 75 per cent of voting shares in a public JSC to submit an offer to the remaining shareholders in the target company allowing them to exit the target by putting their shareholdings to the bidder at a specified price:[31] a mandatory tender offer (MTO);

b allow a shareholder (that on its own or together with such shareholder's affiliates) intends to consolidate a more than 30 per cent stake voluntarily to submit an offer to all other shareholders to sell their shares to the bidder at a specified price: a voluntary tender offer (VTO); and

c where a shareholder (on its own or together with its affiliates) has consolidated more than 95 per cent of voting shares in a public JSC:
- require such shareholder to notify the remaining minorities of their right to put their shares to such shareholder (minority put notice); and
- provided that at least 10 per cent of the shares have been purchased on the basis of an MTO or a VTO, allow such shareholder to call the shares of the remaining minorities thereby consolidating 100 per cent of voting shares in the target company (minority call notice).

The Takeover Rules provide for an eventuality of two competing MTOs or VTOs being submitted in relation to the same target at the same time.

The target company is required to disclose the information on the MTO, the VTO, the minority put notice and the minority call notice to the public. The board is required to issue a recommendation to the shareholders on whether it deems that the MTO or the VTO should be accepted by the shareholders.

Defence strategies

Unlike many Western jurisdictions, the Takeover Rules provide little (or no) specific regulation on defence strategies against hostile takeovers.

Arguably, the main reason behind this is the high degree of capital concentration in the economy, including in public and listed companies. Therefore, takeovers in respect of Russian public targets are more often than not negotiated by a purchaser with key controlling shareholders of the target. The procedures contemplated by the Takeover Rules are usually

31 There are several exceptions to this requirement. For example, the requirement to submit an MTO does not apply where the relevant shareholding thresholds are reached as a result of transfers between affiliated entities or as a result of redemption by the company of certain of its shares leading to the general increase in the stakes of the shareholders and in a handful of other cases.

triggered after the deal of the purchaser with the key shareholders has been completed (e.g., the purchaser might be required to submit an MTO if, as a result of its prior deal with the key existing shareholders, it has consolidated a stake of more than 30 per cent in the target).

The Takeover Rules are therefore primarily focused on granting a certain degree of protection to the minority shareholders in Russian public targets upon the occurrence of a change of control, rather than regulating in detail the ways in which existing shareholders may defend against a takeover bid. Ultimately, in the view of Russian policymakers, shareholders always have a defence instrument by simply declining to accept an offer if they are not happy with its terms.

Key decisions taken by shareholders

It must be taken into account that where an MTO or a VTO procedure contemplated by the Takeover Rules is triggered, the decision-making powers in the company are redistributed between the main governance bodies in favour of the general shareholders' meeting. In particular, only the general shareholders' meeting will be entitled to approve any related-party transactions of the target, any transactions with the value exceeding 10 per cent of the target's assets' aggregate book value, and the issuance of any additional voting shares or instruments convertible into voting shares. This is an illustrative deviation from the generally restrictive approach that Russian policymakers have chosen in relation to the decision-making powers of the general shareholders' meeting. The underlying principle of the Takeover Rules is that a change of control over a public company is a matter for the shareholders in that company to decide, ultimately, through accepting or declining to accept a takeover bid. The CEO, the management and the supervisory boards are, therefore, limited in their ability to influence that decision (or the takeover process as a whole) other than through issuing a recommendation to the shareholders to accept or decline to accept the relevant offer (e.g., through implementing a crown jewel defence).

In addition, the Takeover Rules do not disapply the overriding statutory duty of the management and members of the governing bodies of the target company, or the duty of its controlling persons to act reasonably and in good faith in the best interests of the company.

Obviously, the CEO, the supervisory board and the management board are not able to influence or block private sales of shares by the company's shareholders that are not affected within the framework of one of the procedures contemplated by the Takeover Rules.

Staggered board

Russian corporate governance rules contemplate that the supervisory board is re-elected by the general shareholders' meeting annually in full. There are no instruments under Russian law to appoint a supervisory board in a public JSC, the members of which are classified into different categories, each with an individual rotation cycle.

There may be delays in the purchaser nominating its candidates to the supervisory board or the position of the CEO after it has acquired its stake in the target. These delays result from mandatory notification periods for convocation of an extraordinary general shareholders' meeting (which can be around 50 days if the agenda of the relevant general shareholders' meeting includes the matter of the re-election of the supervisory board). The delay may be even longer if the incumbent supervisory board, which is responsible for convocation of the general shareholders' meeting by operation of law, is not cooperative and refuses to decide on such convocation. In such scenario, the purchaser may be forced to seek to convoke the general shareholders' meeting through court.

The CEO (or joint CEOs) who are responsible for the day-to-day management of Russian companies may be appointed by either the supervisory board or the general shareholders' meeting (depending on the provisions of the charter). Where the CEO is appointed by the general shareholders' meeting, the position in terms of potential delays in such appointment is substantially the same as with the election of the new supervisory board. Where a CEO is appointed by the supervisory board, there will be an additional step after the purchaser has nominated its representatives to the supervisory board, of having the new supervisory board pass a resolution appointing the new CEO.

Given that in a majority of cases takeovers of Russian public targets are carried through private bilateral deals between the purchaser and the key existing shareholders, the parties tend to address those matters in the relevant transaction documents to avoid such delays and limit the possibility of the purchaser having to resort to the support of the courts to effect the requisite appointments.

Poison pill defences

Poison-pill defences are usually structured through issuance of convertible instruments, voting preferred shares, emergency issuance of additional shares to all existing shareholders other than the purchaser and analogous measures.

Russian law does not expressly prohibit those kinds of arrangements (unlike some Western jurisdictions), which makes those types of arrangements theoretically possible. However, the regulation of the instruments customarily involved in structuring poison pill-type defences makes the implementation of any such defence in practice very challenging.

Voting preference shares

As a general rule, preference shares in Russian public companies are non-voting shares and only become voting shares in a limited number of cases (most often, where the dividends due on those shares are not paid out by the company in time). The aggregate par value of all preference shares issued by the company may not be more than 25 per cent of the aggregate par value of the ordinary voting shares. Where the preference shares have become voting shares prior to an MTO or a VTO procedure having been triggered pursuant to the Takeover Rules, those shares may be acquired by the purchaser on the basis of an MTO or a VTO.

Russian law contemplates the concept of voting preference shares that grant voting rights on all or some of the matters within the competence of the general shareholders' meeting permanently or upon occurrence of certain specified circumstances. However, such instrument is available to non-public companies only, which are outside the scope of the Takeover Rules.

Convertible instruments

Russian law allows issuing instruments convertible into voting shares in a company (such instruments include convertible bonds, convertible preference shares and options).[32]

It must be taken into account that after an MTO or a VTO procedure pursuant to the Takeover Rules has been triggered, the issuance of convertible securities is only possible by resolution of the general shareholders' meeting. Any conversion of such convertible securities

32 An option is a security issued by a Russian issuer allowing the security holder to convert the option into other securities of the relevant issuer.

will require the issuance of additional shares by the company, which after an MTO or a VTO procedure has been triggered is also only possible by resolution of the general shareholders' meeting. Prior issued convertible securities may become exercisable after a takeover bid is submitted. However, it is important to remember that such conversion is not automatic and will require the issuance of additional shares (again subject to the consent of the general shareholders' meeting).

Where, after the procedures in the Takeover Rules have been triggered, any step requiring the general shareholders' meeting consent is effected without such consent, it can be invalidated and unwound through court. Bidders for the acquisition of shares in public companies have standing to claim such invalidation.

White knight

As mentioned before, there is a concept of a competing offer factored into the Takeover Rules; however, it is very rarely used in practice given the practical considerations outlined above.

v Contact with shareholders

Mandatory and best practice reporting to all shareholders

Shareholders have a general right to access information and documents concerning the company's activities. Both the JSC Law and the LLC Law list the information that is available to all shareholders and set out the procedure for accessing this information. Access to certain documents of JSCs, such as a company's accounts and the minutes of its management board, is open only to a shareholder or shareholders collectively holding not less than 25 per cent of voting shares. A set of legislative amendments has recently come into force imposing a number of restrictions on the information rights of minority shareholders. The rationale behind the amendments is to protect companies against the risk of greenmailing by minority shareholders. Most importantly, the amendments have increased the minimum ownership threshold for requesting documents and information that the company is not required to disclose to the public by operation of law, and have granted companies a right to deny the provision of particularly commercially sensitive information in the absence of an appropriate justification for a request for documents and information. Significant minority shareholders (holding more than 10 and 25 per cent of voting shares) are exempt from some of those restrictions. Moreover, as mentioned above, the JSC Law and LLC Law have recently been supplemented with a new provision empowering the government to release certain companies from the statutory obligations to provide information on interested-party and major transactions to their stakeholders).

The CGC recommends that companies develop and implement an information policy enabling them to efficiently exchange information with shareholders, investors and other stakeholders. The interaction with shareholders should be facilitated by setting up a company website and posting useful information there, and organising regular presentations and meetings with management.

The current JSC Law requires that shareholders be provided with physical access to documents and information relating to the agenda of the forthcoming general shareholders' meeting at least 21 days before the date of the general shareholders' meeting (certain specific matters require more advanced notice). Shareholders can also request copies of the relevant documents. The company has seven business days to prepare the copies or a longer period if the shareholder requests a substantial amount of information (more than 10 documents or more than 200 pages). The relevant material may be published on the company's website only if this is expressly permitted by the charter.

There is room for improvement of the information provision policies of many large companies, including state-controlled companies.[33] In practice, shareholders may face problems obtaining a comprehensive set of materials for the general shareholders' meeting within a reasonable time frame. This is especially relevant for foreign shareholders controlling shares in Russian companies through a long chain of depositaries.

The CGC states that companies should provide shareholders with an opportunity to coordinate their actions in relation to the general shareholders' meeting. In the past, no specific steps have ordinarily been taken to ensure that shareholders can share their views on the agenda before the general shareholders' meeting; however, in December 2017[34] the CBR introduced draft rules on joint demands and propositions of shareholders, enabling them to cooperate on and propose items to the agenda jointly by means of signing one document only (instead of each shareholder submitting a separate set of documents to the company).

VI OUTLOOK

Since 2010, the government programme to transform Moscow into an international financial centre has been the key driving force behind corporate governance reforms in Russia. One key idea behind that initiative was to make the Russian jurisdiction more attractive to international financial investors and give a boost to domestic capital markets. In parallel, the government intended the non-state pension funds to play an important role in increasing the liquidity levels of domestic markets by channelling the monies under their management to Russian publicly traded companies.

However, following the political crisis in Ukraine, Russia becoming subject to an EU and US sanctions regime significantly reduced the interest of international investors in the Russian market and in Russian assets in general. The government's plans concerning the role of pension funds as a key liquidity source on the Russian market were significantly revised because of the resulting budgetary difficulties and the consequent changes to the basic elements of the Russian pensions system.

Despite these unfortunate developments, corporate governance remains one of the most important policy issues. Key discussion platforms on the subject (e.g., the OECD Russia Corporate Governance Roundtable) also remain operational, not least because Russian policymakers and companies themselves have realised the importance of good corporate governance, irrespective of the level of interest of foreign investors in the Russian jurisdiction.

The key area of focus for Russian legislators remains balancing the contrasting interests of various internal stakeholders. While the Russian governance system is characterised by highly concentrated ownership, which is usually associated with higher levels of oversight and control over the actions of management, this oversight and control, while indeed exercised by controlling shareholders, was not backed by appropriate legal instruments until recently.

33 Alexander Shevchuk, 'The main problems of corporate governance in Russia and the possibility of resolving such problems through the application of the Corporate Governance Code and associated regulatory mechanisms' in 'OECD Russia Corporate Governance Roundtable: Meeting Documents' (May 2013), pp. 9–10.

34 The revised draft was introduced in October 2018.

Russian policymakers continue their work on further enhancing management accountability. One of the suggested innovations (which have not yet been approved by the Parliament) relates to the treatment of quasi-treasury shares. While treasury shares owned by a company itself are non-voting and are not counted towards a quorum, there is no similar limitation for shares in the company held by its subsidiaries. Therefore, as has been the case in numerous high-profile shareholders' conflicts surrounding prominent Russian companies, the control by management of a significant quasi-treasury stake results in an excessive entrenchment of the management.

The concepts of accountability of management and controlling persons remain of even greater importance in the financial services sector. With the general trend for clearing the sector of corrupt and bad-faith participants, suitability criteria for management and its liability for actions detrimental to the clients of financial services firms may be expected to remain one of the key matters of public concern.

Protection of minority shareholders in the process of takeovers is another hot topic. The debate over legislative amendments concerning takeover regimes is still ongoing. One of the key proposed changes to the takeover regime concerns the indirect change of control over public companies. The takeover rules at this stage are triggered only through the change of ownership of a significant stake in the company itself. The change of control over a significant shareholder does not trigger the takeover rules and has on numerous occasions been used to avoid the implementation of the minority protection measures contemplated by the law.

In summary, the government is continuing its work on improving the Russian governance regime with a view to reaching a balance of interests between the various interested parties, despite the unfavourable political and economic circumstances. Hopefully, those efforts will receive an additional boost if and when the international sanctions against Russia are lifted.

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