

## **3. ESTABLISHING A LEGAL PRESENCE**

In Russia, foreign investors may:

- Establish a representative office or a branch of a foreign legal entity;
- Establish a Russian legal entity in the form of an enterprise with foreign investment, which is either (a) entirely foreign-owned, or (b) co-owned with a Russian partner(s); and
- Act directly as a pure foreign investor.

### **3.1 Representative Office and Branch of a Foreign Legal Entity**

#### **3.1.1 Legal Status**

A representative office or a branch of a foreign legal entity is not considered to be a Russian legal entity, but rather a body representing the interests of a foreign legal entity in Russia.

A representative office is entitled to carry out liaison and ancillary functions in order to promote the business of its foreign founder. Representative offices are not expected to engage in commercial activities in Russia. Consequently, most representative offices are not subject to profits tax, unless their activities give rise to a “permanent establishment” for tax purposes, *i.e.* when a foreign legal entity engages in regular commercial activity through its representative office (for example, the sale of goods or the provision of services).

A branch is a subdivision of a foreign legal entity, which may fulfill all or part of the functions of its foreign founder. These functions include contracting with Russian entities with payments in foreign currency and rubles, sales and marketing and other business activities.

The obligations imposed on a branch may include the same obligations as those imposed on a representative office. However, a branch has less flexibility in selecting an accrediting authority in Russia compared to a representative office. This can sometimes affect certain areas such as the effectiveness of visa support.

### 3.1.2 Registration

There are several bodies authorized to grant accreditation to representative bodies, including those responsible for the accreditation of representative offices in a particular industry - representative offices of foreign banks, for example, are accredited by the Central Bank of the Russian Federation. The bodies most frequently charged with the accreditation of foreign entities are the Chamber of Commerce and Industry of the Russian Federation (the “CCI”) and the State Registration Chamber at the Ministry of Justice of the Russian Federation (the “SRC”).

All documents from a foreign legal entity must be notarized and apostilled/legalized in the country of execution, and any document supplied in a language other than Russian must be accompanied by a translation which has a notarized certification. Accreditation is usually granted for a period of up to three years, with the right to extension.

Branch offices must be accredited by the SRC in accordance with the 1999 Federal Law *On Foreign Investments*.

Following accreditation, the representative office or branch office must carry out a number of post-accreditation procedures before it becomes fully operative, including registration with the State Statistics Committee, with the tax authorities, and with the Russian social benefits funds.

## 3.2 Forming a Russian Legal Entity

The *Civil Code of the Russian Federation* recognizes, among others, the following types of commercial legal entities:

- General partnerships;
- Limited partnerships;
- Limited liability companies;
- Additional liability companies; and
- Joint stock companies.

The establishment and operations of limited liability companies (“LLC”) and joint stock companies (“JSC”) are governed respectively by the Federal Law No. 14-FZ *On Limited Liability Companies* dated 8 February 1998 (as amended), (the LLC Law) and the Federal Law No. 208-FZ *On Joint Stock Companies* dated 26 December 1995 (as amended), (the JSC Law).

The two most popular forms of corporate structure are LLCs and JSCs.

### **Choosing Between an LLC and a JSC**

In choosing between an LLC and a JSC in establishing a wholly-owned subsidiary, LLCs appear to be more popular than JSCs, because they are easier to establish and finance, since there is no legal requirement that an LLC must register its shares.

A JSC is often a preferred corporate form for joint ventures in Russia for the following reasons. In LLCs a participant is entitled to leave the company in certain circumstances and receive his proportionate share of the value of the LLC's assets and this right may not be waived. In addition, participants in an LLC who either individually or collectively hold at least a 10% interest in the company's charter capital can apply to a court seeking the expulsion of another participant. In order to actually exclude a participant from the LLC, the other participant(s) must prove that the participant substantially hindered the company's operations or materially breached its obligations.

Further, in contrast to the JSC law, the LLC Law contemplates a large number of issues which require a unanimous voting decision of all of the LLC participants.

Starting from July 1, 2009 when the amendments in the LLC Law enter into force, the participants in an LLC will be allowed to regulate their relations by concluding shareholders agreements similar to Western jurisdictions.

## **3.3 Limited Liability Companies**

### **3.3.1 Number of Participants**

An LLC may be established by one or more persons or legal entities (the "participants"). However, if the number of participants exceeds 50, the LLC must be reorganized into an open joint stock company or a production cooperative within one year. An LLC may not have as its sole participant another business entity consisting of a single person.

### **3.3.2 Rights of Participants**

The participants in an LLC have the right to:

- Participate in the management of the LLC in accordance with procedures established by the *LLC Law* and the company's charter;

- Obtain information concerning the activities of the LLC and have access to its accounting and other documents in accordance with the procedures established by the LLC charter;
- Participate in the distribution of profits;
- Sell or otherwise assign their participation interests in the LLC charter capital, or a part thereof, to one or more of the participants in the LLC in accordance with the procedure established by the *LLC Law* and LLC charter; and
- Receive a portion of the assets left after settlement with creditors in the case of the liquidation of the LLC.

The participants in an LLC also have other rights as provided by the *LLC Law*, and may have additional rights set forth in the LLC charter during the establishment of the LLC, or which are granted at a later date by a decision of the LLC's general participants' meeting. The following points should be noted with regard to granting of additional rights to LLC participants:

- Where additional rights are granted by the decision of the LLC's general participants' meeting, this decision must be unanimous; and
- Additional rights granted to a particular participant in the LLC do not transfer to any party acquiring all (or a part) of such participant's ownership interest if it is transferred.

### 3.3.3 Obligations of Participants

The participants in an LLC are required to:

- Make contributions to the charter capital as specified in the *LLC Law* and the LLC charter (or in the decision on the establishment of the LLC, if there is only one participant in the LLC) and within the time periods specified in the *LLC Law*; and
- Keep confidential all information concerning the activities of the LLC.

Participants in an LLC also have other obligations as provided for by the *LLC Law*, and may have additional obligations set forth during the establishment of the LLC in the LLC charter, or which are imposed on them at a later time by a decision of the LLC's general participants' meeting.

The following issues should be considered when imposing additional obligations on participants of an LLC:

- When additional obligations are imposed by the decision of the LLC's general participants' meeting on all LLC participants, this decision must be made unanimously;
- If additional obligations are imposed by the decision of the LLC general participants' meeting on a particular LLC participant, such decision must be made by a two-thirds majority vote of the total number of votes held by the LLC participants, provided that the LLC participant on whom such additional obligations are imposed voted in favor of such decision or consented to them in writing; and
- Additional obligations imposed on a particular participant(s) in the LLC do not pass to any party acquiring all (or part) of such participant's ownership interest in case it is transferred.

### 3.3.4 Charter Capital

The charter capital of an LLC consists of contributions made by its participants. The initial charter capital may not be less than RUR 10.000 (approximately USD 280 applying the exchange rate of 36 rubles to one US dollar).

At least 50% of the charter capital amount must be paid by the date of the LLC's registration, and the balance must be paid in full within the first year of its operation. Contributions may be made in cash or in kind, and certain customs benefits may be available for in-kind contributions made by foreign investors. The charter capital may be increased only after the original charter capital has been paid in full.

### 3.3.5 Participation Interests

A participation interest (*i.e.* an ownership share) in an LLC is not considered a security under current Russian legislation. Therefore, in contrast to the shares of a joint stock company, LLC participation interests do not need to be registered.

Participation interests in an LLC may be sold to third parties if allowed by the LLC charter, but they are subject to the right of first refusal of other participants to purchase the participation interests at the price offered to the third parties. The participants in an LLC if allowed by the LLC charter may have a unilateral right to withdraw from the LLC and to be compensated for their participation interests.

### 3.3.6 Management Structure

The general participants' meeting is the highest governing body of the LLC. The LLC participants may choose to create a board of directors to govern the operations of the LLC.

The General Participants' Meeting has the right to:

- Amend the charter;
- Define the basic goals and directions of the LLC;
- Delegate to a commercial organization or to an individual entrepreneur the authority reserved to the LLC executive and approve the conditions of the agreements with such organizations or persons, if such decision does not fall into the competence of the Board of Directors in accordance with the LLC charter;
- Assign supplemental rights and duties to the participants in the LLC;
- Approve the annual financial report and the distribution of profits;
- Alter the amount of the charter capital of the LLC;
- Approve regulations governing the internal activities of the LLC; and
- Reorganize or liquidate the LLC, appoint a liquidation commission, and approve the liquidation balance sheet of the LLC.

The daily management of the LLC is the responsibility of the executive body, which may be comprised of one person (the general director) or may consist of both the general Director and the management council. The executive body is responsible for all matters which do not fall within the authority of either the board of directors or the general participants' meeting. The general participants' meeting or (if provided by the LLC charter) the board of directors may choose to delegate the powers of the executive body to an external commercial organization or to an individual manager on a contractual basis.

### 3.3.7 Registration

With effect from 1 July 2002, the Federal Law *On State Registration of Legal Entities* (the *Registration Law*) transferred the authority for registration of legal entities in Russia to the local bodies of the Federal Tax Service of the Russian Federation. As a result, activities connected with the state registration of legal entities and with their registration as taxpayers are now under the auspices of the local tax inspectorates.

The following documents are required for registration purposes:

- An application;
- The protocol of the founders' meeting or, if the LLC has only one founder, the resolution of the founder on the establishment of the LLC;
- The charter of the LLC;
- A copy of the passport of the proposed general director of the LLC;
- Power(s) of attorney issued by the founder(s) for establishment of the LLC;
- Power(s) of attorney issued by the founder(s) for filing the application for the state registration of the LLC;
- Confirmation of the legal status of the founder(s) (*e.g.* extract from the trade register or certificate of good standing);
- The charter (articles of association, by-laws) of any foreign legal entities;
- Confirmation of payment of the state registration fee;
- Foreign tax registration certificate of founders (to be provided to a bank);
- Bank letter of good credit standing of a foreign legal entity; and
- Confirmation of the foreign legal entity's contribution to the charter capital of the LLC.

Any Russian founder participating in an LLC must also provide additional documentation. All documents from a foreign legal entity must be notarized and apostilled/legalized in the country of preparation. Any document supplied in a language other than Russian must be accompanied by a Russian translation which has a notarized certification.

## **3.4 Joint Stock Companies**

### **3.4.1 Types of Joint Stock Companies**

A significant number of commercial organizations have been established since the *JSC Law* came into force on 1 January 1996. While the adoption of the *LLC Law* in 1998 introduced another option for investors seeking to establish a corporate entity, the *JSC Law* represented one of the most significant pieces of civil legislation of the post-Soviet era, and JSCs remain among the most important commercial corporate forms and structures for doing business in Russia.

A JSC is a legal entity which issues shares in order to raise capital for its activities. A shareholder of a JSC is not generally liable for the obligations of the JSC, and bears the risk of any such loss only in the amount paid by it for the shares.

Two types of joint stock companies exist in Russia:

- Closed joint stock companies; and
- Open joint stock companies.

An open JSC may have an unlimited number of shareholders. Shareholders in an open JSC are entitled to freely dispose of their shares. The number of shareholders in a closed JSC may not exceed 50, and the JSC must be transformed into an open JSC within one year should this number be exceeded. As with participants in an LLC, shareholders in a closed JSC have a right of first refusal to acquire shares sold by other shareholders to third parties, at the price offered to the third parties. Shareholders in both open and closed JSCs have a preemptive right to acquire newly issued shares that are to be privately placed, in proportion to their existing shareholdings.

Shareholders in an open JSC also have a preemptive right to acquire newly issued shares that are to be publicly placed, in proportion to their existing shareholdings, but do not have a right of first refusal to acquire shares sold to third parties.

All JSCs are required to maintain a shareholders' register. The register includes information about each registered shareholder including the number, category, and classes of shares held. A JSC with more than 50 shareholders must delegate the maintenance and keeping of the shareholders' register to a licensed registrar.

### 3.4.2 Formation of a Joint Stock Company

Individuals and legal entities may be the founders of a JSC. A company's foundation document, *i.e.* its charter, must include the following information:

- The name, address, and type of the JSC (*i.e.* open or closed);
- The size of the JSC charter capital;
- The quantity, nominal value, and categories (common or preferred) of shares, as well as the classes of preferred shares issued and distributed by the JSC;
- The rights of the holders of shares of each category;
- The structure and competence of the governing bodies of the JSC, and their decision-making procedures;

- The procedure for preparing for and holding general shareholders meetings, including a list of issues requiring either unanimous consent or a resolution adopted by a qualified majority of votes;
- Information on branches and representative offices;
- Information on the existence of any special right of participation in the management of the company (a “golden share”) vested in the Russian Federation, a constituent entity of the Russian Federation, or a municipality of the Russian Federation; and
- Other provisions required by law.

The charter may include other provisions, so long as these comply with applicable Russian legislation.

### 3.4.3 Charter Capital

The charter capital of an open JSC may not be less than 1,000 times the Russian statutory monthly minimum wage (the monthly minimum wage used for the purposes of calculating the minimum charter capital of the JSC is currently 100 rubles). Currently, using an exchange rate of approximately 36 rubles/USD, the minimum charter capital for an open JSC is approximately USD 2,778. A closed joint stock company must have a minimum charter capital equivalent to at least 100 times the minimum monthly wage - currently approximately USD 278.

In contrast to LLC founders, the founders of a JSC must pay 50% of the JSC charter capital within three months following its state registration, with the balance payable in full within the first year.

### 3.4.4 Shares and Other Types of Securities

A JSC can issue securities in the form of shares, bonds, and issuer’s options. Such securities must be registered with the Federal Service for the Financial Markets of the Russian Federation (the “FSFM”), which replaced the former Federal Commission for the Securities Market (the “FCSM”) in March 2004. A JSC can issue common shares and/or several classes of preferred shares. The total value of a JSC’s preferred shares may not exceed 25% of its charter capital.

The concept of a “fractional share” was introduced on 1 January 2002. A fractional share is a share representing a portion of a whole share, which can come into existence when it is not possible to acquire the whole share during the consolidation of shares, when a shareholder exercises its preemptive right, or in the course of acquiring newly-issued shares. A fractional share grants its owner the same rights that are granted by the whole share of the corresponding category or class, on a pro rata basis.

### 3.4.5 Management Structure

Both open and closed JSCs must maintain two governing bodies: the general shareholders meeting and the Executive Body. An open JSC with more than 50 shareholders must also have a board of directors (also called a supervisory board). An open JSC with less than 50 shareholders and all closed JSCs may appoint a board of directors, although this is not a requirement. The authority of the board of directors is defined by the charter of the JSC and, if a Board is not provided for in the charter, the corresponding authority must be vested with the JSC’s general shareholders meeting.

In addition to the foregoing governing bodies, a JSC must either establish an internal auditing commission or elect an internal auditor to oversee its financial and economic activities, members of which must be elected by the shareholders.

The general shareholders meeting is the highest governing body overseeing the activities of a JSC. Its authority is outlined in the *JSC Law* and cannot be altered. Each common share carries one vote at the general shareholders meeting (except for cases of cumulative voting where provided for in the *JSC Law*), and most decisions are made by a simple majority vote, although for certain key decisions a supermajority of 75% is required.

The daily management of a JSC is the responsibility of the executive body, which may be comprised of one person (the general director) or may consist of both the general director and the management council. The executive body is responsible for all matters which do not fall within the authority of either the board of directors or the general shareholders meeting. The general shareholders meeting may (by a majority vote), choose to delegate the powers of the executive body to an external commercial organization or to an individual manager on the contractual basis: however this decision may be taken only pursuant to a proposal from the board of directors (if the company has a board of directors).

### 3.4.6 Registration

Effective as of 1 July 2002, the procedure for state registration described in Section 3.3.7 above in respect of LLCs is also applicable to JSCs: the only additional requirement in respect to JSCs is the registration of the issuance of the JSC shares with the FSFM, which is obligatory at the establishment of the company and when increasing the charter capital of the JSC.

## 4. ISSUANCE AND REGULATION OF SECURITIES

### 4.1 Introduction

The securities market and securities transactions within the Russian Federation are primarily regulated by Federal Law No. 39-FZ *On the Securities Market* (the *Securities Law*), dated 22 April 1996 (as amended). The offering of corporate securities is regulated by Federal Law No. 208-FZ *On Joint-Stock Companies* (the *JSC Law*), dated 26 December 1995 (as amended) and (with regard to credit institutions) by Law No. 395-1 *On Banks and Banking Activity*, dated 2 December 1990 (as amended). While recent years have seen considerable discussion on changes to the applicable legislation and the structure of the securities markets in general, to date such changes have been limited to the adoption of Federal Law No. 152-FZ *On Mortgage-Backed Securities* (the *MBS Law*), dated 18 November 2003 (as amended). The issuance of securities in the Russian Federation is also subject to a number of regulations issued by the Federal Service for the Financial Markets of the Russian Federation (the FSFM), and other regulatory agencies, as well as the general provisions of the *Civil Code*.

### 4.2 Securities in General

Particular instruments will not be considered securities unless they are specifically recognized as such under Article 143 of the *Civil Code* or other relevant securities laws.

Generally, all types of securities existing in the Russian Federation can be divided into two large groups: those which should be issued in compliance with a specific issuance procedure prescribed by the *Securities Law* and require registration with the securities regulator (such securities are usually referred to as “emissionnyie”) and those which need not be registered (“ne-emissionnyie”).