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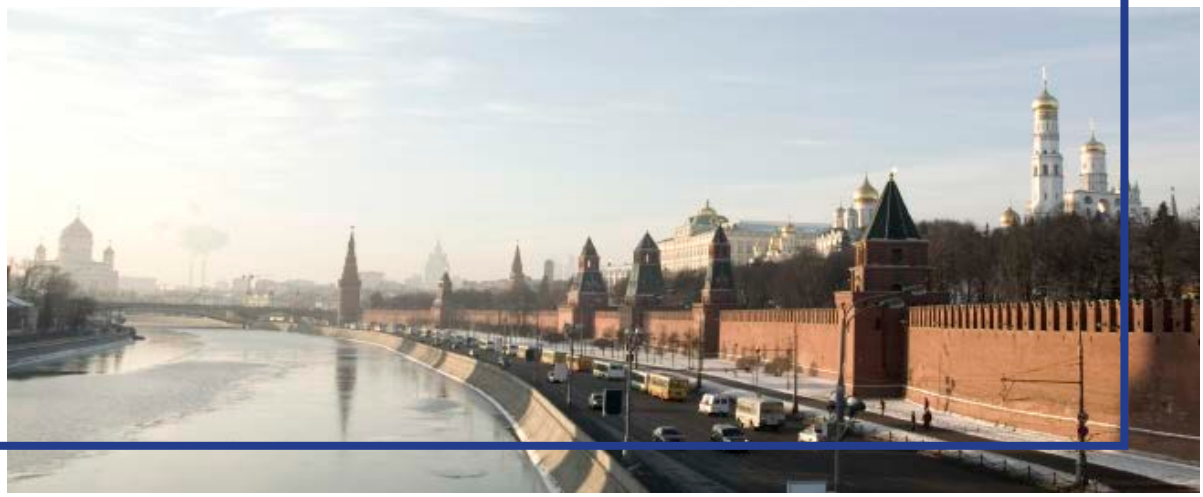
LEGAL NEWSLETTER



Moscow, July 2017

FOREIGN INVESTMENTS REGULATION

The State Duma of the Russian Federation substantially amends the Law on the Procedure for Foreign Investment in Business Companies which are of Strategic Importance for National Defence and State Security dated 29 April 2008 No. 57-FZ (the "**Law on Strategic Investments**") and the Law on Foreign Investments in the Russian Federation dated 9 July 1999 No. 160-FZ. The introduction of the amendments will lead to significant changes in the state regulation of foreign investment in the Russian Federation, as well as to additional restrictions for some foreign investors.

The first group of amendments were introduced by the Federal Law dated 1 July 2017 No. 155-FZ, which came into force on the date of its publication (1 July 2017). These amendments prohibit offshore companies and companies controlled by them from establishing control over companies of strategic importance. Previously this prohibition applied only to foreign states, international organizations and companies controlled by them.

The second group of amendments were introduced by the Federal Law dated 18 July 2017 No. 165-FZ (the "**Law**") and provide for the right of the Chairman of the Governmental Commission for Control over the Implementation of Foreign Investments in the Russian Federation to submit to the Government Commission the transactions made by foreign investors with respect to practically any Russian economic entity. The Law stipulates as well

that Russian citizens who at the same time possess citizenship of another state, and Russian organizations controlled by foreign investors shall also be recognized as foreign investors.

The Law sets forth the powers of the Government Commission to levy on foreign investors any obligations fulfillment of which is related to assurance of the country's defense and state security as a condition for the preliminary approval of a transaction.

NEW RESTRUCTURING PROCEDURE FOR COMPANIES IN PRE-BANKRUPTCY

A legislative draft which suggests a new debt restructuring procedure has been brought to the Russian Government. The Ministry of Economic Development (Minekonomrazvitiya) wants to allow companies in pre-bankruptcy to ask creditors to undergo the self debt restructuring procedure, passing over the supervision stage of bankruptcy procedure.

The debt restructuring procedure could be introduced by the court. For this purpose, the debtor will have to obtain the consent of more than 40% of creditors' votes. In addition, the debt restructuring plan must be approved by at least one class of creditors whose interests are affected. The draft provides for several classes of such creditors – for instance, strategic partners, banks with unsecured loans, etc.

At the moment the debtor is entitled to apply to the court only for recognizing him as bankrupt and after the supervision procedure shall be initiated. Only after these stages are completed can the creditors start the debt restructuring procedure – for example, they can ask for the introduction of a bankruptcy administration or a financial recovery.

In addition, the draft law provides that after reviewing the application for recognition of the debtor as bankrupt, the court will be able to initiate the bankruptcy liquidation procedure without introduction of supervision procedure. This will allow the term of the bankruptcy procedure to be shortened and will reduce costs.

MANDATORY NOTARIAL CERTIFICATION OF REAL ESTATE TRANSACTIONS

Deals leading to the creation, change or cancellation of rights which are subject to mandatory state registration (for instance, sale and long-term lease of real estate assets) are suggested to be notarially certified. On 6 June 2017, the Draft Law No. 193850-7 "On the Amendment to the Article 8.1 of the First Part of the Civil Code of the Russian Federation" was introduced to the State Duma of the Russian Federation.

The amendment is aimed at eliminating unfair deals with real estate and protecting

socially vulnerable groups. The explanatory note states that the provision of Russian legislation of a simple written form of the contracts with real estate gives parties the opportunity to profit from unprotected groups of citizens through fraud.

However, the Government did not recommend the Draft Law to be approved. In its opinion, the amendment makes the financial situation of socially vulnerable groups worse, as they have to pay a notarial fee, while the notary will not bear full material liability for his action in case they are challenged and declared void. At the moment the draft is still under consideration by the State Duma of the Russian Federation.

ABOLITION OF MANDATORY PRE-TRIAL PROCEDURE

The mandatory pre-trial procedure remains in force only in respect to claims for debt collection. Federal Law dated 1 July 2017 No. 147-FZ amends the Arbitration Procedure Code and Civil Code of the Russian Federation and limits the application of the mandatory pre-trial procedure to "civil disputes over the collection of monetary funds".

Civil disputes on the collection of funds based on disputes arising from contracts and other transactions as a result of unjust enrichment can be transferred to the arbitration court only after the parties take measures for pre-trial settlement and upon expiry of thirty calendar days from the date of submission of the claim, unless other terms and (or) procedures are set forth by the law or contract.

In addition, the amendments stipulate that any other disputes shall be subject to mandatory pre-trial procedure only in case it is required by the law or by contract. Specific types of disputes are not subject to pre-trial procedure, such as, for instance, bankruptcy disputes, corporate disputes, enforcement of foreign court decisions and arbitration rewards.

At the same time, it is not clear how the amendments will be applied by courts. In particular, the law does not clarify whether these new provisions should apply also to obligations arising within the period preceding the date of entrance into force of these amendments.

CONVERTIBLE LOANS

On 31 May 2017, draft law No. 189256-7 “On Amendments to Certain Legislative Acts of the Russian Federation” was introduced to the State Duma of the Russian Federation (the **“Draft Law”).** The Draft Law amends Federal Law “On Joint-Stock Companies” dated 26 December 1995 No. 208-FZ, Federal Law “On Equity Market” dated 22 April 1996 No. 39-FZ and Federal Law “On Limited Liability Companies” dated 8 February 1998 No. 14-FZ.

The Draft Law introduces a new corporate mechanism – the convertible loan. The contract of convertible loan gives the opportunity to the investors to transform funds for development of the enterprise into the borrower’s shares in case of success of the business project and the increase of investments.

The contract of the convertible loan is concluded by the borrower (the company) and a shareholder or a third party and provides for the right of the latter to set-off the loan amount

in whole or in part as a payment for shares of the debtor irrespectively of the pay-back period. A decision concerning the approval of the convertible loan contract can be provided in the charter. If the company's charter does not provide for such an approval, then it should be unanimously approved by all the shareholders of the borrower.

The loan conversion can be made as a result of a growth of the share capital or of the transfer of the shares, held by the company itself to the lender. As a result, the investor can become a new shareholder. The developers claim that the adoption of the Draft Law will allow companies to acquire funds promptly from the investors, while the investors will minimize their risks: in case of a negative scenario, they will be able to claim repayment of the loan or, if the business develops successfully, to get a stake in the company.

STIPULATION OF LIMITS FOR CONSIDERATION OF TRANSACTIONS AS INTERESTED PARTY TRANSACTION

At the moment, both the Law on Joint-Stock Companies and the Law on Limited Liability Companies stipulate that transactions in respect of the assets whose price or book value are lower than 0,1% of the company's assets book value shall not be considered as interested party transactions, unless the price of such transactions exceeds the threshold stipulated by the Central Bank of the Russian Federation. These thresholds were finally set forth by the Central Bank order No. 4335-У dated 31 March 2017 (**the "Order").**

The Order provides that the thresholds depend on the amount of the company's book value and they are as follows:

- → for a company with an assets book value lower than or equal to 25 billion roubles, the threshold amount is 20 million roubles;
- → for a company with an assets book value from 25 billion to 100 billion roubles, the threshold amount is 50 million roubles;
- → for a company with an assets book value from 100 billion to 1 trillion roubles, the threshold amount is 500 million roubles;
- → for a company with an assets book value from 1 trillion to 2 trillion roubles, the threshold amount is 1 billion roubles;
- → for a company with an assets book value exceeding 2 trillion roubles, the threshold amount is 2 billion roubles.

OVERVIEW OF THE COURT'S PRACTICE

- → **Decision of the Arbitration Court of the North-Western District dated 3 May 2017 (case No. A56-62821/2016 (challenge of the debtor's transactions on special grounds)**

The debtor's general director has challenged the transaction made by the company after the introduction of a supervision procedure based on special grounds (suspicious deals of the debtor, deals leading to preference for certain creditors) prescribed by the Law on Insolvency (Bankruptcy). The courts of three instances have rejected the claim.
Cassation court pointed out that only external or bankruptcy managers are allowed to challenge the debtor's transactions both on special and general grounds, as soon as the general director is not listed among the persons entitled to challenge the debtor's transactions on special grounds provided by the Law on Insolvency (Bankruptcy).

→ **Decision of the Arbitration Court of the North-Western District dated 5 May 2017 (case No. A56-5652/2016 (termination fee could be prescribed by the services agreement)**

The payment of the termination fee in case of unilateral termination of the contract on provision of services shall not be considered as a sanction and does not limit the right of the customer to unilateral refusal. The Arbitration Court of the North-Western District stressed that counterparties could provide such a condition in case the customer terminates the contract early and without grounds. Although the Civil Code of Russian Federation provides that in such cases the customer shall reimburse losses incurred to the service provider, this rule in not of mandatory nature and could be changed by the parties to the contract. The cassation court referred to the position expressed in the Ruling of the Plenum of the Supreme Arbitration Court of the Russian Federation dated 2014 related to the freedom of contract. According to this position, in case the legal provision does not contain express prohibition for parties to contract to agree on other terms and does not fall under criteria of mandatory nature, the parties are allowed to agree on other terms that are prescribed by the legal provision.

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