Answers

1 The question asked candidates to explain the process through which a legislative proposal becomes a federal law and the factors that limit the content of the proposed law.

(a) The process through which a draft law becomes legislation is laid down in the Constitution of the Russian Federation (Article 104 *et seq*).

The vast majority of new laws passed in the Russian Federation are proposed by the government. A programme of legislation is prepared by the ruling political party, which can then normally enact the laws in the desired form and within the desired time frame as, by definition, they have the majority of deputies necessary to complete the process without impediment. Theoretically, various other individuals and bodies may propose new laws. These include deputies of the Duma, members of the Federation Council, the President, legislative bodies of the subjects of the federation and the highest courts in the judicial system. Among the courts that can propose legislation, strictly within their terms of reference, are the Constitutional Court, the Supreme Court and the highest level of the Arbitration Court.

In order to become law, a proposal must be approved by both chambers of the Russian legislature, signed by the President and formally published.

The first stage in the process is for the draft law to be approved by the State Duma, the lower house of the legislature. This requires a simple majority of the deputies. The draft law is then passed to the Federation Council, which then debates and votes on the law. Again, a simple majority of members of the Council is required to approve it.

The draft law cannot proceed until it is signed by the President. If the President is not prepared to sign it, he can propose amendments and re-submit it to the Duma. The President's amendments may be rejected, subject to a vote of at least two-thirds of the deputies and members of the Federation Council being in favour of this course of action. The President must then sign the law.

The formal implementation of the new law takes place a minimum of 10 days after publication in the official 'Rossiyskaya Gazeta'. However, the legislation may specify a future date on which its provisions come into effect, or even a series of dates on which the legislation will be progressively implemented.

(b) As the superior source of law in the Russian Federation, the legislature has broad powers to draft and implement any legislation that it considers to be in the interest of the people. However, there are various constraints that must be considered.

Firstly, a new legislative act cannot conflict with the provisions of the Russian Constitution. The Constitution provides the framework within which the legal system must operate, so any conflicts between federal law and the Constitution are resolved with reference to the latter as the superior source. The government may, of course, propose alterations to the Constitution. These generally have to be effected by referendum and are therefore uncommon.

Secondly, a new legislative act should not contradict the provisions of treaties and other international agreements entered into by the government with other countries.

Thirdly, the new law should not directly conflict with the provisions of existing legislation enacted at the same level.

Lastly, the new law should be effective from the date of its enactment but not be applied retrospectively. Therefore, the law should not render illegal some act that was regarded as legal when actually committed prior to the implementation of the new law. Likewise, the new law should not violate rights that have been created by earlier legislation. For example, a new law extinguishing the rights of foreign investors should not conflict with the minimum guarantees already provided for them under earlier legislation.

2 The question sought to test the candidates' knowledge of how a contract is created and terminated.

(a) Article 421 of the Civil Code of the Russian Federation confers a right of citizens and legal entities to enter into legally binding agreements between themselves. The Code is essentially permissive in this respect, in that the freedom to contract is constrained only by specific instances dictated by law.

In order to enter into a contract it is necessary for the party to have the capacity to do so. In this context, 'capacity' simply refers to the ability to do something that has legal consequences. The Civil Code makes provisions for both natural and artificial legal persons in this respect. Article 17 of the Code deals with the capacity of individuals. Private individuals obtain full active capacity at 18 years of age, or over 16 years of age if married. The Code goes on to limit but not totally restrict the legal capacity of persons between six and 14 years of age and those between 14 and 18 years of age. Once an individual has full active capacity, that person is only restricted insofar as the state restricts or prohibits certain activities. In rare instances a court may decide to take away the right of a citizen to act on his or her own behalf, such as in the event of mental incapacity or where a person has brought hardship on the family due to inappropriate lifestyle choices. In the case of personal insolvency, the freedom to contract becomes limited as the individual is prevented from entering into certain transactions.

For enterprises, Article 48 of the Civil Code identifies three different generic organisational models. The three typologies are differentiated by their capacity to own assets and definitions of their property rights. Therefore, while a partnership or company can do almost anything that a human can do, bodies such as state owned organisations, schools, hospitals and charities, associations and clubs, do not have the corresponding freedom to act.

The capacity of an enterprise can further be restricted by conditions set out in the Charter at the behest of the founders.

As in the case of personal bankruptcy, the freedom to contract of an insolvent company that is subject to supervision by the court of arbitration is restricted.

Various laws restrict the freedom to contract when it is considered to be in the interests of the state or society as a whole. For example, it is forbidden for persons not properly licensed to deal in illegal drugs. Restrictions may also apply to certain foreign transactions to protect the currency or regulate trading activities with some countries.

(b) Under the provisions of Chapter 29 of the Civil Code a contract may be terminated in four generic ways.

Firstly, the contract is terminated when the obligations have been performed in their entirety (Article 409). This is the most common way in which a contract is discharged. For example, a hotel guest agrees to pay 5.000 roubles for a hotel room for the night. Once the guest has stayed the night and has paid in full for the accommodation, the contract is terminated, its objectives having been fulfilled. The Civil Code envisages two further means of performance. Articles 410 and 413 enable the parties to regard the contract as terminated in the event of offset and coincidence of debtor and creditor respectively. The rights to apply offset are limited by instances set down in Article 411.

Secondly, a contract may be terminated by agreement, which in effect means that they can both walk away. In this case it may not be necessary to perform any actions provided that both parties are prepared to accept the consequences and take the matter no further. For example, the hotel guest may telephone to cancel the reservation at the hotel and the hotel manager may be prepared to forego the business, confident that the room can be re-booked. Article 414 provides for novation, through which the parties can replace the contract with a new agreement. Article 415 entitles a party to an obligation to forgive non-fulfilment.

Thirdly, the contract may be cancelled because it is impossible to fulfil the obligations included in it. If the hotel guest arrives at the hotel only to find that it has been burnt to the ground, it is clearly impossible to fulfil the contract. This is sometimes referred to as frustration or *force majeure*. It is common in Russia for contracts to make extensive provisions relating to incidents of *force majeure*. These often seek to anticipate catastrophic events that would render termination of the contract unavoidable. Contracts will often be impossible to fulfil due to supervening illegality (Article 417), such as when a state body declares that a future act will be unlawful. The contract may also be terminated if the subject matter is of a personal nature and one party dies, or in the case of a legal entity, is liquidated.

Fourthly, the contract may be terminated by breach. This occurs when one party breaks the terms agreed. It normally triggers the right of the other party to pursue financial or other redress. Therefore, if the hotel guest fails to arrive and does not cancel the contract, the hotel management may be able to charge a cancellation fee if specified in the contract.

3 The purpose of the question was to test the candidates' knowledge of fixed term labour contracts.

(a) Most labour contracts are open ended and divisible in nature. They have a start date and then roll over periodically until either party decides to terminate the agreement. Their divisibility is normally reflected in the monthly or annual pay for the work.

Fixed term contracts are becoming increasingly common in Russia. Articles 17 and 18 of the Labour Code specify instances in which they may apply, but not where they must apply, so it is left to employers to determine the circumstances in which they are most appropriate.

It is common practice for the labour contracts of senior executives in strategically important positions to be drafted for a fixed period, often one year. This enables the employer to terminate the contract at relatively short notice if the incumbent of the position fails to perform to the desired standard, thereby reducing the prospect of damage to the company's future performance. The higher risk associated with such positions may be offset by substantial exit payments by way of compensation. International standards of corporate governance tend to regard fixed term contracts for directors and other senior personnel as being consistent with the best interests of the company and its owners.

A fixed term contract is also appropriate if the person occupying a position has been recruited to deliver a specific task or set of tasks within a finite time frame. This occurs when the work is project-based, such as a large construction contract.

Persons in short-term employment due to their age or their personal circumstances may be invited to work under a fixed term contract. Such workers include students, those substituting for a temporarily absent permanent employee, retired persons, those suffering certain medical conditions and those involved in seasonal work, such as fruit picking.

(b) On the expiry of a fixed term labour agreement, there are three possible outcomes.

Firstly, the fixed term labour agreement may be cancelled, its terms having been fulfilled by both parties. In such cases, the employee has his or her labour book returned and the employer is free to conclude a new agreement with another person.

Secondly, it is possible for the employer and the employee to conclude a new fixed term agreement, either on the same or revised terms. Under the principles of freedom of contract, the two parties must come to an agreement between themselves in respect of the new rights and obligations that will apply to the position.

Thirdly, the employee may continue to work for the employer under the original terms. This may occur, for example, if at the end of the fixed term neither party takes any action to acknowledge that the agreement has come to an end. This would have the effect of subrogating the fixed term agreement with an indefinite term labour agreement (Article 30).

(c) The fixed term agreement is regarded as an indefinite term labour agreement if a court or labour commission decides that a fixed term agreement has been concluded with no valid underpinning reason for this. The reasoning here, of course, is that if the Labour Code permitted all positions to be filled under a fixed term contract, it would be possible for employers to bypass the protections provided to employees under the Labour Code by simply not using indefinite labour agreements at all.

4 The question tested the candidates' knowledge of contracts of commission and of the role and responsibilities of a *del credere* agent.

(a) A contract of commission is a form of voluntary representation identified in the Civil Code. It is a contractual arrangement through which one person acts on behalf of another, usually in the course of commercial trade. Contracts of commission are governed by Chapter 51 of the Civil Code.

There are at least two parties to a contract of commission. The commissioner promises to carry out defined responsibilities in return for remuneration by the principal.

The contract may be general or specific in relation to the time for which the service will be performed or the territorial limits applicable. There is often a right to execute a contract of sub-commission (Article 994), though this is sometimes specifically excluded in the contract of commission.

The commissioner must carry out the instructions of the principal on the most favourable terms possible. If it is impossible to incorporate specific terms of the deal, performance should reflect the usual terms typical of the field of commerce.

If the commissioner fails to perform the transactions to the standards laid down by the principal, the commissioner may be liable (Article 995). However, such liability may be reduced or eliminated if it can be demonstrated that the actions were taken to reduce greater losses that would otherwise have occurred. For example, the commissioner may decide to sell perishable foodstuffs for a price lower than that specified by the principal if there is a prospect that the goods will perish or deteriorate to the extent that they will become unsaleable.

If the transactions undertaken by the commissioner yield a surplus over and above that anticipated in the contract of commission, this surplus is divided between the commissioner and the principal.

The commissioner must submit a report to the principal on his dealings (Article 999).

The commissioner must be paid a fee by the principal for the services rendered. This is specified in the contract between the parties.

The principal is obliged to accept all goods received and to honour all commitments given that are consistent with the contract of commission. The principal must examine goods received and must report any deficiencies or discrepancies to the commissioner without delay.

Once the services to be performed under the contract of commission are concluded, the principal must release the commissioner from his obligations under the contract.

Under the terms of a contract of commission, when dealing with a third party the commissioner becomes a party to the transaction and acquires rights and obligations that are then transferred to the principal. There are two separate contracts – the contract of commission and the contract with the third party. Therefore, the principal is not a party to the transaction with the third party, even though the principal may be named in the agreement. As a consequence, the commissioner obtains rights and obligations under the contract with the third party.

If a third party does not fulfil contractual obligations to the commissioner, the commissioner is not liable to the principal unless the commissioner has not taken due care in dealing with the third party or where the commissioner has given surety for the transaction. The commissioner should however inform the principal and transfer the rights under the transaction on the principal's demand.

(b) *Del credere* agents are relevant when it is deemed necessary or beneficial for a commissioner to appoint a sub-commissioner.

A *del credere* agency agreement is one in which an agent or factor, in consideration of an additional premium or commission, guarantees the solvency or creditworthiness of the purchaser of the goods or services. The additional premium or commission is called a *del credere* commission.

The *del credere* agent is often appropriate when goods are sold on credit. The *del credere* agent effectively provides an extra level of protection (or risk reduction) by insuring, warranting, or guaranteeing to the principal that the transaction will be completed. If the obligation of the purchaser is not fulfilled, the *del credere* agent takes responsibility before the principal.

5 The question tested the candidates' knowledge of transactions in which there is an interest.

(a) The federal law on companies limited by shares provides several forms of protection for the shareholders of a company where it is considered that their interests may be compromised. One of these is a restriction placed on 'transactions in which there is an interest', or more simply 'interested party transactions', defined as transactions involving the personal interests of shareholders or certain senior executives of the company.

The provisions relating to transactions in which there is an interest are set out in Articles 81–84.

The federal law states that several categories of person may be interested in a transaction (Article 81):

1. Members of the board of directors.
2. The sole executive body, which may be a managing director, members of a managing organisation and members of a collective executive board.
3. Shareholders owning at least 20% of the voting shares of the company.
4. Groups of persons or their affiliates owning at least 20% of the voting shares of the company.
5. Those who can give authorities that are binding on the company.

These parties or their family or affiliates are deemed to be interested in a transaction if they:

1. Are party to the transaction.
2. Benefit from the transaction.
3. Participate as a representative or intermediary in the transaction.
4. Own, individually or collectively with other interested parties, at least 20% of the voting shares in a legal entity that is a party, beneficiary, representative or intermediary to the transaction.
5. Hold positions in managerial bodies of a legal entity that is a party, beneficiary, representative or intermediary to the transaction.

When these criteria are met, the interested parties have a duty to disclose their interests to the board of directors, internal audit commission and auditor of the company.

(b) These transactions are not prohibited by the federal law, but the company must follow due process to approve them correctly. The transaction may be approved by the board of directors. Directors who are deemed to be interested parties may not participate in the vote on this. In cases where there are insufficient independent directors to vote on the transaction, the authority for its approval passes to the general meeting of shareholders.

Interested transactions for which the general meeting would be asked to give their approval include transactions in which all of the directors are interested, transactions in company property where the value exceeds 2% of the book value of the company's assets as at the most recent reporting date, and transactions placing new shares comprising at least 2% of issued shares. Shareholders deemed to be interested in the transaction are excluded from voting on the matter.

The Charter of the company may place further requirements or limits on these transactions.

(c) The federal law on companies limited by shares identifies five situations in which a transaction will not be regarded as one in which there is an interest (Article 81(2)).

Firstly, any transactions of a company that has a sole shareholder who also performs the duties of the sole executive body are not regarded as interested party transactions. The rationale here, of course, is that the originator of the transaction can only potentially harm him or herself.

Secondly, the same rule applies if all of the shareholders of the company are interested parties to the transaction.

Thirdly, transactions in connection with the pre-emptive rights of existing shareholders to buy additional shares in the company are excluded.

Fourthly, buy-backs of the company's own shares and redemptions of issued shares are excluded.

Lastly, transactions relevant to the acquisition of the company are excluded if another company participating in the acquisition owns more than three-quarters of the shares in the company that is being acquired.

6 The question asked candidates to explain the role and responsibilities of an external manager appointed to an insolvent company, and to set out the alternative outcomes of external management.

(a) An external manager is appointed by the court of arbitration in order to take control of the company's affairs and either restore it to solvency or bring about its ultimate liquidation. The role and responsibilities of the external manager are laid down in Chapter VI, Article 92 *et seq* of the federal law on insolvency. The external manager may be an economist, jurist or a person with other appropriate experience.

The external manager has broad powers. Initially, the manager must secure the assets of the company and evaluate them. Within one month of appointment, the external manager must deliver a report to the creditors' meeting setting out a plan to restore the solvency of the company. Once approved by the creditors, the plan must be laid before the arbitration court within five days.

The operational duties of the external manager include registering and reviewing the claims of creditors, recovery of accounts receivable and reports to the creditors on progress with the recovery plan. To advance the prospects of recovery of the company, the external manager may make any necessary operational changes, including termination of unprofitable departments, divisions or product lines. The external manager may sell off assets except those protected by law (for example, civic amenities for the use of the general community).

Various restrictions apply to the activities of the external manager. Large-scale transactions are prohibited. A transaction falls into this category if the book value of the transaction exceeds 5% of the book value of assets. Transactions that fall outwith the recovery plan are also forbidden if the insolvent company's liabilities exceed 20% of the total claims of the creditors. Transactions in which the external manager has an interest are forbidden.

(b) There are several potential outcomes of the period under external management.

At any time during the period of external management, a composition may be concluded with the creditors of the company. This decision is taken by the creditors' meeting and is subject to the approval of the arbitration court. A composition may include deferral or discounting of debts outstanding, agreements to exchange debt for equity in the company and the performing of the debtor company's obligations by third parties.

If the period under external management has been successful, the company may be able to continue in operation, having had its solvency restored. This unlikely scenario is not unknown, especially if the financial problems originated from illiquidity brought about by a one-off, catastrophic failure, such as the insolvency of a major customer.

If the company is to continue as a going concern, it is more likely that it will do so having made some fundamental changes to the products or services offered, and perhaps to its channels to market. For example, in order to restore solvency it may be necessary to close down some areas of operation altogether or scale down some activities. The company may also operate through alternative distribution channels, such as mail order or the internet in order to dispose of expensive prime retail sites and reduce salary costs accordingly.

Inevitably, a large proportion of companies that enter external management do not survive and are liquidated in due course. This almost always involves financial loss to some parties. The shareholders in the insolvent company bear the highest risk, as their claims are met after those of others, such as employees, secured creditors and unsecured creditors.

7 The question tested the candidates' knowledge of the matters that fall within the exclusive competence of the general meeting of shareholders and of how the powers and accountabilities of a sole executive body are determined.

(a) As companies become larger, the degree of separation between those who own the company and those who manage the company widens. Corporate governance is concerned with systems through which a company is controlled and directed. This is highly relevant to larger companies limited by shares, in which there are typically many shareholders whose interests are dependent on the decisions and actions of those who represent them in managing the company.

The federal law on companies limited by shares balances the interests of shareholders with the need to set up management systems that accommodate discretion and judgement in management. It achieves this by laying down certain matters that are reserved for the exclusive competence of the general meeting of shareholders as the sovereign decision taking organ of the company while creating a template on which management structures may be built.

The following matters fall within the exclusive competence of the general meeting of shareholders (Article 48):

1. Adoption of a new Charter or amendments to the existing Charter; adoption of inner documents and rules.
2. Reorganisation of the company, however achieved.
3. Matters relating to liquidation, including the decision to liquidate voluntarily, appointment of a liquidation commission and adoption of the liquidation balance sheet.
4. Appointment and removal of the board of directors and ascertaining of its powers; forming the company's executive body and where appropriate terminating its powers ahead of time.
5. Deciding the nominal values, quantities and classes of shares to be issued, and the rights attached to each class of share; splitting and consolidating shares.
6. Increasing and decreasing the share capital of the company.
7. Electing the internal audit commission, appointing the external auditor and terminating the powers of either ahead of time.
8. Adopting the annual financial statements of the company.
9. Approval or rejection of major transactions and interested party transactions.

It should be stressed that although these matters will be determined by the general meeting of shareholders, in practice the shareholders will take account of the recommendation of the directors of the company.

In addition to the above matters, the Charter may reserve additional matters to the exclusive competence of the shareholders' meeting.

(b) The provisions of Chapter VIII of the federal law on companies limited by shares apply to the board of directors and the executive body of a company.

The sole executive body of a company limited by shares is often the general director of the company. This person is elected by the general meeting of shareholders, though the founding documents of the company may provide for election by the board of directors (which is less usual).

The federal law on companies limited by shares states that the main duty of the sole executive body is to 'conduct the current activities of the company'.

The sole executive body does not have to be a physical person. It can be a juridical entity such as another limited company. In some situations this is regarded as an additional layer of control, as the individual or group taking the decisions on behalf of the sole executive body will invariably be controlled by those who own the company acting as sole executive body.

The three sources of authority that determine the powers of the sole executive body of the company are the Charter of the company, the employment contract and the provisions of federal law.

The Charter of the company is a direct expression of the wishes of those who created the company, amended as appropriate by decisions taken in general meetings.

The employment contract is the detailed set of rights and obligations between the company and the sole executive body. Under the federal law on companies limited by shares, an employment agreement must be concluded between the company and a general director (article 69.3).

However, the federal law on companies limited by shares also confers certain powers that fall within the exclusive competence of the sole executive body. One such power is the ability to act on behalf of the company without a power of attorney. The general director can also hire and dismiss employees and confer the right of subordinates to act under power of attorney. Significantly, the federal law goes on to state that the sole executive body is competent for 'all other current affairs not reserved for the competence of other governing bodies'.

Amendments to the federal law on companies limited by shares introduced as recently as 2006 reinforce the accountabilities of general directors. Article 71 requires directors to act reasonably and in good faith, which is a reiteration of the Anglo-American concept of fiduciary responsibility. The requirement to do so is restated in Article 53 of the Civil Code. Whereas prior to 2006 directors were only liable to the company for their actions, the amended legislation extended their accountability to the company and to the shareholders. Potential liability should be judged against 'customs of commerce' as described in Article 5 of the Civil Code, which can be taken to mean widely applied and generally accepted standards of behaviour.

It should be noted that these accountabilities are hierarchical in nature. No provision in the Charter, nor any clause in an employment contract, may contradict the provisions of statute law. Therefore, it is impossible for a person to disclaim statutory responsibility by including a relevant clause in the Charter or the employment contract.

8 The purpose of this question was to test the candidates' ability to apply the principles of contract law to a case study scenario.

(a) A contract is an agreement entered into voluntarily by two or more persons or entities, with the intention that the relationship thus created is enforceable before the law. The creation, administration and termination of contracts is governed by the Civil Code of the Russian Federation. A contract brings into being civil rights and obligations relating to the parties who enter into it. Chapter 28 of the Civil Code lays down the principles governing contracts.

A contract is instigated (but not concluded) by the making of an offer by one person or entity to another. An offer is an expression of willingness to be bound on specific terms. The offer does not have to be directed towards one specific person or entity but cannot be so general as to engender a response from an unlimited number of persons (Article 435). Therefore, a document offering a car to five specific customers may be regarded as an offer, but an advertisement for a car in a newspaper would be regarded as an invitation to make an offer.

The offer should set out the intentions of the communicator (the offeror) and the essential terms to which the counterparty (the offeree) is invited to agree. It is customary in Russia for offer documents to be detailed, envisaging most features of the proposed transaction as well as terms that may confer a right to modify or withdraw from the agreement.

For the contract to be concluded it is necessary for the offer to be accepted (Article 438). Only the person or entity to whom the offer is directed may accept it. Acceptance must be complete. If modifications are proposed, this cancels the original offer and creates a new offer, which the original offeror is free to accept or decline (Article 443). In order for acceptance to be valid there must be some action on the part of the offeree. In the normal course of business dealings, silence or inaction cannot be regarded as acceptance (Article 438(2)).

In the case study scenario, three paintings have been acquired by ZAO Picture and have been made available to three different clients. The first matter to be resolved is to decide whether the communication from the company to the three clients comprises an offer or merely an invitation for them to make an offer for the painting. The letter to the clients is directed at specific persons and is reasonably detailed in relation to the subject matter of the proposed deal. The artist's name is given and a description of the paintings is provided. The company has also included the price sought and the time limit by which responses should be made to secure the paintings. If would be reasonable for the recipients of the letters to regard the letters as offers capable of acceptance.

(b) The second issue is to analyse whether the three situations resulted in the conclusion of binding contracts.

Nikolai's response was an acceptance but the receipt of the acceptance came after the deadline for purchase set by the company. The company can choose to accept the offer or reject it. If the painting intended for Nikolai had been sold to another purchaser because he had not responded by the deadline, Nikolai could not enforce his acceptance as he had not complied with the requirements in the letter of offer.

Peter's response is an acceptance with modifications. An acceptance is only binding if it assents to all the terms contained in the offer. As Peter has specified that he expects a 10% discount, this has two effects. Firstly, it cancels the original offer. Secondly, it comprises a new offer (or counter-offer) which ZAO Picture can accept or reject.

Svetlana did not reply to the offer from ZAO Picture at all, but the company sent a painting with the invoice, assuming that she would purchase it. Inaction can rarely be taken to signify acceptance and ZAO Picture cannot regard its action as concluding a binding contract between the parties. Svetlana is free to accept or reject the offer that has been made to her, but the invoice that has been submitted is not enforceable.

9 The question tested the candidates' understanding of the legal and practical implications of funding the expansion of a sports company through the alternative means of share capital and loan capital.

OAO Sportclub is an open company limited by shares and as such has the capability of issuing new shares or company bonds to fund its expansion plans.

The company can issue additional ordinary shares to raise funds from existing and new investors. As an open company, the shares can be offered to the public, provided that existing shareholders are given their statutory pre-emption rights to purchase the shares ahead of new investors (federal law on companies limited by shares).

If new shares are issued, existing shareholders purchasing the shares increase their stake in the company and acquire additional voting rights, usually on the basis of one vote per share. Further rights of shareholders may be stipulated in the Charter of the company. Some investors' rights may be enhanced if their new purchases take their stake beyond the thresholds necessary to secure various constitutional rights. New investors acquire voting rights for the first time. Konstantin should be aware that as the major shareholder his level of control over the company's affairs may be diluted by the potential expansion of the shareholder base. In a sports company it may be the case that some will invest for emotional as well as financial reasons, and this could have a future bearing on the level of involvement sought by shareholders.

The share capital comprises permanent risk capital put up by the owners of the company. As such, they would expect long-term capital growth and a regular dividend as a return on the investment. Both would be dependent on the underlying future performance of the company. There is no automatic legal right to a dividend. Share capital cannot generally be withdrawn from the company.

Ordinary shareholders are entitled to a dividend if declared. However, the company may fail to generate sufficient profit to pay a dividend in bad trading years, and even if the company is profitable, the company can choose to retain profit to plough back for reinvestment. Any recommendation of the directors in this respect cannot be set aside by the general meeting of shareholders.

Marina's proposal to raise bonds could be based on a financial assessment, as the cost of the capital may be lower to reflect the lower risk to the investor. There is also greater certainty in relation to outbound cash flows, as the payments to investors can be predicted accurately.

By contrast with share capital, loan capital provides no right of ownership or control over the company, though bond holders do obtain certain rights to participate in (or influence) decision taking if the company becomes insolvent in the future. The basis of the relationship between a bond holder and the company is a civil and contractual one, with rights and obligations laid down in the written agreement between the parties and governed by the Civil Code. Bond holders receive interest and the entitlement to this interest is contractual, whether the company performs well or badly. In years where trading performance is disappointing, the company still has to pay returns to bond holders, as well as the capital when it falls due. If the company cannot meet the obligation to pay, the bond holder can litigate for the debt, which may in turn prompt a case for insolvency.

In the event that the company is liquidated, the provisions of the Law on Insolvency ensure that the bond holders have a more secure position. The funds due to them are repaid before the shareholders receive any money back at all. This risk element is likely to be reflected in the price of the alternative types of security, and potentially also in the projected regular returns.

10 The question tested the candidates' knowledge of the main types of business enterprise that may be established in the Russian Federation, and their understanding of how the advantages and disadvantages of each are applicable to the needs of a new business.

The scenario described four investors seeking to establish a retail chain of beverage and food outlets.

As the four colleagues do not wish to expose their personal assets to risk, they should immediately reject the possibility of setting up a partnership. Whilst it is possible to use a partnership structure to establish a new business of this type, the personal assets of the partners would be inseparable from their business assets and they would operate on an unlimited liability basis (Article 69, Civil Code). This is clearly contrary to the needs they have expressed. All four persons are active participants in their existing business, which probably means that the commandite partnership is also inappropriate. Therefore, although Sven and Trudi see some benefit in the partnership model, they should be encouraged to reject this as a way forward.

The needs and aspirations of the participants suggest that they should form either a limited liability company or a closed company limited by shares.

Both types of business have a separate legal personality in law which would enable them to separate their personal financial resources from their business investment. In the short-term it is unlikely that there will be more than 50 investors, so either business form would appear to be suitable.

The limited liability company provides a suitable structure for a start up business. It is a simple business form that requires minimal founding capital and there is little complexity involved in dealing with the constitutional aspects. It has the simplest procedures necessary to establish the business. The stake of each party is measurable and identifiable, and if deemed necessary the number of participants may be increased as the business expands (Articles 87–94, Civil Code).

An alternative business form is the company limited by shares. The closed model could be established initially, with a view to opening up the company to further investment should the strategic vision of Uri and Viktor materialise. Although the company limited by shares has a higher statutory capital threshold and greater complexity in respect of constitutional and operational matters, these issues should not deter the individuals, all of whom have been involved in an existing successful business (Articles 96–104, Civil Code).

The advantage of the company limited by shares is that once it is established the same business model can be used as a platform for future growth. The case study suggests that at least two of the founders are highly ambitious and that all of them see it as likely that external investors will need to be attracted in the future. These factors suggest that eventually the company could become an open company limited by shares with a stock market listing. Generally, well-established open companies limited by shares should find it less difficult to attract either share capital or loan capital.

The case study also indicates that at least some of the founders view the business as a way of accumulating wealth for themselves and their families. The company limited by shares offers the opportunity to do this. If the securities are quoted on the stock exchange in due course of time, the investors could choose to build or transfer securities, and eventually of course bequeath them for future generations.

There are corresponding drawbacks to all of the business forms. Historically, the limited liability company is a robust enough form of business until the level of operations reaches a certain critical mass but then offers limited possibilities for long-term growth such as that envisaged by Uri and Viktor. However, the company limited by shares is more expensive and complex to set up and has more onerous reporting and compliance requirements. For example, the company has to establish a formal management structure as well as internal and external audit.

Fundamentals Level – Skills Module, Paper F4 (RUS)
Corporate and Business Law (Russia) **December 2008 Marking Scheme**

1	**(a)**	Proposal to Duma and vote	2 marks
		Proposal to Federation Council and vote	1 mark
		Role of President, power of veto	2 marks
		Enactment, effective date	1 mark
			(6 marks)
	(b)	Conflict with international law	1 mark
		Conflict with Constitution	1 mark
		Conflict with existing laws	1 mark
		Retrospective legislation	1 mark
			(4 marks)
			(Total 10 marks)
2	**(a)**	Explanation of freedom to contract	1 mark
		Examples of limitations on freedom to contract	1 mark per point, maximum 5 marks
			(6 marks)
	(b)	Performance	1 mark
		Agreement	1 mark
		Frustration	1 mark
		Breach	1 mark
			(4 marks)
			(Total 10 marks)
3	**(a)**	Difference between fixed and indefinite term contract	1 mark
		Examples of cases where fixed term contract appropriate	1 mark per point, maximum 3 marks
			(4 marks)
	(b)	Termination of contract on expiry	1 mark
		Renewal of existing contract	1 mark
		Continuation of existing contract	1 mark
		Effect of failing to act at end of fixed term	1 mark
			(4 marks)
	(c)	Explanation of consequences	Up to 2 marks
			(Total 10 marks)
4	**(a)**	Definition of contract of commission	1 mark
		Rights and obligations under contract of commission	1 mark per point, maximum 6 marks
			(7 marks)
	(b)	Definition of *del credere*	1 mark
		Role of *del credere* agent in contract of commission	Up to 2 marks
			(3 marks)
			(Total 10 marks)
5	**(a)**	Parties who may be interested persons	Up to 2 marks
		Criteria to establish if transaction is one in which there is interest	Up to 2 marks
			(4 marks)
	(b)	Process for approving transaction	Up to 2 marks
	(c)	Statutory exclusions to transaction in which there is an interest	1 mark per exclusion, maximum 4 marks
			(4 marks)
			(Total 10 marks)

6	**(a)**	General description of duties of external manager	Up to 2 marks
		Responsibilities of external manager	1 mark per point, maximum 4 marks
			(6 marks)
	(b)	Composition	1 mark
		Company to continue in business	1 mark
		Restructured company to continue in business	1 mark
		Liquidation of company	1 mark
			(4 marks)
			(Total 10 marks)
7	**(a)**	Matters reserved for exclusive competence of general meeting	1 mark per point, maximum 5 marks
			(5 marks)
	(b)	Responsibilities under Charter	1 mark
		Responsibilities under employment contract	1 mark
		Statutory responsibilities	Up to 3 marks
			(5 marks)
			(Total 10 marks)
8	**(a)**	Characteristics of offer and invitation to treat	Up to 4 marks
			(4 marks)
	(b)	Application to each scenario	2 marks
			(6 marks)
			(Total 10 marks)
9		Nature of shareholder and bond holder relationships	Up to 2 marks
		Legal characteristics of share capital	Up to 3 marks
		Legal characteristics of loan capital	Up to 3 marks
		Application to scenario	Up to 2 marks
			(Total 10 marks)
10		Analysis of partnership	Up to 2 marks
		Analysis of limited liability company	Up to 2 marks
		Analysis of closed company limited by shares	Up to 2 marks
		Analysis of open company limited by shares	Up to 2 marks
		Conclusion and application to scenario	Up to 2 marks
			(Total 10 marks)