Answers

1 The question asked candidates to explain the process through which a proposal to enact legislation becomes a federal law, and to describe the limitations faced by the legislature when creating new laws.

(a) Chapter 3 of the Constitution of the Russian Federation sets out the structure of the legislature, its powers and the ways in which federal laws may be enacted.

Chapters 5 and 6 of the Constitution set the structure of the Russian legislature, which is bicameral in nature, comprising the State Duma and the Federation Council (Article 95). Together, these form the Federal Assembly of Russia. The State Duma comprises 450 deputies elected by proportional representation. The Federation Council is the upper house, made up of senators representing federal subjects that include the republics, oblasts, krais, federal cities and okrugs. Most of the primary legislation enacted in Russia is considered by both bodies.

Articles 102 and 103 of the Constitution demarcate the powers of the State Duma and the Federation Council.

Various individuals and bodies have the right to submit draft laws. These include the State Duma itself, deputies of the State Duma, the Federation Council, senators and the President. Draft laws are initially considered by a committee of the State Duma.

In order to become law, a draft must pass through three readings. The first reading of a draft law gives deputies the opportunity to discuss its provisions. On conclusion of the first reading, the Duma may decide to accept the draft law, accept it with amendments or reject it. If amendments are to be contemplated, these are discussed by a committee. The second reading discussed the findings of the committee responsible for considering the draft law. On conclusion of this stage, any final discrepancies are eliminated in conjunction with legal specialists. The draft law is usually adopted on the third reading if a simple majority (226 deputies) vote in favour (Article 105(2)).

Once adopted by the State Duma, the law is passed to the Federation Council for further consideration and potential amendment. The referral of the draft law to the Federation Council takes place within five days of its adoption by the State Duma, and the senators then have 14 days to consider it. If the Federation Council fails to do so within the 14 days limit, the draft law is deemed to be automatically adopted, except in those areas where the Federation Council's express approval is required.

If the Federation Council rejects a draft law, a conciliatory commission deals with the matters of disagreement. In the event that the State Duma opposes the proposals of the Federation Council, the former may enact the law subject to a majority of two-thirds of the deputies.

Within five days of a federal law is adopted, it is submitted to the President for promulgation. The President must sign or reject the law within 14 days. If he rejects or proposes amendments to the law, it can then be passed by two-thirds of the members of the State Duma and the Federation Council.

Article 15(3) of the Constitution states that laws must be published. Notices of new laws are placed in *Rossiyskaya Gazeta*.

(b) There are various legal and practical limitations that constrain the rights of legislators to create new laws.

Article 15(1) of the Constitution states that the Constitution has supreme juridical force, and that laws enacted in the Russian Federation shall not contradict the Constitution. If the government wishes to enact such legislation, it is therefore necessary to propose amendments to the Constitution, which in turn may only be achieved by a referendum.

Article 15(4) of the Constitution states that universally recognised norms of international law and international treaties and agreements form a component of the Russian legal system. If an international treaty or agreement sets rules other than those envisaged by law, the provisions of such international agreements will be binding. In effect, this removes the right of Russian legislators to pass laws whose provisions are at odds with international laws formally accepted by the State.

Article 85 of the Constitution empowers the President to suspend acts by executive bodies that are unconstitutional or otherwise infringe human rights.

In addition to these legal constraints on the power of legislators, there are practical limitations on their ability to enact new laws. It is time consuming to create new laws, so there is a finite limit to the number of draft laws that can be considered by the State Duma in any given year. In practice, therefore, it is necessary to prioritise legislative initiatives, and where necessary defer less important proposals for future consideration. Similarly, in fields of commerce that are fast moving, complex or interrelated, it may be necessary to introduce a series of regulatory acts over time.

2 This question tested the candidates' knowledge of the meaning and operation of forfeit and pledge, both of which are means of securing obligations. The relevant legal provisions are set down in chapter 23 of the Civil Code.

(a) Articles 330–333 of the Civil Code set down provisions relating to forfeit.

A forfeit is a fine, or financial penalty, that is incurred by a party to a contract if the contract is breached or if it is improperly discharged. A forfeit therefore applies if one party to a contract fails to carry out his or her obligations under the contract, or carries out the obligations partially or with some delay that has not been agreed between the parties.

There are two generic types of forfeit.

Firstly, a legal forfeit is a financial penalty stipulated by law. In the event of a failure to discharge obligations under the contract, the legal forfeit may be claimed irrespective of whether the counterparty has suffered losses or not. However, the parties may agree that a higher forfeit may be payable under specified circumstances.

Secondly, a contract forfeit is a form of liquidated damages specified in a contract and therefore agreed between the parties to the contract.

Article 394 of the Civil Code elaborates on the nature of the forfeit. If losses have been sustained by one party to the contract and these losses are not fully covered by the forfeit, the losses may be claimed. However, the agreement may make specific provisions for only the forfeit and not losses to be claimed (exclusive forfeit), or for the party that has incurred losses to choose whether to claim for forfeit or for losses (alternative forfeit).

Legal forfeit may be claimed as an automatic right when expressly provided for by the law. For a contract forfeit to be valid, it must be agreed in written form, irrespective of the form of the principal agreement.

If a court considers the amount of a forfeit to be disproportionate to the consequences of the breach of the contract, it has the right to reduce the forfeit.

(b) Articles 334–358 of the Civil Code set down provisions relating to pledge.

A pledge is a method of securing an obligation through which the owner of an asset offers the asset as collateral for a debt. The two parties to the agreement are the pledgor and the pledgee. In the event that the pledgor fails to discharge the obligation, the pledgee has a right to sell the pledged asset in order to realise its value and be repaid from the proceeds.

The pledgor can be a debtor or a third party who is willing to support the obligation of another.

The creation of a pledge implies the creation of rights over an asset rather than the transfer of legal ownership of the asset. If the pledged asset is sold in order for the creditor to be repaid, it is sold on behalf of the owner. Therefore, if the sale of the pledged asset results in a sum greater than the secured obligation, any surplus belongs to the owner.

The pledged property may take many forms. If it is immovable property such as land and buildings, the contract is subject to the detailed provisions of the Law on Mortgages. Less tangible assets such as intellectual property and rights under a contract may also be pledged. However, Article 336 forbids the debtor from pledging rights that are inalienably connected to the individual, such as alimony and rights under claims for compensation of harm.

As the owner of the pledged property, the pledgor has freedom to use the asset, subject to conditions agreed in the contract with the pledge. Therefore, the owner or a pledged building may occupy and use the premises, and even create leases, subject to any conditions set out in the contract of pledge. It is common for the pledge to insist on certain rights and duties. For example, if the object of pledge is a building, the pledge will invariably insist that the property is continuously insured for its reinstatement value so that in the event that serious damage arises the pledgee is not left with practically worthless collateral.

Article 339 states that any contract of pledge must be made in written form. In addition, if the law stipulates that the principal contract must be in notarised form, then the contract of pledge must also be notarised. Even if the law makes no such stipulation, the parties may choose the notarised form by mutual agreement. For contracts in respect of immovable property, it is also necessary to register the agreement in the Unified State Register.

The pledge agreement sets down the rights and obligations of the two parties to the agreement, as well as the consequences of failing to discharge obligations under the agreement. However, it should be noted that Article 348 lays down detailed constraints in respect of the realisation of pledged property. Generally, the pledge has to petition the court in order to sell the pledged property, unless otherwise agreed in a notarised agreement between the debtor and creditor. The method of sale and criteria relating to the minimum price of sale are also governed by the Civil Code (Article 350).

3 The question asked candidates to explain the provisions of the Labour Code in respect of fixed-term labour agreements, and to explain the alternative outcomes that can arise when a fixed-term labour agreement expires.

A fixed-term labour agreement is a legally binding contract through which an individual is employed for a specific period of time. This contrasts with the majority of labour agreements that are open-ended and have no expiry date.

It is necessary for fixed-term labour agreements to be regulated in order to ensure that employees can rely on many of the rights set out in the Labour Code. Without such regulation it would be possible for employers to simply rollover fixed-term labour agreements for all, thereby nullifying the rights in the Labour Code.

Fixed-term labour agreements are regulated under Articles 59, 77 and 79 of the Labour Code.

Article 59 states the circumstances under which a fixed-term labour agreement may be concluded:

(1) for replacing a temporarily absent employee for whom the job is retained in accordance with the law (Article 79 states that such an agreement terminates on the return of the absent employee);

(2) for the period of performing temporary (up to two months) work as well as seasonal work when due to natural conditions the work can be performed only during a certain season (Article 79 states that such an agreement terminates at the end of the relevant season);

(3) with persons enrolling in the organisations located in the Polar North areas or in the localities equated with them, if this is brought about by relocation of the job venue;

(4) for performing urgent work on preventing accidents, incidents, catastrophes, epidemics, epizootics as well as for dealing with the consequences of the these;

(5) with persons enrolling in small business organisations that employ up to 40 persons (up to 25 persons in the trading and consumer services organisations) as well as working for individual employers;

(6) with persons being transferred to a job abroad;

(7) for performing work out of the regular operational scope of the organisation as well for performing work in connection with the knowingly temporary (up to one year) expansion of production or volume of the services rendered;

(8) with persons joining organisations formed for a predetermined term or in performing a predetermined work;

(9) with persons hired for performing predetermined work in cases when its completion cannot be determined by a specific date;

(10) for jobs directly connected with practical training and professional training of the employee;

(11) with persons attending day schools;

(12) with part-time employees;

(13) with old-age pensioners as well as with the persons to whom temporary work is only allowed due to their health in accordance with a medical opinion;

(14) with creative personnel in mass media, movie industry, theatre and concert organisations, circuses, and with other persons participating in creation and/or performance of art works, professional sportsmen in accordance with the lists of professions approved by the Russian Federation government;

(15) with researchers, teachers and lecturers, with other personnel concluding labour contracts for a definite term as a result of the competition held in the manner set by the law or another normative legal act of a state authority or a local self-government body;

(16) in case of election for a predetermined term to an elective body or to an elective position as paid job, as well as in case of enrolling in the work directly connected with supporting activities of elective body members or officials in state authority and local self-government bodies as well as in political parties and other public associations;

(17) with heads, deputy heads and chief accountants of organisations irrespective of their organisational and legal status and form of ownership;

(18) with persons assigned to temporary jobs by official employment agencies, including public works;

(19) in other cases stipulated by federal laws.

Fixed-term labour agreements may be concluded for a period not exceeding five years. In practice, such agreements between senior executives and their companies are usually for shorter periods, such as annual contracts that may be either rolled over or discharged subject to the performance of the individual.

Articles 77 and 79 set out various provisions relating to the termination of contracts.

Article 77(2) specifies that a fixed-term labour agreement is terminated except where the relationship is continuing and neither party seeks to terminate it. Article 79 requires the employer to give no less than three days notice of termination.

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.

4 The question asked candidates to explain the meaning and significance of separate legal personality, and to describe the process through which a company limited by shares is formed.

(a) Separate legal personality refers to the existence of a business organisation as a legal entity separate from those who own it and those who manage it. Article 48 of the Civil Code alludes to this concept in subsection 1, which states:

‘(The legal entity is an organisation)…that has in its ownership, economic management or operative management the set apart property and is answerable by its obligations with this property and may on its own behalf acquire and exercise the property and personal non-property rights, to discharge duties and to come out as a plaintiff and as a defendant in the court.’

Simplifying this definition, the legal entity that enjoys separate legal personality can own assets and incur liabilities in its own right. It can take legal action on its own behalf and be subject to legal action by others.

The concept of separate legal personality is amplified by other laws. For example, Article 2(1) of the Federal Law on Joint-Stock Companies states, ‘Shareholders shall not be liable for obligations of the company and shall bear the risk of losses associated with its activity only to the extent of the value of shares of stock owned by them.’

As a consequence of the separation of the legal entity and its owners, the owners generally enjoy limited liability, in that they only bear obligations up to their committed investments in the organisation. Those who manage the organisation, who may or may not also be its owners, take decisions on its behalf but generally avoid any personal consequences of these decisions, except where they may have acted illegally or negligently, in which cases they may be accountable under the law and to the company respectively.

The management of an entity that has a legal separate personality can be structured according to the wishes of the shareholders. They are entitled to run the business directly or indirectly, or may alternatively choose to employ or engage the services of others to do so. The shareholders can also decide to retain a high level of control or dilute their influence, perhaps by inviting potential investors to share in the ownership of the enterprise in return for injections of capital.

Another significant feature of the organisation having a separate legal personality is that its ownership can be transferred during the life of the owners and bequeathed on death. The organisation therefore has perpetual succession.

With the benefits that accompany separate legal personality also come responsibilities. Legal entities must comply with the laws applicable to their chosen corporate form. They must also make formal returns and disclosures to State bodies.

(b) The formation of a company limited by shares is governed by The Federal Law on Joint-Stock Companies.

Article 8 of this law states that a company may be created either as an entirely new legal entity or by reorganisation of an existing entity.

Article 9 provides for a decision on forming a company to be formalised by a founders' meeting, or in the case of a sole founder, by the decision of that person alone. The meeting must agree on the Charter, the governing bodies of the enterprise and the inspection committee. The governing bodies and the inspection committee must be elected by no less than three-quarters of the founders agreeing to their nomination.

Unanimous decisions are required to approve the monetary valuation of securities, other items or property rights, or other rights having monetary valuation contributed by the founders to pay for the company stock. Article 26 provides for the minimum Charter capital of a company.

The founders must enter into a formal contract in writing to confirm the decision to form the company, the content of the Charter, how the company will be capitalised and the rights and duties of the founders.

Article 10 states that the number of shareholders of a closed company limited by shares may not exceed 50 persons. The number of shareholders of an open company limited by shares is unlimited.

Article 11 states the minimum content of the company Charter.

Article 13 compels the new company to be registered by entering its details in the Unified State Register.

5 The purpose of this question was to test the candidates' knowledge of the purposes of capital, and the legal provisions relating to reducing the Charter capital of a company.

(a) There are four purposes of capital.

Firstly, capital is required to finance the business. Capital may be accumulated in three ways. Share capital is the owners' equity in the business, or risk capital put up by the founding shareholders or those who subsequently agree to invest in the company. Loan capital is made up of long-term investments by those who agree to lend the company money on a long-term basis under civil contracts. The essential difference between these first two categories is that share capital may be regarded as 'permanent' capital which can only be withdrawn by following specified legal processes, while loan capital will ultimately be taken out of the business when the principal due to creditors is repaid. The third source of capital is the retained profits of the enterprise, built up over time.

Secondly, capital provides a protection against unforeseen losses. It provides the enterprise with a 'buffer' should the financial plans of the company fail to come to fruition or if the company fails to anticipate external shocks, such as downturns in key markets or other adverse economic movements.

Thirdly, capital provides a creditors' 'buffer', though only to the extent that the capital recorded in the accounts of the company represents true value. It is a long-standing principle that those who contemplate advancing funds to a company should be able to look at the accounts and assume that the net worth reflected in these documents will be a true indication of the company's financial position, and that any dilution of capital resources will distort this.

Lastly, capital is required to comply with the law. The Federal Law on Joint-Stock Companies lays down minimum capital requirements with which all companies must comply. Article 26 lays down the basic requirements for the level of capital required, while Article 29 lays down precise requirements that must be followed if a company wishes to reduce its capital. Article 35 lays down rules in respect of the reserve fund and net assets. Article 43 limits the dividends payable, ensuring that they can only be paid out of profit and other distributable resources.

(b) Article 29 of the Federal Law on Joint-Stock Companies lays down detailed requirements in respect of reductions in Charter capital. Article 30 provides protection for creditors when capital is to be reduced.

The decision to reduce Charter capital is taken by the general meeting of shareholders on the recommendation of the board of directors. Such a decision must be supported by at least three-quarters of the shareholders present at the meeting.

For a new company, if the Charter capital is not paid up in full within the necessary time limits, the company must adopt a decision to reduce the capital to the actual paid up amount.

After the first fiscal year of operation, the company must ensure that the net asset value of the company is at least represented by its capital. If the capital is less than the net asset value, the company must take a decision to adjust its capital to a level not exceeding the net asset value.

If a company cannot maintain its capital at the minimum level required by law, it must be reorganised by adopting a corporate form for which its capital position is acceptable. If this cannot be done, the company must be liquidated.

There are various further legal conditions that apply if a company wishes to reduce its capital. The Charter capital of the company must be paid in full. Any declared dividends must have been paid in full, including sums due to preference shareholders with cumulative rights. Any redemptions of stock due to shareholders must have been paid. The company must also be free of the symptoms of bankruptcy, and ensure that the reduction in capital will not result in the insolvency of the company.

Subject to these legal constraints, a company may reduce its capital by reducing the face value of shares or by reducing the number of shares, providing this is envisaged by the Charter of the company.

Details of the decision to reduce Charter capital must be notified to the authorities within 90 days of the date of the decision.

The company must make a public disclosure of the reduction in capital within 30 days of the decision. It must publish the decision in the mass media and issue a further notice to creditors informing them of the reduction and the new Charter capital amount. In turn, the creditors of the company have a right to recall their loans to the company by submitting a demand to the company within 30 days of the date of the company's notice to them.

6 The question asked candidates to explain the matters that fall within the exclusive competence of the general meeting of shareholders, and to describe how the general meeting of shareholders takes decisions.

(a) Article 48(1) of the Federal Law on Joint-Stock Companies states the matters that fall within the exclusive competence of the general meeting of shareholders:

(1) amendments to the constitution of the company or agreeing a new version of the constitution of the company;

(2) reorganisation of the company;

(3) liquidation of the company, appointing a liquidation commission and endorsing an interim balance sheet and the final liquidation balance sheet;

(4) determining the composition of the board of directors (supervisory board) of the company, electing its members and terminating their powers before expiry of their term of office;

(5) determining the quantity, nominal value and classes of shares, and the rights attached to them;

(6) increasing the authorised capital of the company by means of increasing the face value of shares or floating additional shares, unless the increase of the company's authorised capital by additional share floatation is referred to the scope of responsibility of the board of directors (supervisory board) of the company by the constitution of the company or the present Federal Law;

(7) decreasing the authorised capital of the company by means of cutting the face value of shares, acquiring (by the company) a part of shares for the purpose of cutting their total numbers and also redeeming the shares acquired or bought out by the company;

(8) forming the company's executive body, terminating its powers before due time, unless the resolution of these matters is put within the scope of responsibility of the company's board of directors (supervisory board) by the constitution of the company;

(9) electing the members of the internal audit commission of the company and terminating their powers before due time;

(10) endorsing an auditor for the company;

(11) payment (announcement) of dividends as per the results of the first quarter, half-year, or nine months of the financial year;

(12) approval of the annual reports and of the annual accounting reporting, including the reports on the profits and losses (accounts of profits and losses) of the company, and also the distribution of profit (including the payment (announcement) of dividends, except profit distributed as dividends as per the results of the first quarter, half-year, or nine months of the financial year) and of the losses of the company as per the results of the financial year;

(13) setting out a procedure for holding the general meeting of shareholders;

(14) electing the members of the tabulation commission and terminating their powers before due time;

(14) splitting and consolidating shares;

(15) approval of interested party transactions, except where these are provided for under Article 83;

(16) approval of major transactions deals, except where these are otherwise provided for in Article 79;

(17) acquisition of floated shares in the cases stipulated by the present Federal Law;

(18) making decisions on having a stake in financial-industrial groups, associations and other unions of commercial organisations;

(19) endorsing the in-house documents governing the operation of the company's bodies;

(20) resolving other issues under the present Federal Law;

(21) other matters specified in the Charter of the company.

(b) Article 69 of the Federal Law on Joint-Stock Companies states that decisions of the general meeting of shareholders must be taken on the principle of one vote per voting share. Voting shares are the ordinary shares of the company. However, preference shareholders have the right to vote under certain circumstances, including when the company has failed to pay the dividend due on such shares, on matters relating to amendments of the Charter that are of direct significance to preference shareholders and on matters relating to reorganisation and liquidation.

In order for the decisions of a general meeting to be binding, it is necessary that the meeting has a quorum. This is the minimum number of shareholders that have to be present, or in the case of postal meetings to vote. Article 58 makes provisions relating to the quorum, which is normally 50% of those entitled to vote, or 30% if an inquorate meeting is reconvened. A lower quorum may apply to companies with large numbers of shareholders.

There are three ways in which voting may be organised. Shareholders may vote by physically attending the meeting and casting their votes in person. Mixed voting enables votes to be cast either in person or by postal ballot. Absentee voting occurs when those casting their votes do so by postal ballot. It should be noted that absentee voting cannot be permitted for most of the matters ordinarily considered by the annual meeting of shareholders, and is therefore only appropriate for extraordinary general meetings. Absentee voting must be carried out using ballot papers, the content of which is prescribed by Article 60(4).

Cumulative voting is a special form of voting applicable to the election of directors. Each voting shareholder has a number of votes equal to the number of candidates for positions on the board of directors and may cast these votes according to personal preference. For example, a shareholder may decide to allocate the votes between some or all of the candidates equally or unequally, or can choose to use all the available votes for just one candidate.

While most decisions relating to company administration may be taken by a simple majority, some matters are subject to 'super majority' voting. In such cases, a majority of three-quarters of those voting is required. They include changes to the Charter, decisions on reorganisation and liquidation, decisions on the value, number and classes of shares to be issued, acquisitions of placed shares, appointment of executive bodies and the internal audit commission, and major transactions where the value of the transaction exceeds 50% of the balance sheet value of the assets of the company as at the last accounting date.

7 The question asked candidates to explain the meaning and scope of the term 'corporate governance', and to describe the roles of the internal and external auditors in promoting best practices in corporate governance.

(a) Corporate governance may be defined as the system through which an organisation is directed and controlled.

In most jurisdictions, including the Russian Federation, corporate governance relies much on subjective interpretation of how companies, their owners and their managers should behave rather than a prescriptive set of legal rules. The notable exception to this is the USA, where a rigorous statutory corporate governance regime has been established based on the Sarbanes-Oxley Act. Nevertheless, good corporate governance implies the need to comply with the laws relevant to the organisation, so operating legally is one platform upon which best practices must be built.

The owners of a company are its shareholders, so a natural starting point from which to consider the scope of corporate governance is the needs of shareholders and how they are treated by the organisation. Shareholders put up the risk capital for the organisation and are therefore entitled to make claims on the organisation – for income streams through dividends, maintenance or enhancement of wealth through robust policies to maintain and improve the value of equities, and for timely and accurate information. Best practices in corporate governance should be to implement policies that will ensure that the rights of shareholders are addressed and that shareholders are treated equitably. Many of the provisions contained in federal laws relating to the various types of legal entity promote these aims.

It is generally recognised that the responsibilities of business organisations extend beyond the shareholders. In addition, businesses should take account of the needs of stakeholders, particularly employees, creditors and the community. The rights of employees and creditors are protected to some extent by the Labour Code and laws relating to legal entities respectively. There is very little legislation in place to promote the needs of the community (or the natural environment), so the practices adopted by companies will often reflect the judgments of decision-takers such as directors and other senior executives.

As corporate governance relates to the way in which organisations are directed, it follows that the board of directors, or the equivalent bodies in other organisations, have a vital role to play. It is up to the highest level of management to formulate policies that address the medium to long-term needs of the organisation, balancing the needs to maximise shareholder value with the (sometimes conflicting) needs of the community and the environment. Decision-takers should also ensure that there are adequate systems of control in place to ensure that the organisation can meet its objectives.

Policies in respect of disclosure and transparency are particularly relevant to larger organisations, including most companies whose securities are quoted on the stock exchange. In such cases there is a 'knowledge gap' between those who own the business and those who take decisions on their behalf. As most of the information disseminated to shareholders and others is historical in nature, directors of companies have a responsibility to make appropriate disclosures in order to keep stakeholders informed.

(b) **(i)** According to Article 85 of the Federal Law on Joint-Stock Companies, the role of the internal auditors is to exercise control over the financial and economic activity of the company. As corporate governance is concerned with the systems through which an organisation is controlled, the internal auditors are therefore inextricably associated with best practices in corporate governance.

Systems of control are particularly important in ensuring that a business organisation can meet its objectives. Control systems should be capable of identifying variances between actual and planned objectives in order to provide a platform upon which corrective action may be taken.

Internal auditors provide an independent means of evaluating and validating the controls that exist in the organisation. Without such controls it is possible that the needs of shareholders and other stakeholders could be compromised. It is also possible that the information used to construct published information, such as the financial accounts, may be inaccurate and incomplete.

It is important to note that an internal audit function is only legally obligatory for certain types of business organisation. Though particularly relevant to the operations of larger entities such as companies limited by shares, it is generally acknowledged that such a function will become increasingly important in the future.

(ii) The external auditor's role in corporate governance is particularly concerned with proper dissemination of information by the company to shareholders, government and the wider public. In relation to the scope of corporate governance as discussed in part (a) above, the external auditor's work is especially important when addressing issues relating to disclosure and transparency.

In the context of companies limited by shares, Article 86 of the Federal Law on Joint-Stock Companies summarises the role of the auditor as 'exercising the verification of the financial and economic activity of a company in accordance with statutory acts of the Russian Federation on the basis of a contract concluded with him.' It is generally recognised that this duty is primarily concerned with giving an independent professional opinion on whether the published financial accounts of a company present a true and fair view of the operations of the company.

8 The question tested the candidates' ability to apply their knowledge of the law applicable to non-contractual obligations to a case study in which a chief executive of a company caused damage arising from a car accident.

Non-contractual obligations arise from torts, or civil wrongs. Unlike contractual obligations, which arise from relations between known parties, the parties involved in civil wrongs are often unknown to one another. Chapter 59 of the Civil Code recognises that civil wrongs may give rise to pecuniary obligations to settle damage caused by negligent behaviour, subject to certain conditions being present.

The general rules applicable to liabilities in tort are triggered by the occurrence of an undue action or deed. In the scenario, Alexander has lost control of his vehicle, and his action in almost immediately offering to reimburse the cost of the destroyed vegetables would suggest that he acknowledges that such a deed has occurred.

In assessing liability for such actions or deeds, the courts will consider whether an unlawful act has occurred or can be presumed, whether there has been loss or damage, and the existence of a direct causal link between the deed and the losses or damage suffered. In the scenario the facts appear to speak for themselves, as none of the damage would have occurred had Alexander not lost control of the company vehicle.

The vegetable stall:

Having acknowledged that he has destroyed the stock of the vegetable stall, Alexander wrote a formal note recognising the claim of the owner of the stall for reimbursement of 50.000 roubles. This note was countersigned by the owner of the stall. As chief executive officer of –OAO- Trade, he would be capable of representing the company without power of attorney, so this commitment to pay 50.000 roubles to the owner of the stall has the characteristics of a contract, albeit a very basic form of contract. In fact, as Alexander was driving back to his office from a business meeting in a vehicle owned by the company, it is indisputable that –OAO- Trade would be vicariously liable for Alexander's actions.

The owner of the vegetable stall rather opportunistically increased the claim by 50% in a letter to –OAO- Trade. The company could argue that its representative had already agreed a final sum payable in respect of the damage, so the increased claim is unlikely to succeed. A possible exception arises if the owner of the vegetable stall could prove that he was somehow incapacitated at the time he signed the note (for example, due to shock arising from the accident), or that he was coerced into signing the note.

The restaurant:

Having acknowledged that he caused the damage to the vegetable stall, Alexander would find it difficult to deny causing damage to the restaurant. Provided the value of the damage to the shop front and the furniture could be validated, the restaurant owner has a claim against –OAO- Trade. However, it is questionable whether the trade that would be lost over a three month period would

be a valid subject of claim, as the damage to the restaurant would have to be very severe indeed to disrupt the business for that period of time.

Alexander and –OAO- Trade:

–OAO- Trade is certainly liable for the actions of its employee during the ordinary course of business. Therefore, any proven liability arising from the accident must be met by the company. In turn, -OAO- Trade has the right of regress action against Alexander and can claim for any compensation paid to the owners of the vegetable stall and the restaurant to be reimbursed by Alexander.

9 The question asked candidates to demonstrate their understanding of the law relating to general partnerships. The first part of the question concerned the possible removal of a partner, while the second part asked candidates to examine issues relating to succession in the event of the death of a partner.

(a) A general partnership is one of the most flexible forms of business. It is possible for a partnership to have as many partners as mutually agreed, subject to a minimum of two partners remaining in the business.

The scenario described a disagreement between the partners on whether to remove a partner or not. Three partners agreed that Peter was not putting sufficient effort into the business, while one partner disagreed with this. At face value, it would appear that three of the five partners forms a majority, which should be capable of removing Peter from the partnership.

The proposal is defeated by Article 76(2) of the Civil Code, which states that the partners have a right to demand through a court that a partner be expelled in conformity with the unanimous demands of the remaining partners and in the face of serious grounds. Given that Viktoria is a dissenting voice and acknowledges that Peter brings valuable ideas to the business, there is no such unanimous agreement. The grounds necessary to remove Peter from the partnership are therefore unfounded.

The three partners have an alternative course of action in that they could resign from the partnership and form a new partnership between them. The decision to do so would be subject to six months notice of withdrawal (Article 77(1)), and they would remain liable for any obligations arising from their work with the existing partnership. Their willingness to form a new partnership would also depend on the extent to which they could operate without the services of Peter and Viktoria.

(b) Article 78(2) of the Civil Code envisages the possible courses of action that can be taken when a partner in a general partnership dies.

The heir to the deceased partner has a legal right to join the partnership, but only with the consent of all other partners. In the case study, it is clear that the surviving partners are opposed to working with Svetlana, so they can prevent her from joining the partnership in succession to her mother.

Svetlana has the right to make a claim against the partnership in respect of Anna's share in the joint capital, and this would have to be paid out from partnership resources. In turn, Svetlana would also bear responsibility for Anna's obligations to third parties. Therefore, although Svetlana has no legal right to compel the surviving partners to accept her as a partner, she can make a claim for the residual value in the partnership attributable to her late mother, net of any obligations for which she was answerable.

The partnership can continue in business with the surviving four partners, either choosing to continue with the reduced number of partners or replacing Anna with a new partner unanimously agreed between them.

10 The question asked candidates to analyse a scenario in which a chief executive officer had persuaded her colleagues on the board of directors to agree to a disastrous diversification, despite the reservations of some of her colleagues and some of the shareholders. It asked candidates to describe the actions that the shareholders could take and to examine the accountabilities of the directors for their actions.

(a) As the owners of the business, the shareholders have a powerful influence on its strategy and operations. However, in larger companies the shareholders have to place their trust in the knowledge, experience and judgements of senior executives. Strategic decisions usually imply some degree of risk, so it is inevitable that while some initiatives will succeed others will fail.

The shareholders exercise their powers through general meetings. When faced with issues that have serious implications for the company, it is possible to convene an extraordinary general meeting for the purpose of resolving the problems that are envisaged. However, in the case study the dissentient shareholders collectively hold 8% of the shares of the company, which falls short of the 10% threshold necessary to convene such a meeting. As a consequence, unless they can persuade shareholders owning a further 2% of the shares in the company to convene an extraordinary general meeting, they are unable to call a meeting.

The collective 8% of shares held by the dissentient shareholders is sufficient to place items on the agenda of the next annual general meeting of shareholders. In doing so, they would be able to bring their concerns to the attention of the other shareholders, presumably backed by the directors who consistently opposed the diversification plans.

Should the evidence of mismanagement be sufficiently conclusive, Article 71 of the Federal Law on Joint-Stock Companies also empowers shareholders holding at least 1% of the shares in a company to apply to the court for compensation of losses caused by the actions of directors.

(b) Article 71(1) of the Federal Law on Joint-Stock Companies states that members of the board of directors, 'must, when exercising their rights and performing duties, operate in the interests of the company and exercise their rights and perform duties with respect to the company reasonably and in good faith.'

Subsection 2 of the same Article states that, '...the management organisation or manager shall bear responsibility to the company for losses caused to the company due to their at-fault actions (or failure to act), unless other grounds for responsibility have been established by federal laws.'

These legal provisions place accountability for management failures firmly in the hands of members of the board of directors. It therefore follows that Tamara and the members of the board who backed her ideas may be accountable to the company for losses inflicted by their decisions. The burden of proof in relation to the size, nature and causes of losses would rest with those bringing the action against the relevant directors.

In the case study, three of the directors of –OAO- Relax confirm that they consistently voted against Tamara's proposals at board meetings. It is likely that they could support their decision with evidence of the reasons for their opposition. If this is the case, the shareholders would have a strong case against the directors who they feel are to blame for the company's problems.

The directors who opposed Tamara's strategy are protected by Article 71(2), which states that directors who voted against decisions that led to losses (or did not vote at all) will not bear responsibility for the losses suffered.

Fundamentals Level – Skills Module, Paper F4 (RUS)
Corporate and Business Law (Russia) **December 2011 Marking Scheme**

1	**(a)**	Passage of draft law through Duma and Federation Council	1 mark
		Readings and stages	1 mark
		Voting majority requirements	1 mark
		Right of amendment and veto	1 mark
		Signature by President	1 mark
		Publication	1 mark
			(6 marks)
	(b)	Limitations under Constitution	1 mark
		Limitations under international agreements and treaties	1 mark
		Action by President	1 mark
		Practical limitations	1 mark
			(4 marks)
			(Total 10 marks)
2	**(a)**	Meaning of forfeit	1 mark
		Operation of forfeit	Up to 3 marks
			(4 marks)
	(b)	Meaning of pledge	1 mark
		Operation of pledge	Up to 5 marks
			(6 marks)
			(Total 10 marks)
3		Definition of fixed-term labour agreement	1 mark
		Five year limit	1 mark
		Criteria for using a fixed-term agreement in Labour Code	Up to 5 marks
		Alternative outcomes on expiry of agreement	Up to 2 marks
		Consequences of creating an unlawful fixed-term agreement	1 mark
			(Total 10 marks)
4	**(a)**	Meaning of separate legal personality	1 mark
		Any of the following, maximum 5 marks:	
		Limited liability	1 mark
		Perpetual succession	1 mark
		Ownership implications	1 mark
		Capital implications	1 mark
		Legal and compliance implications	1 mark
			(5 marks)
	(b)	Founders' agreement and meeting	1 mark
		Charter and inner documents	1 mark
		Capital requirements	Up to 2 marks
		Registration	1 mark
			(5 marks)
			(Total 10 marks)
5	**(a)**	Source of finance	1 mark
		Buffer against unforeseen losses	1 mark
		Creditors' buffer	1 mark
		Compliance with the law	1 mark
			(4 marks)
	(b)	Voting requirements	1 mark
		Criteria necessary to reduce capital	Up to 4 marks
		Notification requirements	1 mark
			(6 marks)
			(Total 10 marks)

6	**(a)**	Per matter falling within exclusive competence of meeting	$^1/_2$ mark (5 marks)
	(b)	One share, one vote principle Voting in person Absentee voting Mixed voting Cumulative voting	1 mark 1 mark 1 mark 1 mark 1 mark (5 marks) **(Total 10 marks)**
7	**(a)**	Definition of corporate governance Scope of corporate governance	1 mark Up to 5 marks (6 marks)
	(b)	Role of internal auditors Role of external auditors	Up to 2 marks Up to 2 marks (4 marks) **(Total 10 marks)**
8		Nature of civil wrong and bases of liabilities Effects of written promise to compensate Liability of company for employee's actions Right of regress action Analysis of liabilities in the scenario	Up to 2 marks Up to 2 marks 1 mark 1 mark Up to 4 marks **(Total 10 marks)**
9	**(a)**	Right to dismiss and application to case Alternative courses of action	Up to 3 marks Up to 2 marks (5 marks)
	(b)	Right of successor to become partner Rights and obligations of successor	Up to 2 marks Up to 3 marks (5 marks) **(Total 10 marks)**
10	**(a)**	Limitation on right to call meeting Right to place item on agenda of annual meeting Right to litigate	1 mark 1 mark Up to 3 marks (5 marks)
	(b)	Obligations of directors Liability of directors for losses Ability of directors to avoid responsibility for losses	1 mark Up to 2 marks Up to 2 marks (5 marks) **(Total 10 marks)**