

Amendments to the Federal Law 'On Joint-Stock Companies'

4 May, 2010, amendments to the Federal Law 'On Joint-Stock Companies' were introduced for consideration of the State Duma of the Russian Federation. The amendments envisage restrictions for cross holding of a company through its subsidiary structures.

The draft law on introducing amendments to the Federal Law as of 26.12.1995 N 208-FZ 'On Joint-Stock Companies' (hereafter – FZ "On Joint-Stock Companies") envisages restrictions for, so called, 'circuit' and 'cross' holding of joint-stock companies. In case of the circuit holding of shares, a subsidiary company purchases voting shares of the parent company and participates in its management¹.

In case the draft law passes subsidiaries or affiliates holding shares of the parent open joint-stock company (hereafter – OJSC) shall be deprived of the right either to vote at the general meeting of the OJSC or participate in dividend distribution. Furthermore the law drafters desist from using categories of 'subsidiaries' or 'affiliates' that are stipulated by current legislation. As suggested the draft law shall govern, if anything, legal entities that are involved in (i) consolidated financial statements filed in compliance with the International Accounting Standards (IAS) and/ or (ii) consolidated accounting reports in accordance with the Russian accounting standards provided for the OJSC. The mentioned legal entities shall be defined as '**consolidated legal entities**'.

It shall be noted that currently open joint-stock companies applying to the ambiguity of legislation do not make consolidated accounting reports². Current laws oblige credit organizations³ only to provide consolidated accounting reports inclusive of those to comply with the IAS standards. Filing and disclosure of the reports in accordance with the IAS or US GAAP standards are also required to put shares or bonds into A1 and A2 quotation lists of stock exchanges⁴. Thus, the draft law shall affect few OJSCs, first and foremost – major public companies and credit organizations.

In addition to the right to vote and that to participate in dividend distribution the consolidated legal entities lose the right to purchase financial tools verifying rights to the parent OJSC's shares. Such financial tools held by the consolidated legal entity shall be alienated within 180 days after the draft law comes into effect. Whether this extends to all types of derivatives that grant rights to purchase shares – the draft law does not clarify⁵. Options and warrants as they are cannot verify rights to shares of the OJSC; they merely provide an opportunity to purchase shares. However according to the IAS the 'potential voting rights' attached to the equity-linked options and other tools can be considered when the affiliation degree of a company is determined (therefore the exercise date and some other factors, in particular, shall be taken into account)⁶.

The notion of 'consolidated legal entities' involves both subsidiaries and affiliated legal entities of the OJSC ('associated' in terms of the IAS), as both the first and the former are subject to be included in the

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¹ Cross holding is widely spread, say, in Japan. Cross holding is restricted in a lot of developed legal systems. Under US Model Business Corporation Act, corporation can not vote by its shares of some other corporation, if the latter holds majority of voting shares of the first corporation. UK law prohibits acquisition of shares of a parent company by its subsidiaries. In many other EU states certain limit of mutual holding is set.

² The obligation to make the consolidated accounting reports is stipulated with Paragraph 91 of the Regulation for accounting and reporting in the Russian Federation approved by the Ministry of Finance of the RF as of 29.07.98 № 34н. Pursuant to the Order if a company has subsidiaries and related companies it shall provide the consolidated accounting report in accordance with the procedure that shall be stipulated by the Ministry of Finance of the RF in addition to the accounting report proper. However the mentioned procedure to be set by the Ministry of Finance of the RF has not been prescribed by now. The only paper related to the reporting is the Order of the Ministry of Finance of the RF №112 as of 30.12.1996 'On Methodic Recommendations for Preparation and Submission of the Consolidated Reporting'. Though the act is not a regulatory document (upon the statement of the Ministry of Justice of the RF as of 19.03.1997 № 07-02-285-97 the Order is not he subject to the state registration). As there is no procedure provided by the law the rules for an obligatory submission of the consolidated accounting reports are in fact invalid.

³ Article 43 of the Federal law as of 02.12.1990 N 395-1 (revised as of 15.02.2010, amended as of 08.05.2010) 'On Banks and Banking Activity', 'Regulation for the Consolidated Reporting' approved by the Bank of Russia as of 30.07.2002 N 191-П (revised as of 09.07.2007), Paragraph. 3 of Instruction of the Bank of Russia as of 25.12.2003 N 1363-У (revised as of 08.10.2008) 'On Preparation and Submission of Financial Statements by Credit Organizations', the IAS 28 'Investments in Associated Companies. Consolidation'.

⁴ Paragraphs 4.5.1., 4.5.2., 4.6.1., 4.6.2. of the Regulation for Activity in Organization of Securities Markets Trading' approved by the Order of the FFMS of Russia as of 09.10.2007 N 07-102/нз-н (revised as of 26.01.2010)

⁵ According to Article 2 of the Federal Law 'On Securities Market', 'the financial tool' is a security or a derivative'.

⁶ Paragraphs 14, 15 of the IAS 27МСФО (IAS) 27 'Consolidated and Separate Financial Statements. Consolidation'.

consolidated financial statements and/ or accounting reports⁷. Following this, the consolidated legal entities comprise as well those legal entities the OJSC holds 20 or more per cent of shares in (stake).

It shall be underlined not only subsidiary or related companies shall be referred to the consolidated legal entities. Say, if a subsidiary company has an opportunity to determine decisions of a third company, the third company shall be considered and mentioned as a subsidiary in the consolidated financial statements and/ or accounting reports of the parent company. The same is applicable to the related companies of the subsidiary legal entity that in their turn shall be taken as related in the reporting of the parent company.

Furthermore, the executive bodies of the OJSC can significantly change the circle of persons/ legal entities that fall under the category of 'the consolidated' ('the perimeter of consolidation'). For instance, data on a subsidiary company can be not included in the consolidated financial statements in case the parent company 'cannot determine decisions' to be taken by the subsidiary company. Data on a related company can be not included in the consolidated reporting in case the data on the related company do not have significant impact on forming the idea of financial status and financial activity of the group. Thus, in some cases 'the perimeter of consolidation' is subject to be enlarged or reduced at the discretion of the OJSC.

The draft law wording does not clearly indicate the moment that shall determine legal entities as 'the consolidated'. However, it states that when disclosing the consolidated financial statements or accounting reports the OJSC is obliged to provide a list of its consolidated persons/ legal entities to the person running the share register.

⁷ Paragraphs 1.3-1.6 of the Order of the Ministry of Finance of the RF as of 30.12.1996 N 112 'On Methodic Recommendations for Preparation and Submission of the Consolidated Reporting' and Paragraphs 4.1., 4.2. of the Notes to the qualitative consolidated financial statements of the Appendix 1 to the Methodic recommendations 'On the Procedure for Preparation and Submission of the Financial Statements by Credit Organizations' approved by the Letter of the Bank of Russia as of 07.02.2010 № 24-T, the IAS 28 'Investments in Associated Companies. Consolidation'.