Directors' Liability and Indemnification

A Global Guide, Third Edition

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1. Introduction

In recent years new provisions on directors' liability were introduced into Russian law as a part of an extensive reform of Russia's Civil Code and corporate law. The statutory framework governing duties of directors comprises the Civil Code of the Russian Federation[1] and federal laws on particular forms of legal entities (such as joint-stock companies[2] or limited liability companies[3]) (hereinafter 'the company laws') as well as relevant provisions of other codes and federal laws (the Criminal Code, the Code of Administrative Offences, the Federal Law on the Securities Market, the Federal Law on Insolvency (Bankruptcy), etc).

Although Russia has a civil law system, court rulings (especially those of higher courts) in fact can have persuasive authority for commercial courts reviewing similar cases. The Highest Arbitration Court of the Russian Federation, in Resolution 62 of the Plenum on Certain Issues of Compensating Damages by Members of the Governance Bodies of a Legal Entity, dated July 30 2013, (hereinafter 'the Damages Resolution') has provided some helpful guidance on a number of issues related to the duties of directors and their liability. In this chapter, the company laws and the Damages Resolution collectively will be termed 'the relevant legal sources'.

We note that as a result of a reform of the Russian court system, the Highest Arbitration Court of the Russian Federation has been merged with the Supreme Court of the Russian Federation. Prior to this merger the Highest Arbitration Court had been quite active in issuing interpretative guidance on business law matters. While the Damages Resolution and the earlier binding practice of the Highest Arbitration Court on directors' and officers' liability will continue to have effect for the lower commercial courts, the Supreme Court may in future opt to alter guidelines previously adopted by the Highest Arbitration Court.

2. Directors' duties

2.1 Who is a director?

Although there is no statutory definition of the term 'director', in the context of

1 Civil Code of the Russian Federation, Part I (Federal Law 51-FZ of November 30 1994), Part II (Federal Law 14-FZ of January 26 1996), Part III (Federal Law 146-FZ of November 26 2001), Part IV (Federal law 230-FZ of December 18 2006), in each case as subsequently amended.
2 Federal Law 208-FZ on Joint-Stock Companies of December 26 1995, as amended.
3 Federal Law 14-FZ on Limited Liability Companies of February 8 1998, as amended.

directors' and officers' liability the term generally applies to any of the following groups of persons:

- a sole executive body – ie, the CEO (chief executive officer) of a company, usually referred to as a director, general director, president, chairman of the management board, etc;
- a provisional sole executive body;
- an outside management body (a managing company or a manager);
- a member of a collective executive body (management board); and
- a member of a collective governance body (eg, a supervisory board or a board of directors).

This chapter does not address the duties and liabilities of any officers or senior executives other than those of directors. Such other officers are employees of the company and their duties and liabilities are governed primarily by labour law and their employment contracts.

Russian companies may have a two-tier board structure (consisting of a management board and a board of directors (a supervisory board)). The latter consists of individuals only, who are elected directly by the shareholders. In all other cases, individuals who are directors are employees of the company.

2.2 Nature of duties

Broadly speaking, directors have fiduciary duties of loyalty and care to the company. To be more precise, the legal basis for directors' liability is a long-standing rule provided for in the company laws that directors "must act in the interests of the company, reasonably and in good faith". Should they breach their duties, they have to compensate for any loss incurred by the company, shareholders or third parties. 'Loss' includes the actual damage, expenses to be incurred in the future as a result of the breach, and lost profits. Russian law does not provide for punitive, aggravated, exemplary or multiplied damages in relation to a breach of directors' duties.

The duty of loyalty also includes the duty to inform the company of a director's interest in a particular transaction and, more generally, of a conflict of interests, if so provided by the company's corporate documents. The director shall compensate the company in full for loss incurred by the company as a result of the director's failure to do so.

The CEO also owes a statutory duty of confidentiality to the company and its contractors. The engagement contract with the CEO has to set out the CEO's duties and liabilities with regard to the preservation of commercial secrets.[4]

2.3 Standards of care and conduct

As mentioned above, the relevant legal sources provide for the following basis of directors' fiduciary duties: when exercising their rights and discharging their duties, directors must act in the interests of the company and exercise such rights and discharge such duties to the company in good faith and reasonably.

4 Article 11(6) of Federal Law 98-FZ on Commercial Secrets, dated June 29 2004, as amended.

The relevant legal sources further provide that a director may not be liable for damages if he voted against the decision that has caused damage to the company or, acting in good faith, did not participate in the voting. When determining grounds for liability and amount thereof, standard market practice and other relevant circumstances should be taken into account.

Generally, the courts apply the following test when deciding whether a director had acted in good faith and reasonably: whether the individual had taken all necessary measures to properly discharge his obligations and had acted with due care and prudence required by the nature of the obligation and market practice.

The Damages Resolution has for the first time provided for more detailed guidance for courts as to whether a director has acted in good faith and reasonably. In particular, the Highest Arbitration Court of the Russian Federation has stated that a court may find that a director acts not in good faith if, among other things, such director:

- acts with a conflict of interest – where his personal interests or the interests of his affiliates conflict with the interests of the company; or
- is aware or should have been aware that his actions (or his failure to act) are not aligned with the interests of the company.

The Damages Resolution further sets forth that a court may find that a director acts unreasonably if, among other things, the director:

- makes a decision without considering material information that he is aware of;
- does not request reasonably necessary information before making a decision; or
- enters into a transaction ignoring existing internal compliance procedures for analogous transactions.

The Central Bank of the Russian Federation, which is the financial markets' regulatory authority in Russia, has recently adopted a new Code of Corporate Governance that, although not generally mandatory for companies, provides some guidance as to what directors should do to ensure they fulfil their fiduciary duties to the company. In particular, a director should, among other things:

- exercise the care and prudence that are expected from a good manager in analogous situations given analogous circumstances;
- make himself informed and request information from the executives that is necessary for making informed decisions;
- avoid any conflicts of interest; and
- (for members of the board of directors) actively participate in the meetings of the board of directors and any committees thereof.

The Code of Corporate Governance also states that a director is presumed to be acting reasonably and in good faith if the director is not personally interested in a particular decision and has carefully studied all the information necessary for taking such decision. At the same time, all the other relevant circumstances should provide evidence that the director is acting exclusively in the interests of the company.

(a) Notable recent court cases

Since 2014 there has been a substantial change in court practice with regard to the liability of a company's management. The starting point for this was a number of cases reviewed by the Highest Arbitration Court, most notably the so-called *Kirov factory* case.[5] In this groundbreaking case, the Highest Arbitration Court explained that it is generally expected that the CEO of a company will act reasonably – ie, in a way that is expected from a good manager in an analogous situation under analogous circumstances. In the case at hand the court pointed out that the CEO's failure to request information about a certain transaction should be interpreted as an intentional breach of duties, or culpable omission, by the director.

Further, the court pointed out that the CEO acted with a potential conflict of interest – ie, there was serious doubt that he acted solely in the interests of the company. The court stated that entering into transactions with a conflict of interest cannot be deemed as undertaking a general commercial risk.

Another important conclusion reached by the same court, which subsequently found its way into the Damages Resolution, is that failure to act in good faith may result in shifting the burden of proof from the plaintiff to the director.

In another prominent ruling against a CEO for inappropriate delegation of his powers,[6] the Highest Arbitration Court stated that the delegation of all powers of the CEO without any justification or regard to the character or scale of business cannot be deemed reasonable and consistent with standard business practice. The court pointed out the importance of the CEO's immediate and personal involvement in the management of a company, supervision of subordinates and maintenance of the governance structure that would be appropriate for the scale of business. The court further decided that if the company were to incur damages as a result of the CEO's failure to comply with any of the above, the CEO would have to compensate the company for such damages.

Another decision reached by a district arbitrazh court[7] suggests that if a CEO did not comply with an order of a regulatory authority, resulting in penalties, the company may claim damages in the amount of such penalties. The court emphasised that acting in good faith and reasonably also includes due exercise of the duties imposed by applicable public law. If the company is liable for tax, administrative or other offences that are due to the CEO's failure to duly fulfil his statutory duties, the company may file a claim against the CEO for damages. The court has, amongst other things, considered whether it was in the scope of the CEO's authority to cure the breach and if the CEO was able to do it from a financial standpoint. Furthermore, although at the time the breach was discovered the company had a new CEO, the court found that the breach emerged and was continuing at the time when the previous CEO held office. The court concluded that a newly appointed CEO (who had been in the office for less than a month when the inspection revealed the breach) could not have cured the breach in such a short period of time. Thus, the previous director was held liable for damages incurred by the company as a result of his omissions.

5 Resolution 12505/11 of the Highest Arbitration Court of the Russian Federation Presidium, March 6 2012.

6 See Resolution 9324/13 of the Highest Arbitration Court of the Russian Federation Presidium, January 21 2014.

7 Decision F06-3500/2015 of the Arbitrazh Court of Povolzhskiy District, December 15 2015.

2.4 To whom duties are owed

The relevant legal sources provide that a director generally owes duties to act reasonably and in good faith to the company. The obligation to act in the interests of the company implies that the directors have to act in the interests of the company as a whole and not of any particular shareholder. When determining what constitutes the 'interests' of a company, it is necessary to consider that the generation of profit (creating long-term value) is the main business purpose of a company. The provisions of the foundation documents and decisions of corporate bodies of the company (eg, decisions on a determination of the priority areas of activities of the company, approval of the strategy or business plan, etc) must also be taken into consideration for the purposes of determining the company's interests.

There is a very limited number of cases where a director owes his duties directly to the shareholders, and a shareholder may file a claim against a director for compensation of loss incurred by that shareholder (see section 3.3 below). As discussed in detail in section 3.4 below, a director also owes certain duties to investors, holders of company securities and creditors.

2.5 Common defences to, and exemptions from, liability

Russian court practice in connection with the personal liability of directors is still rudimentary and does not allow determination with any degree of certainty of the specific steps that a director should take, generally or in a specific situation, to ensure that he has a strong defence against a claim for personal liability. When deciding cases with regard to directors' liability, the courts require that the plaintiff prove all of the following:

- breach of fiduciary duties;
- wrongfulness of the action or omission;
- damages; and
- causation.

A director may provide clarifications with regard to his actions (or his failure to act), state other reasons as to why the damages occurred (eg, poor market conditions; a contractor, employee or representative of the company acting in bad faith; unlawful actions of third parties; accidents; natural hazards and other events, etc) and may provide relevant evidence in support of such clarifications.

A director may, among other things, invoke the following defences against personal liability:

- the director voted against the decision the adoption of which resulted in damages or acting in good faith did not participate in voting;
- the actions (or the failure to act) of the director did not exceed general commercial risk (the Russian equivalent of the more commonly termed 'business judgment rule');

- the transaction entered into by the director proved to be unfavourable only after the consummation of the transaction and as a result of non-performance of the obligations thereunder. However, the director will not be exempt from liability if the transaction had been initially entered into with the purpose of not performing or unduly performing the obligations arising therefrom;
- the director proves that although the transaction he entered into is by itself not on favourable terms, it is part of a series of interrelated transactions having a common business purpose that are intended to be favourable for the company;
- the director has entered into an unfavourable transaction to prevent more substantial damages;
- a particular matter or transaction is not within the scope of authority of the director. The authority of a director is set out in the company laws, the company's charter or the company's corporate documents providing for each director's rights and obligations. However, if the director is a member of the board of directors (supervisory board), in some cases the courts broadly interpret the directors' scope of authority as general management of the company and find directors liable for not exercising proper supervision over the executives of the company;
- it was not evident that the director's actions qualified as a breach of duties at the time the breach occurred – including any lack of consistency in application of the law by tax, customs and other authorities; and
- the company has already resorted to other remedies (eg, by recovering damages from an employee or a contractor) and has been compensated for the incurred damages.

Any agreement limiting or excluding the liability for acting in bad faith (for public companies – both for acting in bad faith and for acting unreasonably) is void.

3. Who can bring civil claims

3.1 The company and its liquidators

In most cases a claim against a director is filed either by the company or by its shareholders on behalf of the company. If a shareholder files a claim in the interests of the company, that shareholder acts as a representative of the company and the company would still be the claimant.

A company may file a claim for compensation of loss incurred by it as a result of a director's wrongful actions or omissions, but only if the director acted unreasonably or in bad faith, amongst others, or if his actions were not consistent with normal business practices or average commercial risk.

A bankruptcy manager on his own initiative or on the initiative of the creditors' meeting/committee may file a claim for loss against the CEO of a company for (i) belated filing for bankruptcy, (ii) premeditated bankruptcy or (iii) the CEO's actions or omissions that resulted in bankruptcy (eg, as a result of entering into certain transactions on behalf of the company, or because of a failure to properly maintain the company's accounting documents). Although, as discussed above, a bankruptcy manager may file claims on his own initiative, he still acts primarily in the interests of the creditors. In cases (i) and (iii) a representative of the employees, a (former) employee or an authorised governmental agency (such as the taxation service) may also file the above claim. The CEO has subsidiary liability to the creditors – ie, he must compensate them for any damage suffered that has not been compensated for by the company due to insufficiency of funds – but only when the CEO's actions or omissions caused the damage.

A bankruptcy manager, external manager, shareholder, creditor or authorised agency may also file a claim against any director for loss resulting from any breach of the bankruptcy law by that director.

As a general note, the bankruptcy legislation is tailored in such a way that directors other than the CEO play a very limited role in the bankruptcy proceedings and so their exposure to potential claims for damages is similarly limited.

3.2 Minority shareholders on behalf of the company (derivative actions)

Despite the fact that the relevant legal sources provide for a possibility of derivative actions, in practice such actions are extremely rare. One of the main reasons for this is that procedural rules have not yet been tailored in Russia for derivative actions.

A claim for compensation of loss incurred by the company as a result of a director's wrongful actions or omissions may be filed by its shareholders on behalf of the company. In a joint stock company, shareholders holding individually or jointly at least 1% of the outstanding ordinary shares may file a claim for compensation of loss incurred by the company. There is no participation threshold for filing a derivative claim by the participants of a limited liability company; thus any participant can file a derivative claim regardless of the size of its interest.

Before filing a claim, a shareholder of a joint stock company must notify the other shareholders of the claim by sending a written notice to the company no later than five days before the claim is filed. If the court allows the claim, a non-public joint stock company must notify its shareholders, while a public joint stock company must publish a statement on the Internet with regard to the court allowing the claim (along with the documents submitted with the claim) within three days after the court allows it.

As discussed above, a shareholder filing a claim for compensation of loss acts on behalf of the company, so the court may not dismiss the claim even if the shareholder was not a shareholder at the time when the actions or omissions of the directors or the damage resulting therefrom occurred.

A shareholder claim against a director in the bankruptcy proceedings (see section 3.1 above) cannot prevent shareholders from filing claims for compensation for damages in the amount exceeding the subsidiary liability of the CEO outside the bankruptcy proceedings.

3.3 Minority shareholders on their own account

There is a very limited number of grounds in Russian law for a shareholder to file a

claim against directors for compensation of loss incurred directly by that shareholder.

A shareholder of a public company may on its own account file a claim for compensation for loss incurred by that shareholder as a result of violations by directors of their statutory obligations in the process of acquisition of more than 30% of voting shares of a public joint stock company (ie, for breach of the mandatory tender offer rules that apply to directors of the target company).

A claim for damages for inaccurate, incomplete or misleading information in a securities prospectus, a securities issuance report or a quarterly report of the company may be filed by shareholders against the directors who signed or approved those documents.

3.4 Investors in securities claims and other third parties

As a general rule, third parties may claim compensation of loss incurred by them from the company. The scope of instances when claims may be brought by third parties against directors is very limited.

Even so, such instances include the bringing of claims by investors or holders of the company's securities against directors who signed the securities prospectus, notice or report on the securities issuance or a quarterly report, or directors who voted for approval of any such documents, for any loss incurred as a result of inaccuracy, incompleteness of the provided information or this information being misleading.

Another instance is where creditors may file a claim for compensation for damage against directors in the process of reorganisation of the company if, under the general rule, such damage is caused by those directors' culpable actions or omissions (eg, corporate decisions approving reorganisation). As a general rule, a creditor of a company in reorganisation may request an accelerated discharge of its obligations (or, if acceleration if not possible, termination of the respective obligations and compensation for damages). Accordingly, directors may become liable to creditors for such damages for the directors' culpable actions or omissions when discharging their obligations in a reorganisation process.

Employees of the company may file a claim for monetary compensation of loss incurred as a result of a breach of their employment rights, but only against the company and not against its directors.

For claims against directors by third parties in bankruptcy proceedings, see section 3.1 above.

4. The regulatory and criminal liability landscape

4.1 The most common types of criminal offences alleged against directors

The Criminal Code of the Russian Federation sets out a number of grounds for criminal liability of directors. The most common types of criminal offences alleged against directors are set out in Chapter 22, "Economic crimes".

Common types of criminal offences imputed only to the CEO (and not other directors) include the following:

- unlawfully drawing upon a loan that has led to earning profits exceeding Rb1.5 million (around US$22,000) where the borrower provided the creditor with knowingly inaccurate information about the company;
- fraudulent evasion of repayment of indebtedness exceeding Rb1.5 million;
- premeditated or fraudulent bankruptcy, if this has caused damages exceeding Rb1.5 million; and
- failure to pay salaries to company staff for more than three months with an ulterior motive or personal interest.

Both the CEO and other directors (to the extent they took part in the relevant action or decision within the scope of their authority) may be held criminally liable for, amongst other things, the following offences:

- unlawful use of insider information, if this has resulted in harm to natural persons, companies or the state in an amount exceeding Rb2.5 million (around US$37,000) or the offender earning profits exceeding Rb2.5 million;
- illegal entrepreneurship, if this has led to the offender earning profits exceeding Rb1.5 million – ie, the company operates without state registration or a licence (if such licence is needed) or breaches the terms of the licence;
- repeated unlawful use of a trademark, if this has caused damages exceeding Rb1.5 million;
- prevention, limitation or elimination of competition, if the above activities have resulted in harm to natural persons, companies or the state, or have led to the offender earning profits exceeding Rb1.5 million;
- abuse of the process of securities issuance, if such abuse has resulted in harm to natural persons, companies or the state in an amount exceeding Rb1 million (around US$15,000);
- fraudulent non-disclosure of information in the securities market, if such abuse has resulted in harm to natural persons, companies or the state in an amount exceeding Rb1 million;
- unlawful refusal or evasion of convocation of the general shareholders' meeting, if this has resulted in harm to natural persons, companies or the state in an amount exceeding Rb1 million or in the offender earning profits exceeding Rb1 million;
- falsification of a resolution of the general shareholders' meeting or of the board of directors meeting; and
- breach of the requirements of employees' health and safety (if this has resulted in grievous bodily harm).

A criminal penalty may only be imposed on the offender for actions that have all the elements of the criminal offence – in particular, when the action is against the public good and leads to consequences that are against the public good, is pursued in a form prohibited by the Criminal Code under the threat of penalty, and constitutes a culpable act.

Separately from criminal liability, directors may also be subject to administrative

and disciplinary prosecution. The qualification of an action or omission as a crime or administrative offence depends on the gravity of the harm (injury) suffered as a result of the action/omission, the level of profits received by the offender, the existence or otherwise of aggravating circumstances, and the level of danger to society by the action/omission.

Administrative offences may result from such actions/omissions as:

- unlawful use of insider information (if not subject to criminal liability);
- violation of statutory regulations on the keeping of the company's official documents;
- violation of the statutory procedure for the issuance of company securities;
- violation of statutory disclosure obligations in the securities market;
- unlawful transactions with securities; and
- violation of regulations on the preparation and holding of the general shareholders' meeting.

Disciplinary offences that may be imputed to directors include, amongst others:

- reaching an unjustified decision that has led to impairment of the company's assets;
- unlawful use of the company's assets or other damage to the company;
- breach of provisions of labour law, of other statutory labour regulations and of provisions of a collective bargaining agreement; and
- being employed by other entities without the consent of the relevant governance body or shareholders.

4.2 Enforcement

Courts of general jurisdiction have exclusive power to resolve cases relating to criminal, administrative or disciplinary offences committed by directors, with just a few exceptions (eg, premeditated or fraudulent bankruptcy) that are subject instead to the jurisdiction of commercial courts.

Among other entities, investigative agencies, law enforcement agencies, tax authorities, labour and employment authorities, the Central Bank of Russia, financial and budget supervision authorities, the Federal Antimonopoly Service and state non-budgetary funding entities are most commonly involved in initiating proceedings against directors for the offences described in section 4.1 above.

4.3 Penalties

Sanctions for criminal offences committed by directors acting in their respective capacity generally include:

- fines;
- disqualification, or prohibition to hold certain offices or engage in certain activities;
- compulsory community service;
- remedial work (namely, withdrawal in favour of the state of 5% to 20% of the offender's salary received at the principal place of work);
- compulsory labour (namely, working at a location determined by penitentiary authorities accompanied by withdrawal in favour of the state of 5% to 20% of the offender's salary);
- restriction of freedom;
- apprehension; and/or
- imprisonment.

Most of the criminal offences that directors can be charged with are misdemeanours, with a limitation period expiring two or six years after the crime was committed (depending on the gravity of the penalty).

The most common types of penalty that can be imposed on a director for an administrative offence are fines and disqualification. The statute of limitations for administrative offences commonly imputed to directors constitutes one year from the date the offence takes place. In the event of continuing violation, the limitation period begins from the date when the violation was discovered.

For a disciplinary offence, a director may be subject to a warning, reprimand, dismissal or other disciplinary sanctions provided for in law or in the company's by-laws. Disciplinary sanctions may be imposed within a month from the date when the violation was discovered but not later than six months after the date when the violation was committed.

4.4 Bribery and corruption

Russia's Criminal Code provides for the liability of directors for receiving a bribe. A bribe is any unlawfully received money, securities, other property, services or proprietary rights.

Bribery is punishable by:

- a fine in an amount that is 15–70 times the amount of the bribe, with prohibition to hold certain offices or conduct certain activities for up to three years;
- compulsory community service for up to five years, with or without prohibition to hold certain offices or conduct certain activities for up to three years; or
- imprisonment for up to seven years, with a fine in an amount that is up to 40 times the amount of the bribe.

Aggravating circumstances, leading to stiffer penalties, include the following:

- commission of bribery by a group of persons or by an organised group;
- bribery attended with extortion; or
- where the director undertook unlawful actions or omissions in consideration for the bribe.

At the beginning of 2013, amendments aimed at bolstering the prevention of corruption were introduced through the adoption of Article 13.3 of Federal Law 273-FZ on Counteraction against Corruption, dated December 25 2008 (subsequently amended). The provisions set forth that all entities doing business in Russia are now required to have measures in place to prevent corruption. Although it is difficult to

predict precisely how this requirement will be implemented in practice, the changes should provide a certain incentive for the adoption and implementation of compliance procedures and ethical business conduct.

5. Claims culture

5.1 Litigation culture

The legal framework with regard to directors' liability is still rudimentary and only in recent years has it got on track with consistent development. Indeed, before the adoption of the Damages Resolution, the regulatory framework on directors' liability was limited to the general wording of the company laws as to the duty of directors to act in the interests of the company reasonably and in good faith, and their liability for culpable actions.

Arising from an insufficiency of legislative guidance and established court practice on the matter, suing management has not been popular among shareholders. Another reason was that before 2013 the courts requested that claimants prove the exact amount of damages caused by the actions or omissions of directors; the courts would dismiss a claim if the claiming party failed to do so (as discussed above, the Damages Resolution advised against such approach). This led to a situation where directors were not facing significant exposure (and there was no guidance setting out ground rules the violation of which led to such exposure) to the risk of having to compensate an aggrieved party for damages incurred by the company, its shareholders or third parties.

Nevertheless, the number of claims against directors for recovery of damages had been rising steadily until 2013, when the trend was reversed. As a possible explanation, the Damages Resolution clarified under which circumstances a director may be held liable for losses caused to the company. As a result, it became clear for directors, on the one hand, what kind of behaviour they should avoid and for claimants, on the other, what kind of claims are most likely to succeed.

Generally, there are no official statistics in Russia in respect of types of claim most commonly filed against directors.[8] According to relevant public legal sources, most cases are filed against a company's CEO and fewer cases are filed against members of the board of directors and managing companies. Common claims include allegations relating to the dissipation of assets (eg, a sale of assets below their market price or to an affiliate without due corporate approval, the acquisition of 'bad' promissory notes, or lending money to insolvent borrowers) and the payment of unreasonably high salaries or other means of remuneration to a company's employees.

5.2 Impact of recent financial and economic trends on claims

After the global credit crisis occurred in 2008, the Russian law on bankruptcy was amended to expand the scope of persons who may be held liable for a company's bankruptcy. In particular, the law established that 'persons controlling the debtor' may be held liable if the debtor's property was diminished as the result of actions taken under the instruction of such persons. 'Persons controlling the debtor' are defined as those who, in the course of the two years prior to bankruptcy, have been able to actually determine the debtor's actions, such as major shareholders or persons authorised to act on behalf of the debtor.

In addition, under the new rules a company's CEO may be held liable for the bankrupt company's debts if the company's books and records were not kept properly. The amendments were aimed at restoring the debtor's bankruptcy estate. According to publicly available information, the number of relevant bankruptcy cases increased significantly in 2009 as compared with 2008, which may be attributed to the above-mentioned amendments.

5.3 Collective redress systems

A collective redress system in the form of a private class action has been formally allowed by the Russian legislature only since 2009. However, no detailed regulation of the class action procedure has yet been developed (eg, the procedural rights of those persons other than the person initiating the class action are not adequately regulated). The number of class actions has, as a result, remained insignificant, with just a few one-off precedents of shareholders' class actions.

A claim may be considered as a class action if no fewer than five persons have acceded to the claim. Other persons may accede to the claim by submitting a written application authorising one of the claimants to act on their behalf. A person initiating a class action must notify other possible claimants through any means determined by the court, including by public announcement in the media. A shareholder in the case described in the first bullet point below should notify other shareholders through the company. Such notification must be made at least five days prior to filing of the claim with the court. Generally, the persons who choose not to accede to the class action cannot file an identical claim afterwards.

The law generally allows for class actions to be initiated against a director of a company. As mentioned in sections 3.2 and 3.3 above, such class actions may be filed as follows:

- by a company's shareholders, for losses caused by a director of the company if the director has acted in breach of his duties to the company (damages may be recovered in favour of the company only) – eg, he enters into an interested-party transaction without the necessary corporate approvals;
- by a public company's shareholders for their losses as a result of the director's violation of his statutory duties in a mandatory tender offer procedure; or
- by a company's shareholders or holders of the company's securities for their losses resulting from inaccurate, incomplete or misleading information disclosed in the securities prospectus.

A class action is expected to be reviewed by the court within five months from the date of acceptance of the claim by the court.

8 There is, however, some data available with regard to claims against directors of specific institutions – eg, directors of bankrupt credit institutions in 2005–2015. Please see www.cbr.ru/credit/likvidbase/print.asp?file=b_list.htm.

5.4 Funding of claims and whether losing party pays

As a general rule, each party bears its own legal costs. At the same time, the winning party may recover its costs (including legal fees, court charges and other expenses) from the losing party. To do so, the winning party should demonstrate that such costs were reasonable and indeed incurred. The Supreme Court in its recent ruling[9] has confirmed its adherence to the above approach and has also given guidelines on what constitutes reasonable legal fees (legal fees that in comparable circumstances are usually charged for similar services) and what should be considered in determining whether the fees are reasonable (the content, amount and complexity of the claim; the scope of services; the time consumed by counsel; the disposition time, etc).

Conditional/contingency fee agreements are not prohibited and widely used in practice, although not at all regulated in any detail. It is uncertain whether a contingency fee arrangement is enforceable against the losing party. Court practice has previously allowed for contingency fees to be recovered in 'reasonable' amounts; but in a recent case the Supreme Court found such a fee to be irrecoverable from the losing party because it was provided for in an agreement between the winning party and its counsel and the losing party was not a party to that agreement.[10]

5.5 Plaintiff's bar

In practice, there is no developed plaintiff's bar or similar organisation in the Russian Federation, mainly because the legal framework relating to directors' liability is generally underdeveloped.

5.6 Procedural barriers to the bringing of claims

General formalities applicable to all other court claims apply to court claims against directors. In addition to general requirements, the claimant has to notify other shareholders through the company of its intention to file a claim (see sections 3.2 and 5.3 above).

A claim against a director should be filed with an appropriate court. Existing court practice confirms that such claims are non-arbitrable and only state arbitrazh (commercial) courts at the place of incorporation of the company are competent to decide them. Starting from September 2016, however, such disputes in theory will be regarded as arbitrable provided that the company, all its shareholders and other persons concerned are parties to the arbitration clause. It is still unclear how this provision will work in respect of directors who are not personally party to the arbitration clause.

The general limitation period of three years applies to claims against directors. The limitation period commences at the moment when the claimant learns (or should have learned) about the violation and who the proper respondent is. A shareholder may file a claim even if he was not a shareholder when the violation occurred. In that case the limitation period is considered to have commenced at the moment when the shareholder's predecessor learned (or should have learned) about the violation. Where a claim against a director is brought by the company, the limitation period is considered to have commenced at the moment when the company, through a new director, could learn about the breach or when a controlling shareholder learned (or should have learned) about the violation.

9 Resolution 1 of the Supreme Court Plenum of January 21 2016.
10 Decision 309-ES14-3167 of the Supreme Court, dated February 26 2015.

6. Indemnification rights

6.1 When a company can indemnify

Russian law contains no rules concerning the indemnification of directors by the company. Unlike Anglo-Saxon jurisdictions, company documents in Russia do not contain indemnity provisions. The existing legal framework leaves little room to arrange for such indemnification for the following reasons: first, it is prohibited to enter into any agreement to eliminate or limit a director's liability for bad-faith actions in non-public companies and for both bad-faith and unreasonable actions in public companies; and, secondly, it is generally prohibited to enter into an agreement to eliminate or limit anyone's liability for wilful breach of obligation. Although an indemnification agreement does not limit or eliminate liability but instead compensates for directors' losses resulting from such liability, the indemnification agreement may be found void if it is found to violate the foregoing prohibitions. The authors are not aware of any relevant court practice on this issue.

Against this background, it is theoretically possible – and indeed happens in practice – that a company enters into an agreement with one of its directors providing for indemnification of such director's losses (eg, litigation expenses), including also resulting from his negligence provided that the director was not acting wilfully or in bad faith (and unreasonably, in the case of a public company).

It should be noted that in 2010–2012 there was an unsuccessful attempt to amend the legislation to allow indemnification agreements with directors.

6.2 Formal requirements for indemnification rights

Please see section 6.1.

6.3 What cannot be indemnified

There are a substantial number of circumstances where a director may not be indemnified. In particular, a company may not indemnify a director for administrative or criminal penalties as this would contradict the principle of personal liability of the offender.

However, it should be possible to indemnify a director for defence costs incurred as a result of administrative or criminal prosecution, but only if the case is ultimately dismissed. The Highest Arbitration Court of the Russian Federation, in its Resolution 1522/13 of the Presidium, dated July 23 2013, has allowed a company to recover from the losing party the amount of legal fees the company paid for representation of its CEO in an administrative case, thus implicitly acknowledging the validity of such an arrangement. It is unclear whether the courts would agree to indemnification for defence costs if the director is ultimately found guilty of a criminal or administrative offence.

7. D&O insurance

7.1 Ability to purchase D&O insurance

Owing to insignificant litigation exposure of directors, the Russian directors' and officers' (D&O) insurance market has stayed underdeveloped for a relatively long time compared with other markets (eg, those of the United Kingdom and the United States).

It was not until 1997 that the first Russian D&O policy was issued for directors of OJSC VimpelCom, one of the major Russian mobile network operators and the first Russian company listed on the New York Stock Exchange (NYSE). The NYSE listing provided a major incentive for the company to obtain D&O insurance; and, generally speaking, those companies that trade on foreign exchanges and/or have foreign individuals on the boards of directors are up to now primarily interested in D&O insurance. The Russian D&O insurance market is still lagging behind with only approximately 300 D&O policies issued as at 2014.[11]

There are no specific legislative guidelines for D&O insurance, except for the general provisions of the Russian Civil Code and the Law of the Russian Federation on the Organisation of Insurance Business in the Russian Federation (hereinafter 'the Insurance Law'). Nevertheless, the Code of Corporate Governance recommends companies to purchase D&O insurance.

The Civil Code explicitly prohibits the insuring of illegal interests, and there is no clarity as to whether certain aspects of D&O insurance policies that are based on international market standards could be viewed as illegal interests. Russian D&O insurance policies may cover defence expenses, employees' claims, damages inflicted on third parties, etc. Thus, clearly, D&O insurance contracts may provide for different options meeting the specific requirements of each company.

D&O insurance reimbursement by an amount that exceeds the loss incurred as a result of a director's actions constitutes a taxable profit of the person that suffered such damages.

7.2 Local rules on D&O cover provided by foreign insurers

D&O insurance is a recent addition to the insurance products generally available on the Russian insurance market. The Insurance Law sets out that Russian residents may only be insured by companies incorporated in Russia that meet certain licensing requirements. This requirement could be interpreted as prohibiting a non-Russian insurer from underwriting a D&O policy for directors of a Russian company or a Russian subsidiary. The violation of licensing requirements entails administrative and criminal liability, including fines, compulsory community service or arrest.

If a non-domestic insurer underwrites a D&O policy covering directors of a Russian company in their capacity, such arrangements should exist outside the jurisdictional reach of the Russian Federation. Practice exists whereby a domestic licensed insurer provides the insurance, and then immediately reinsures this risk outside Russia (thus passing on the risk to a foreign reinsurer).

11 Vladimir Kremer, "D&O Adventure in Russia", *Current Insurance Technology*, issue 5 (2014).

7.3 Licensing of a foreign insurer to provide insurance

As stated above, a non-domestic insurer may do business in Russia provided that it meets specific licensing requirements.

First of all, any such insurer must incorporate a legal entity in Russia, and it must be licensed by the Central Bank of Russia. The procedure for both domestic and non-domestic insurers is the same; nonetheless, the Central Bank of Russia might suspend authorisation of Russian subsidiaries of foreign insurers, or Russian insurance companies with a foreign interest in the charter capital exceeding 49%, when the total foreign interest in different insurance companies in Russia exceeds 50%.

Secondly, if a non-domestic insurer sets up a subsidiary in Russia, or its interest in a Russian insurance company exceeds 49%, to be licensed to operate in Russia it must have operated as an insurance company in its jurisdiction for at least five years preceding the application for authorisation in Russia.

Further requirements are provided in relation to certain types of insurance, depending on the foreign investors' interests in Russian companies. Moreover, preliminary approval of the Central Bank of Russia is required for transactions with foreign investors regarding their interests in Russian companies.

As for non-domestic insurance brokers, the general rule is that they are not allowed to do business in Russia. Certain exceptions – eg, regarding their agency in reinsurance operations – are provided by law.

As indicated above, foreign reinsurers licensed in their respective jurisdictions may without any limitation reinsure the risks of domestic underwriters, including those issuing D&O insurance.

8. Concluding remarks

In recent years there has been a rapid development of legislation and court practice with regard to directors' and officers' liability in Russia. An important factor that has – and potentially will continue to have – a major impact on the regulation of directors' and officers' liability is the ongoing structural reform of Russian civil law that has taken place over the past few years.

Many of the new rules and principles remain untested and so there is much interpretation to be done by courts in the coming years. We generally expect that directors' and officers' liability rules will be further developed by the courts and the legislature, which should bring more clarity as to which actions of management may be successfully challenged. This is an ongoing process and the courts are now facing the challenge of giving more substance to polysemic and judgment-based terms (eg, 'good faith', 'reasonably' and 'conflict of interest') applying in the context of directors' and officers' liability.

In recent years there have also been a number of decisive steps taken to soften criminal liability for certain economic offences. At the same time, the State Duma of the Russian Federation was as at April 2016 considering the draft of a new Code of Administrative Offences, which provides for a substantial increase of fines for offences, some of which can be imputed to directors.