

New Venture Capital Partnership Possibilities

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The new Federal Law "On Economic Partnerships" comes into force on July 1, and lawmakers expect the law to be useful where venture projects have a need for a specific legal entity as the project vehicle. The new law is a response by lawmakers to the needs of Russia's emerging venture investment market for advanced commercial entities.

The new law provides for a new commercial entity format called an "economic partnership" (khozyaistvennoye partnerstvo), and the process for establishing an economic partnership will be regulated with regard to the specific needs of venture projects.

Lawmakers have focused on shaping a legal structure that:

1. Ensures specific "corporate characteristics" (associated with rights and capabilities available to all legal entities, including limited liability of participants for company obligations, reflecting their contributions) with minimal corporate reporting and documentation requirements;
2. Permits phased funding for company operations by participants through contributions to company capital, and provides penalties for breaching funding obligations they have committed to;
3. Enables structuring management under a maximum flexibility joint venture agreement, with parties able to include the company and stakeholders who may not be participants, and ensure that such an agreement has enforceable sanctions. This level of joint venture agreement flexibility also requires:
 - the possibility of non-proportional right and obligation distribution between participants (including voting rights, profits and losses),

- the introduction of specific procedures for ownership share transactions,
- participant agreement on valuing contributions to the company,
- potential agreements prohibiting stakeholders from becoming involved in setting-up or funding competing projects,
- potential liability for soliciting employees, or engage in activities that compromise other business critical aspects;

4. Enables various possible contribution formats (including assets, property rights or other rights with a monetary value, as well as goodwill, expertise, business ties, etc.);

5. Restricts or prohibits project withdrawal by participants during specific periods, or before agreement specified objectives are met;

6. Guarantees the maximum possible defense for confidential information against third parties;

7. Reduces state regulatory burdens, and includes simplified liquidation procedures;

8. Formalizes possible participant priorities in favor of specific creditors or participants if the company undergoes voluntary or compulsory liquidation.

Unfortunately, there is no legal structure that satisfies all of the above criteria stipulated in the current legislation. This means that the law is looking to bring a new commercial vehicle into the Russian legal framework, to meet the needs of both Russian and foreign investors, for legal structures used in business projects all over the world.

The provisions of the draft law are focused on the need for detailed regulation over the legal aspects of establishing, operating and ending an economic partnership, as well as promoting, in the near future, consistent court practice on its actual business use.

The key regulatory provisions specific to an economic partnership enable flexible and comprehensive agreements to be made between partners and other stakeholders, which facilitate all participants, where agreed, to have participation rights in the managing of an economic partnership, enable phased funding of an economic partnership, and limit liability for partners stemming from company transactions.

Under the new law, a partnership joint venture agreement will encompass the system, structure and powers of partnership management bodies, the way they are established, and the processes and procedures that shape work practices.

The draft law means that an economic partnership will come under largely unique legal regulations that are clear and straightforward to understand for the international venture capital community, and meet existing international project management standards.

The cornerstone principle of the new legal framework is incorporating as much discretion as possible into the economic partnership structure, which enables partners to set rules that are appropriate for their business or project. In our next publication, we will examine specific mechanisms under the law that implement this approach.

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