

Russia: legal documentation in VC transactions

For VC transactions in Russia, the required legal documents depend on the type of investment being made and the holding company's jurisdiction of incorporation. In Russia, it is common for VC entrepreneurs to use not just companies incorporated in Russia, but also companies incorporated in the Republic of Cyprus (the most popular jurisdiction). If the startup targets the US market, it will typically incorporate a company in Delaware.

The form of legal entity most often used in Russian VC transactions is the limited liability company. The joint stock company, an alternative form of legal entity, is rarely used due to the non-flexibility of Russian laws governing joint stock companies and the more extensive legal requirements. For example, various filings with the Russian Central Bank (the joint stock companies' regulator) are required to issue shares in a joint stock company and the process may take more than one month (compared to one day in Cyprus). The limited liability company, in contrast, is less regulated and is much cheaper to administer.

However, the equity stake in the limited liability company is determined as a percentage (ie, a shareholder holds participation interest expressed as a percentage of the entire charter capital of the limited liability company) and not by the number of shares. This complicates the structuring of VC transactions involving preferred rights of investors (which is typically accomplished through issuing several classes of shares with different rights). Another item to consider is that information about participants in a Russian limited liability company is publicly available, while information about shareholders of a joint stock company is accessible only by the joint stock company itself and its shareholders.

In Cyprus, venture capital investments are structured through Cypriot limited liability companies, which can have several classes of shares with different rights. Information on shareholders of Cypriot limited liability companies is publicly available and can be requested from the Cypriot Registrar of Companies.

The principal document for an typical equity investment in Russia and Cyprus is the investment agreement, which is sometimes also called the subscription agreement. This agreement contains provisions governing the issuance and sale of equity securities by the company, their purchase by investors, the subscription price and other financial terms; conditions precedent to closing; the parties' representations, warranties and indemnities; and limitation-of-liability provisions.

Investment agreements in Russia are usually governed by Russian law. Investment agreements in Cyprus are usually governed by English law.

From a purely legal perspective, the investment agreement itself is not necessary to complete the issuance of equity securities (both in Cyprus and Russia). Shares can be allotted and issued on the basis of shareholders/directors resolutions of the company and other corporate documents necessary to comply with corporate formalities under applicable law. The main purpose of the investment agreement is to provide an investor with contractual protections (through warranties and indemnities).

In Cyprus, documents required to issue shares can be signed by counterparts and electronically. In Russia, subscription documents must be notarized by a Russian notary. The notary certifies the signature of the party to the relevant document and confirms the capacity and authority of the signatory. While being a technical issue, notarization results in additional paperwork and expenses.

Venture capital investments are also effected via convertible debt. The main documents for convertible debt financing include:

the note purchase agreement, which governs the sale of the convertible notes by the company and their purchase by the investors and contains the subscription price and other financial terms, conditions precedent to closing and the parties' representations, warranties and indemnities

the convertible note, which contains the provisions governing the conversion of the principal and interest evidenced by the note into preferred equity (although sometimes these provision are found in the note purchase agreement).

These instruments are typically used with respect to Cypriot companies. Although it is possible under Russian law to set off debt of a company against an obligation of the shareholder (third-party borrower) to pay the consideration for the newly issued shares, Russian law does not recognize the concept of a convertible loan agreement. Despite this, convertible loan note agreements are sometimes used by parties in Russia, but their enforceability in Russian courts is questionable.

Along with the investment agreements, the parties to VC transactions enter into shareholders agreements. The shareholders agreement contains provisions regulating corporate governance, reserved matters, share transfer provisions and various rights of the investors (such as right to receive information and right to participate in future fundraising rounds).

Shareholders agreements with respect to Russian companies are governed by Russian law. At some point in the past, it was quite popular to choose English law for shareholders agreements in relation to Russian companies but this is no longer relevant due to regulatory changes in Russian law and court practice (eg, disputes between shareholders of a Russian can be resolved only by arbitration institutions that are recognized by Russian state authorities). Shareholders agreements with respect to Cypriot companies are governed by English law.

As a matter of practice, provisions of the shareholders agreement (both in Cyprus and in Russia) are mirrored in the articles of association of the companies.

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