



Option as a tool for confidential business ownership

Option is a contract which provides the optionee with a right (but not the obligation) to do a deal with a person that has provided such option in accordance with the terms thereof.

Use of options in the Russian Federation

Almost a year and a half ago, legal structure of an option was first officially applied in Russia. It was a very important step as part of reformation of civil law, which offered new tools for structuring business arrangements and, therefore, new opportunities for project implementation.

However, options had successfully been used by Russian businesses even before the above date, but only with the application of foreign law and, accordingly, foreign companies. Thus, the key opportunities for using options are generally known, e.g.:

- ✓ Motivation of company managers;
- ✓ Motivation of employees of small emerging companies;
- ✓ Structuring investor relations;
- ✓ Resolution of conflicts in a project.

This article is devoted to one of the opportunities for using options, namely, the confidentiality of business ownership.

Confidentiality issues

Purposes and reasons for confidential ownership may vary. In this regard, it should be noted that on December 21, 2016, the amendments to the Federal Law "On Counteraction of Legitimization (Laundering) of Proceeds of Crime and Financing of Terrorism"¹ become effective. According to the above amendments, the companies will have to provide information about their beneficial owners, i.e. those who own, directly or indirectly, more than 25% of a company's assets, or are able to control its activities. Companies have to update such information at least annually, document it and maintain for a period of at least 5 years, and provide it upon request to tax and other authorities.

In some cases, such changes make the issue of confidential business ownership particularly topical. Over

time, this problem was solved using various methods, ranging from simple notional agreements to sophisticated offshore corporate structures. However, notional agreements are frequently not protected from a legal perspective, and offshore structures are losing the confidence of businesses due to the policy of deoffshorization pursued by the Russian government.

Technically, in the legal approach, one can own a business only formally, which in itself means that such ownership will be somehow documented. For example, the ownership of shares of a limited liability company is reflected in the Unified State Register of Legal Entities, which is accessible to everybody via the Internet. Share ownership is recorded by the Registrar, however such information is often not publicly available, and depends on the amount of shares and specifics of the company. Therefore, whatever tools for confidential business ownership you are considering, it is obvious that they must be executed as documents with a limited access for unauthorized persons, and, moreover, the actual owner should not be an official beneficiary, particularly in the context of the new amendments regarded above.

Advantages and implementation

Concerning the confidentiality issue, options are often very useful. The main advantages here are:

- ✓ An option is executed in the form of an agreement, which is not reflected in open sources, making it highly confidential (although in the case of shares of limited liability companies, any option has to be notarized);
- ✓ Option agreements may provide for flexible terms of option exercise, as well as a nominal owner's liability;
- ✓ An option is a good and inexpensive (unlike offshore structures) supplement to notional agreements with nominal business owners.

What do we see in practice? Suppose that there is a certain company or even a group of companies, representing a separate business. In order to make the information about the beneficial owner of the business as confidential as possible, its nominal owner should be introduced into the company (or the parent company, in case a group of companies); such nominal owner provides the actual owner with an option to purchase stocks or shares in the company's capital.

As a result, this is what we have: the actual owner is not an official beneficiary of a company, but the nominal owner has to follow his/her instructions, since otherwise such nominal owner may at any time lose his/her share in the company's capital. So as to transfer stocks to the actual owner, one only needs to accept an offer issued under the option, which takes place without involving the nominal owner.

Option specifics

Certainly, there are no ideal or all-purpose tools, and option is no exception. When using options, one has to keep in mind at least the following specifics:

- ✓ A nominal owner can alienate his/her shares. Among other things, the shares may be transferred to successors of the nominal owner in case of his/her death, however, this risk can be reduced to some degree (with regard to a sale, for example, by imposing financial liability for violating the terms of the option; with regard to inheritance – by drawing up a will);
- ✓ The actual owner is not entitled to its company's dividend, which is not always a problem (depends on the specifics of the project), since there is a lot of alternative methods of cash flow distribution.

In general, the above may be summarized as follows: the best and most reliable choice is direct ownership of business, but if it is undesirable for some reason, an option is quite an effective tool for building business confidentiality control system (especially in combination with other tools), which has however a number of specifics.

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¹ Federal Law No. 215-FZ "On Amendments to the Federal Law "On Counteraction of Legitimization (Laundering) of Proceeds of Crime and Financing of Terrorism" and Administrative Violations Code of the Russian Federation" dated June 23, 2016.