CHANGES TO JOINT STOCK COMPANY LEGISLATION IN RUSSIA

2 October 2009

To Our Clients and Friends:

On June 8, 2009 Federal Law No. 115-FZ dated June 3, 2009 on Amending the Federal Law on Joint Stock Companies and Article 30 of the Federal Law on the Securities Market (the "Law") entered into force in Russia.

The Law introduces changes to Federal Law No. 208-FZ dated December 26, 1995 on Joint Stock Companies (the "JSC Law") and Federal Law No. 39-FZ dated April 22, 1996 on the Securities Market (the "Securities Market Law").

The Law introduces the concept of shareholders' agreements into Russian joint stock company legislation and establishes a procedure for the resolution of deadlocks related to the creation of a sole executive body within a joint stock company and the early termination of the powers thereof.

We set forth below a brief overview of some of the more substantial amendments.

SHAREHOLDERS' AGREEMENTS

Following the "legalization"[1] in Russia (with certain limitations) of that widespread institution of corporate law in the West, as the shareholders' agreement, within the legal framework relating to limited liability companies,[2] the Law introduces a similar institution

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[1] *Some experts believe that the Russian legislation in effect prior to the entry into force of the Law (in particular, Arts 9.2 and 22.3 of the Russian Civil Code) prohibited agreements between company participants/shareholders that govern the exercise of their rights as company participants/shareholders, and this was confirmed by the scant and often inconsistent court practice.*

[2] *These changes were introduced in Federal Law No. 14-FZ dated February 8, 1998 on Limited Liability Companies by Federal Law No. 312-FZ dated December 30, 2008 on Amending Part One of the Civil Code of the Russian Federation and Certain Legislative Acts of the Russian Federation, effective from July 1, 2009 (together, the "LLC Law"). At your request we can provide a review of the more substantial changes introduced into the legislation on limited liability companies by the above federal law.*

(with certain modifications) to Russian joint stock companies legislation.[3]

Scope of Shareholders' Agreements

Under the Law, a shareholders' agreement is deemed to be an agreement[4] pursuant to which the parties undertake to exercise the rights evidenced by shares and/or rights to shares in a certain manner and/or refrain from the exercise of such rights. Shareholders' agreements may envisage the obligation of the parties to (a) vote in a certain way at the general shareholders' meeting, (b) agree to vote in a certain way with other shareholders, (c) acquire or dispose of shares at a predetermined price and/or upon certain conditions being met, (d) refrain from disposing of shares until certain conditions are met or (e) perform other agreed actions in connection with management of the company or the operation, reorganization or liquidation of the company.

The Law thus gives the parties to a shareholders' agreement ample scope to utilize the shareholders' agreement to settle various aspects of their relationship, including those relating to management of the company, withdrawal from the company and/or changes to the participation interest in the company held by the parties to the shareholders' agreement. The Law also permits the inclusion in shareholders' agreements of special procedures aimed at strengthening the protection of the rights of parties to a shareholders' agreement, thus increasing the appeal and relevance of these agreements. For example, under the Law a shareholders' agreement may place an obligation on the parties to acquire or dispose of shares at a predetermined price and/or upon certain conditions being met, or to refrain from disposing of shares until certain conditions are met. Accordingly, these provisions of the Law could be interpreted to permit shareholders' agreements providing for such concepts as a call option (right to force a sale of shares), put option (right to force the purchase of shares), drag-along right (right to force a joint sale of shares), tag-along right (right to join in a sale of shares) and preemptive right to purchase, as well as various methods commonly used for resolving deadlocks. Based on the general rule embodied in the Law that shareholders' agreements may establish an obligation of a party to exercise in a particular way, or refrain from exercising, any rights to shares, the Law may also be interpreted as

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[3] *As compared to the LLC Law, the Law contains more detailed regulation. This would suggest that the provisions of the Law dealing with shareholders' agreements will in certain cases be applied in similar fashion to agreements on the exercise of the rights of participants of limited liability companies.*

[4] *Shareholders' agreements are executed in written form by a single agreement signed by the parties.*

permitting shareholders' agreements to establish an obligation on a party to a shareholders' agreement to refrain from placing an encumbrance on its shares in favor of third parties.

At the same time, because of the nature of Russian joint stock company legislation, a number of matters that are routinely included in shareholders' agreements in Western (European or U.S.) countries either cannot be dealt with in a shareholders' agreement in principle, or may be dealt with, but only in a substantially limited way.

First, a shareholders' agreement cannot be used to amend the scope of the competence of the management bodies of a joint stock company (this includes the general shareholders' meeting, board of directors and the collective executive body of the company) beyond that established in the JSC Law and/or the company charter, as the case may be.[5]

Second, contrary to Western (European or U.S.) shareholders' agreements, Russian shareholders' agreements most likely will not be able to contain provisions placing an obligation on a party to the shareholders' agreement to procure (a) a particular vote by the nominees of such party to the board of directors of the company and/or the collective executive body of the company, or (b) particular resolutions made by a sole executive body of the company appointed on the nomination of such party.[6]

Third, it must be noted that as a general rule the procedure for preparing, convening and holding a general shareholders' meeting, as well as the voting procedure at a general shareholders' meeting, may not be amended at the discretion of the parties to a shareholders' agreement. The Law also expressly states that shareholders' agreements may not place an obligation on a party to a shareholders' agreement to vote as directed by a management body of a company in respect of the shares of which such shareholders' agreement was concluded.

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[5] *The JSC Law limits the competence of the general shareholders' meeting to those matters expressly set forth in the JSC Law, and such scope may not be broadened even by the introduction of the relevant amendments to the company charter, which, among other things, does not permit the tabling of other substantive matters for resolution at the level of the general shareholders' meeting at which the voting may be on matters covered by the shareholders' agreement.*

[6] *Should such obligations be included in a shareholders' agreement it is probable that a court would find them unlawful (and, therefore, null and void), in particular due to the fact that Russian joint stock company legislation provides for the obligation of members of the board of directors and the collective executive body of the company, as well as of the sole executive body of the company, to act in the interests of the company in the exercise of their rights and the performance of their obligations, rather than any individual shareholders (including those shareholders who nominated such persons for election/appointment to the management bodies of the company), and to exercise their rights and perform their obligations to the company reasonably and in good faith.*

Finally, the shares in respect of which a shareholders' agreement is concluded are not encumbered by such shareholders' agreement: *i.e.*, when title to some or all of such shares passes to a third party, the parties to such shareholders' agreement do not as a general rule retain any rights evidenced by the shares, title to which has passed to such third party, and/or rights to such shares, nor do any rights or obligations arising from such shareholders' agreement pass to such third party.

Parties to a Shareholders' Agreement

The Law does not expressly state who may be a party to a shareholders' agreement; however, based on the provisions of the Law we may conclude that a party to a shareholders' agreement must be a person or entity that owns the company shares pursuant to Russian law. Thus, a possible interpretation would be that a trustee of the company shares, a depositary, or the holder of the securities of a foreign issuer evidencing rights to the shares of a Russian company (such as ADRs or GDRs),[7] among others, may not be a party to a shareholders' agreement. Furthermore, pursuant to the Law, the company in respect of whose shares the shareholders' agreement was concluded may not be a party to such shareholders' agreement, as is often the case in Western (European or U.S.) shareholders' agreements.

Shareholders who own either ordinary or preferred shares in either a closed or open joint stock company may be parties to a shareholders' agreement. A shareholders' agreement may only be concluded in respect of all of the shares belonging to a party to the shareholders' agreement. It may also be inferred from the Law that a shareholders' agreement may be concluded either between all or between some (not necessarily all) of the company shareholders.

Enforcement of a Shareholders' Agreement

Under the Law the courts must uphold the rights of parties to a shareholders' agreement arising from such shareholders' agreement. The Law provides that any party to a shareholders' agreement that is in breach of any of its obligations thereunder must as a general rule pay damages to the "aggrieved" party for losses incurred by such breach (*ubytki*), and/or a penalty (*neustoika*) and/or compensation (*kompensatsiya*), as set forth in the shareholders' agreement.

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[7] *In this case, due to the specifics of the Russian system of recording rights to shares, it is likely that the owner of the shares of the Russian company will technically be the foreign issuer, rather than the holder of the securities of a foreign issuer evidencing rights to the shares of a Russian company.*

It may be extremely difficult to prove the amount of losses incurred and the origin of such losses, as well as a causal relationship between failure to comply with the terms of the shareholders' agreement and the losses incurred, while the penalty set forth in the shareholders' agreement to cover any breach thereof may be reduced pursuant to Art. 333 of the Russian Civil Code at the discretion of a court if it is clearly not commensurate with the consequences of the breach of the obligations.

The Law expressly permits a shareholders' agreement to provide for the obligation of a party that is in breach of the shareholders' agreement to pay compensation to the "aggrieved" party as a result of such breach. The Law defines "compensation" as a specific sum of money or an amount to be determined in the manner set forth in the shareholders' agreement. It is unclear what the legal nature of compensation is or how payment of compensation differs from reimbursement of losses or payment of a penalty, which are also expressly set forth in the Law as possible remedies available to the parties to a shareholders' agreement. It is also unclear whether it is possible to simultaneously award compensation in combination with other available remedies, such as a penalty or reimbursement of losses. Of particular importance is the matter of the applicability of Art.333 of the Russian Civil Code (which, as we have previously noted, permits the reduction of any penalty at the discretion of a court if it is clearly not commensurate with the consequences of the breach of the obligations) to the compensation, to which at present there is no clear answer. On the one hand, it could be argued that, since compensation is expressly referred to in the Law together with a penalty and reimbursement of losses, it was the intent of its authors to introduce an additional mechanism designed to protect the interests of the parties to a shareholders' agreement that would operate independently, in contrast to the way the above protective measures operate. On the other hand, it is probable that, should the shareholders' agreement establish an incommensurate amount of compensation, the court will apply the norms of Art. 333 of the Russian Civil Code by analogy.

It follows, therefore, that reimbursement of losses, or payment of a penalty or compensation, will not always be a sufficient remedy for the "aggrieved" party to a shareholders' agreement.

At the same time, in holding to the principle that a shareholders' agreement is binding only upon the parties thereto, the Law substantially restricts other remedies available to the parties of a shareholders' agreement. Thus, pursuant to the Law, an agreement entered into by a party to a shareholders' agreement in breach of such shareholders' agreement may be struck down by a court as invalid upon the application of an interested party to the shareholders' agreement only in the event that it can be proved that the other party to the agreement knew or ought to have known of the restrictions laid down in the shareholders'

agreement.[8] Furthermore, the Law expressly sets forth that a breach of the shareholders' agreement may not serve as a ground to have the resolutions of the management bodies of a company declared invalid. It is not clear whether a civil law remedy such as compelling the performance of an obligation in kind could be applied. Such remedy, in a number of cases where a party to a shareholders' agreement is in breach of its obligations arising out of the shareholders' agreement,[9] could to a greater degree serve the interests of the "aggrieved" party to a shareholders' agreement. Nevertheless, to ensure that the interests of the parties to a shareholders' agreement are protected, it is advisable to include provisions to the effect that reimbursement of losses and/or payment of a penalty shall not release the "defaulting" party to the shareholders' agreement from the performance of its obligations in kind.

Foreign Governing Law

It is not clear whether a shareholders' agreement may be governed by foreign law for the purposes of resolving some of the "problems" of using shareholders' agreements with respect to Russian companies. As discussed in this update, such problems relate, in particular, to a certain narrow view of the scope of a shareholders' agreement as permitted by the Law, and to possible difficulties in the enforcement of shareholders' agreements.

Even if a foreign element is present[10] (for example, one of the parties to the shareholders' agreement is a foreign entity), there is no certainty that a court would take a different position than that formulated by the Khanty-Mansi Regional Arbitrazh Court in the case brought by the shareholders of OJSC Megafon, which stated that a shareholders' agreement regulates the relations within a legal entity which, pursuant to Art. 1202 of the Russian Civil Code, fall under those matters to which the *lex personalis* of a legal entity applies. For all legal entities incorporated in the Russian Federation this is Russian law.

Furthermore, even if a court were to acknowledge the possibility of a shareholders' agreement being governed by foreign law, there is a risk that the court would come to the conclusion that based on the whole body of evidence the shareholders' agreement can objectively be tied only to Russia. In this case, under Art. 1210.5 of the Russian Civil Code,

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[8] *The Law thus reiterates the provisions of Art. 174 of the Russian Civil Code.*

[9] *E.g., where a party to a shareholders' agreement votes at a general shareholders' meeting contrary to the provisions of the shareholders' agreement.*

[10] *Under Russian law, for an agreement involving Russian persons to be governed by foreign law a so-called "foreign element" must be present.*

all of the imperative norms of Russian law would be applied to the relations among the parties to the shareholders' agreement.

The above risks may to a certain degree be mitigated by the inclusion in the shareholders' agreement of an arbitration clause that provides that any disputes arising out of or relating to the shareholders' agreement be referred to a foreign arbitral tribunal. In addition, if the necessary foreign element is present the parties to a shareholders' agreement may enter into the following foreign law-governed agreements: (a) an agreement (such as a deed of guarantee) that establishes additional (to those provided for under Russian law) legal remedies in the event of a breach by a party to the shareholders' agreement of its obligations thereunder, (b) an agreement that addresses other matters concerning the parties to the shareholders' agreement not related to the exercise by them of their rights evidenced by the shares and/or their rights to the shares. In this case it would be advisable to refer any disputes arising out of or relating to such agreements and to the shareholders' agreement to one foreign arbitral tribunal with the possibility of consolidating the various proceedings under one case.

Information Disclosure regarding Shareholders' Agreements

In certain cases the Law provides for mandatory disclosure of information regarding shareholders' agreements. Thus, a person who, pursuant to a shareholders' agreement, has acquired the right to determine the voting procedure at general shareholders' meetings[11] in respect of company shares, the issue of which was accompanied by the registration of a prospectus, may be required by law to notify (a) the company, and (b) the federal regulatory authority responsible for the securities market,[12] that such person has acquired this right. This requirement applies if, as a result of acquiring such right, the person alone or with its

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[11] *The Law does not elaborate on such right as the right to determine the voting procedure at general shareholders' meetings, and does not give examples of when such right will arise, which provides grounds for differing interpretations and could lead to certain complications in applying these norms.*

[12] *Under the Law, if pursuant to a shareholders' agreement a person acquires the right to determine the voting procedure in respect of the shares of a joint stock company, the state registration of the issue (additional issue) of the equity securities of which was carried out by a registration authority other than the federal executive body for the securities market, and regardless of whether or not the issue of the equity securities of such joint stock company was accompanied by the registration of a prospectus, if such person individually or together with its affiliates gains the opportunity, directly or indirectly, to control more than 5, 10, 15, 20, 25, 30, 50 or 75 percent of the votes attaching to the outstanding ordinary shares of the joint stock company, such registration authority must also be notified thereof.*

affiliates directly or indirectly has the ability to control more than 5, 10, 15, 20, 25, 30, 50, or 75 percent of the votes attaching to the outstanding ordinary shares of the company. Such notice must be sent within five days after the date the person acquired such right.[13] In addition, the company receiving the notice must disclose the information in the form of a notice of material fact regarding the person's acquisition of such right pursuant to the shareholders' agreement.

Until such notice is given to the company, the person who must give notice to the company and the persons who, pursuant to the shareholders' agreement, are bound to follow such person's voting instructions at general shareholders' meetings may only vote in relation to such number of shares as does not exceed the number of shares held by such person before the obligation to give notice arose.[14] Furthermore, all shares held by the person obliged to give notice and by the persons bound to follow such person's voting instructions pursuant to the shareholders' agreement will count in determining the presence of a quorum.

Information regarding shareholders' agreements concluded in the year preceding the date of the general shareholders' meeting of the company, which are disclosed to the company pursuant to the Law, must be made available to persons entitled to attend such general shareholders' meeting in preparation for the meeting.

Other

The Law expands the list of documents that a company is required to keep, adding to it notifications to the company of the execution of shareholders' agreements, as well as lists of the persons that have entered into such agreements.

Also, in accordance with Federal No. 135-FZ dated July 26, 2006 on Protection of Competition (the "Law on Competition"), in certain circumstances the acquisition pursuant to a shareholders' agreement of the ability to exercise voting rights bestowed by the shares in the company over and above the thresholds set forth in the Law on Competition may be subject to the prior approval or subsequent notification of the antimonopoly authority.

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[13] *The Law establishes an exhaustive list of information that must be included in the notice to the company and the notice to the federal regulatory authority responsible for the securities market.*

[14] *Any shares in excess of such number are deemed to be non-voting shares. Such consequences will only arise in the event of failure to deliver the required notification to the company and do not apply to notifications to the federal regulatory authority for the securities market.*

DEADLOCK RESOLUTION RELATED TO THE CREATION OF A SOLE EXECUTIVE BODY OF THE COMPANY

One of the innovations of the Law is the establishment of a procedure for the resolution of deadlocks related to such matters as the creation of a sole executive body within a joint stock company and the early termination of the powers that sole executive body, in the event that such matters fall within the competence of the board of directors of the company and the board of directors of the company is unable to adopt a resolution on such matters.

The Law substantially limits the application of the deadlock resolution procedure set forth in the Law, envisaging such application only in the case of joint stock companies where (a) the quorum for meetings of the board of directors of the company set forth in the company charter represents more than half of the elected members of the board of directors of the company, and/or (b) resolutions on the creation of a sole executive body within the joint stock company or the early termination of the powers thereof must, pursuant to the company charter or by-laws governing the procedure for the convocation and conduct of meetings of the board of directors of the company, be adopted by a greater proportion of votes than a simple majority of the votes of members of the board of directors of the company attending the meeting of the board of directors.

Thus, under the Law, in the event that (a) the board of directors of the company does not adopt a resolution on the creation of a sole executive body within the company at two consecutive meetings or within two months of the termination or expiration of the term of office of the previous sole executive body of the company, or (b) the board of directors of the company does not adopt a resolution on the early termination of the powers of the sole executive body of the company at two consecutive meetings of the board of directors of the company, such matters may be tabled for resolution at the general shareholders' meeting simultaneously with the matter of early termination of the powers of the board of directors and the election of a new board of directors of the company. Should either of the above circumstances occur, a joint stock company that is required to disclose information in the form of a notice of material fact must also disclose the failure of the board of directors to adopt the respective resolution in the form of a notice of material fact, while other companies must notify shareholders of the failure of the board of directors to adopt the respective resolution in the manner envisaged for notices of forthcoming general shareholders' meetings within 15 days after the date of the respective event.

The Law sets forth a detailed procedure for the convocation of a general shareholders' meeting in the event of the onset of the above circumstance.

In accordance with the Law, the charter of a company that is subject to the deadlock resolution procedure discussed above and a shareholders' agreement concluded in respect of the shares of such company may establish other mechanisms for the resolution of such deadlocks.[15]

In evaluating how the Law generally deals with the resolution of deadlocks, it must be noted that the Law is somewhat unsystematic and inconsistent. For example, the procedure for deadlock resolution envisaged in the Law takes account only of issues relating to the creation of a sole executive body and the early termination of the powers thereof, ignoring without explanation other matters essential to the operation of a joint stock company. In addition, this mechanism is ambiguous in its treatment of a company's minority shareholders, since it envisages that a matter that is not resolved by a qualified majority of the votes of the board of directors (or because there is no "enhanced" quorum) will be tabled for resolution by a simple majority of the company's shareholders. These shortcomings of the Law had been pointed out at the drafting stage, and such criticisms became one of the reasons for the inclusion in the Law of provisions regarding shareholders' agreements that had not originally been included in the draft Law. It was the intention of the drafters of the Law that shareholders' agreements be used, *inter alia*, to provide a more flexible mechanism for the resolution of deadlocks.

OTHER CHANGES

The Law sets forth additional disclosure requirements for joint stock companies whose securities issuance was accompanied by the registration of a prospectus, and for persons acquiring the ordinary shares of such joint stock companies or rights to determine the voting procedure in respect of such shares. Thus, under the Law, if a person acquires the shares of a joint stock company whose securities issuance was accompanied by the registration of a prospectus, or acquires the right by agreement with a shareholder to determine the voting procedure in respect of such shares at the general shareholders' meeting, and if as a result of such acquisition such person alone or with its affiliates directly or indirectly acquires the ability to control more than 5, 10, 15, 20, 25, 30, 50, or 75 percent of the votes attaching to the outstanding ordinary shares of the company, then such person must disclose the details of such acquisition in the scope provided by the Law, by notifying the joint stock company and the federal regulatory authority responsible for the securities market not later than five days from the date of the relevant entry in the securities account (depo account) or from the

[15] *It is not clear whether such mechanisms may be included in the charters of joint stock companies that do not meet the criteria discussed above.*

establishment of the right to the disposition of votes attaching to the shares at the general shareholders' meeting, including pursuant to an agreement.[16] For its part, a joint stock company that receives the relevant notification is obliged to disclose such acquisition in the form of a notice of material fact.

In contrast to the previous version of the JSC Law in effect prior to the entry into force of the Law, the Law expressly provides that a company charter or company by-laws governing the procedure for the convocation and conduct of meetings of the board of directors of the company may only provide that resolutions of the board of directors be adopted by a greater number of votes of members of the board of directors than the simple majority of votes of members of the board of directors of the company attending the meeting established (as a general rule) by the JSC Law.

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We would be happy to answer any questions you may have on this or any other aspect of joint stock company legislation.

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[16] *The previous version of the Securities Market Law in effect prior to the entry into force of the Law only required that a person disclose information on any direct (and not on any indirect) acquisition by such person alone (and not by its affiliates) of any ordinary shares in a company over and above the thresholds established by the Securities Market Law. This provision remains in effect after the entry into force of the Law.*