CLIENT UPDATE

PLENUM OF HIGHER *ARBITRAZH* COURT CLARIFIES CERTAIN ISSUES OF D&O LIABILITY

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On August 20, 2013, the Higher *Arbitrazh* Court of the Russian Federation ("**VAS**") published Plenum Ruling No. 62 of the Higher *Arbitrazh* Court dated July 30, 2013 on Certain Issues Related to Indemnification by Persons who are Members of Corporate Bodies (the "**Ruling**") on its official website, in which *arbitrazh* courts were provided with clarifications on a wide range of issues arising in court practice when hearing cases on recovery of losses incurred by a legal entity through the actions[1] of persons who are or were members of its corporate bodies ("**Directors**").

Not only did this VAS Ruling summarize legal positions already articulated in court practice, it also introduced a whole range of new issues that, in our opinion, could have a significant impact on the development of court practice related to Directors' and Officers' liability for losses incurred by a legal entity through their actions.

[1] For the purposes of this client update, the term "action" should also be deemed to include "omission".

Below, we review the key legal positions articulated by VAS in its Ruling. It must be noted that the Ruling does not touch upon issues of recovery of losses caused by Directors to the participants[2] of a legal entity, its creditors, or other persons in respect of which liability is in certain cases envisaged by applicable law,[3] or issues of the liability of a person controlling a legal entity.

- A claim against a Director[4] for the recovery of losses incurred by a legal entity may be brought by:
  - the said legal entity; and
  - a participant of the legal entity (but only where the law grants such participant the right to bring such claim),[5] which:
    - was a participant of the legal entity at the time that the Director performed the actions resulting in losses for the legal entity;
    - was not a participant of the legal entity at the time that the Director performed the actions resulting in losses for the legal entity, but was a participant at the time that the losses actually arose for the legal entity; or
    - at the time that the Director performed the actions resulting in losses for the legal entity, or at the time that the losses actually arose was not yet a participant of the legal entity, but acquired shares[6] in the legal entity from a person / predecessor in title that (i) held shares in such legal entity during the above-specified periods, or (ii) itself acquired the shares from another person that held shares in such legal entity during the above-specified periods.
- The statutory period during which actions for the recovery of losses may be brought by the legal entity itself against the sole executive body begins upon the earlier of the following events: (i) documents/information become available to the new sole

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2 For the purposes of this client update, "participant" includes, *inter alia*, founding members, shareholders, and participants of limited liability companies, etc.

3 *E.g.*, Art. 71.2, second paragraph of Federal Law No. 208-FZ on Joint Stock Companies, dated December 26, 1995 (the "**JSC Law**"), Art. 22.1(3), Art. 25.6, and Art. 30.11 of Federal Law No. 39-FZ on the Securities Market, dated April 22, 1996, et al.

4 Pursuant to paragraph 1 of the Ruling, persons who are members of a corporate body are deemed to include (i) the sole executive body – the director, general director, etc.; acting sole executive body; management company or manager of a commercial entity; head of a unitary enterprise; or chairman of a cooperative, etc.; (ii) members of a collective corporate body – the members of the board of directors / supervisory board, or of a collective executive body (management board, management) of a commercial entity; or members of the management body of a cooperative, etc.

5 Pursuant to Art. 71.5 of the JSC Law, a shareholder(s) holding not less than an aggregate of 1 percent of the outstanding ordinary shares of a company may bring court proceedings against a Director.

6 For the purposes of this client update, the term "share" includes, *inter alia*, shares, participatory interests, etc.

executive body indicating there was a breach of duty by the previous sole executive body, or (ii) breaches by the sole executive body become known or should have become known to a controlling participant that had the capacity to terminate the powers of the sole executive body.

- For a claim against a Director to be successful, the plaintiff must prove (i) the existence of circumstances evidencing that the Director acted in bad faith and/or unreasonably, (ii) that the legal entity incurred losses and the amount of such losses, and (iii) a causal relationship between the actions of the Director and the losses incurred by the legal entity.
- It is deemed proven that a Director has acted in bad faith when, among other things, the Director:
  - acted in the face of a conflict between his personal interests (interests of persons affiliated with the Director) and the interests of the legal entity;
  - concealed information about a transaction that he performed from the participants of the legal entity or provided the participants of the legal entity with inaccurate information about the respective transaction;
  - performed a transaction without the requisite approvals of the relevant corporate bodies as required by law or the charter; and
  - knew or should have known that at the time these actions were performed they were not in the interests of the legal entity.
- It is deemed proven that a Director has acted unreasonably when, among other things, the Director:
  - makes a decision without taking into account information known to him that is relevant to the given situation;
  - took no action prior to the decision aimed at obtaining information necessary and sufficient to make such decision and consistent with customary business practice in similar circumstances; and
  - performed the transaction without adhering to the corporate procedures customarily required or laid down within the legal entity in question for the consummation of such transactions (*e.g.*, coordinating with the legal department, accounts department, etc.).
- A Director cannot be deemed to have been acting in the interests of a legal entity if he was acting in the interests of one or more of its participants, but to the detriment of the legal entity.

- If a legal entity is found to have committed a public liability violation (tax, administrative, etc.) because a Director has acted in bad faith and/or unreasonably, the Director may be sued for recovery of the resulting losses incurred by the legal entity.
- A Director may be required to indemnify a legal entity for losses incurred through the actions of representatives, counterparties under civil contracts, or employees of the legal entity if the Director acted in bad faith and/or unreasonably in selecting the relevant representatives, counterparties, or employees, or in controlling such persons.
- The fact that an action of a Director resulting in adverse consequences for a legal entity, including the consummation of a transaction, was approved by the collective corporate bodies of the legal entity or by its participants, or the Director acted on the instruction of such persons cannot *per se* be used as grounds to reject a claim for the recovery of losses from the Director.
- Any members of the collective corporate bodies of a legal entity who voted against a resolution that resulted in the incurrence of losses or who, acting in good faith, did not take part in the voting are not liable for any losses incurred by the legal entity.
- Whether or not a claim for the recovery of losses from a Director is successful is not dependent upon whether there were any other civil law remedies available to the legal entity for the recovery of its material losses.

I. APPLICATION OF ART. 53.3 OF THE CIVIL CODE

In paragraph 1 of the Ruling, VAS explains that the provisions of Art. 53.3 of the Civil Code apply not only to persons who act on behalf of a legal entity by virtue of the law or the legal entity's constitutional documents, but also to all Directors (including persons who are members of the collective corporate bodies of the legal entity).[7]

The VAS thus extends the application of Art. 53.3 of the Civil Code to all Directors,[8] as well as the duty envisaged in this Article of the Civil Code, namely: (i) the duty to act in good faith and reasonably in the interests of the legal entity, and (ii) the duty to compensate any losses incurred by the legal entity as a result of the breach by the Director of the duty to act in good faith and reasonably in the interests of the legal entity.

The representatives and employees of a legal entity are solely liable to the legal entity for any losses that they inflict, as provided for by the relevant norms of the Civil Code and the Labor Code of the Russian Federation, respectively, and in this case the provisions of Art. 53.3 of the Civil Code do not apply. However, pursuant to Art. 53.3 of the Civil Code, it may be incumbent upon a Director to indemnify the legal entity for such losses if it is proved that the Director acted in bad faith and/or unreasonably in selecting the respective representatives or employees or in exercising control over them.[9]

II. RIGHT TO FILE A CLAIM AND COMMENCEMENT OF STATUTE OF LIMITATIONS ON CLAIMS AGAINST DIRECTORS

In paragraph 1 of the Ruling, VAS reaffirmed the customary practice whereby a claim for the recovery of losses inflicted on a legal entity by a Director may be filed (i) by the legal entity itself, and (ii) by a participant of such legal entity, but only where the law[10] grants such participant the right to file the respective claim.

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7 For the purposes of elaborating a uniform approach on matters related to D&O liability for all types of legal entities, the VAS Ruling invokes the provisions of Art. 53.3 of the Civil Code of the Russian Federation (the "**Civil Code**"), and does not essentially refer to any special provisions of law governing D&O liability as it applies to specific types of legal entities. For this reason, the VAS Ruling provides a more extensive interpretation of the provisions of Art. 53.3 of the Civil Code.

8 In accordance with paragraph 12 of the Ruling, the clarifications contained in the Ruling also apply where *arbitrazh* courts hear cases on the recovery of losses from a liquidator / members of a liquidation commission, administrator or receiver, unless otherwise provided for by law or required by the nature of the relations.

9 For more detail, *see* paragraph IV.iv) of this Client Update.

10 Pursuant to Art. 71.5 of the JSC Law, a shareholder(s) holding not less than an aggregate of 1 percent of the outstanding ordinary shares of a company may bring court proceedings against a Director.

Here it is important to note that even if a Director is sued for the recovery of losses incurred by a legal entity as a result of the consummation of a transaction by the legal entity, this does not rule out the possibility of a claim being filed for the invalidation of such transaction, and vice versa. Thus, a legal entity and/or a participant (where such participant is entitled under the law to file the respective claim) may choose to (i) file a claim only against the Director, (ii) file a claim only for the invalidation of the transaction, or (iii) file both of the above claims.

i) A participant sues

VAS has somewhat broadened the scope of the participants of a legal entity that may sue a Director for recovery of the losses of a legal entity, laying down in paragraph 10 of the Ruling that a participant of a legal entity at the time that the Director performed the actions resulting in losses for the legal entity, or[11] that at the time the losses actually arose was not yet a participant of the legal entity, may bring court proceedings against a Director for recovery of the respective losses (and such participant's claim may not be rejected solely on the grounds that it was not a participant of the legal entity at the given period of time), provided that it acquired shares in the legal entity from a person / predecessor in title that (i) held shares in such legal entity during the above-specified periods, or (ii) itself acquired the shares from another person that held shares in such legal entity during the above-specified periods.

VAS also explained that the statute of limitations on a claim of such participant commences from the day that the predecessor-in-title (or the predecessor of the predecessor-in-title, as the case may be) of such participant learned or should have learned of the violation on the part of the Director, thereby completely ruling out the possibility of an "artificial extension" of the statute of limitations through resale of the company's shares.

The conclusion may therefore be drawn that VAS takes the position that when rights to shares transfers to a buyer, the buyer of such shares also acquires the procedural rights of the previous owner of such shares, *i.e.*, there is a sort of succession of procedural rights. This approach diverges from that previously elaborated on within the practice of VAS[12] to

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[11] The use of the conjunction "or" here may be interpreted as VAS stating its position that a person that was not a participant of the legal entity at the time that the Director performed the actions resulting in losses for the legal entity, but was a participant at the time that the losses actually arose for the legal entity, is entitled to file a claim against such Director for indemnification of the legal entity for such losses.

[12] *See, e.g.*, Ruling No. 7981/10 of the Presidium of VAS, dated 02.11.2010 in Case No. A56-35901/2009, Ruling No. 9736/03 of the Presidium of VAS dated 02.12.2003 in Case No. A35-4767/02-C11, Ruling No. 10220/09 of the Presidium of VAS dated 08.12.2009 in Case No. A27-15661/2008-1.

mounting a challenge to transactions performed by a company where a person that sells its shares after the company has completed the transaction forfeits the right to challenge such transaction, while the person that acquires such shares does not acquire the right to do so.

It may be assumed that the above succession of procedural rights will apply whether all or part of a shareholders' shares in a company are acquired (*i.e.*, if part of a shareholder's shares are sold, both the shareholder selling part of its shares and the persons acquiring such shares will be entitled to sue a Director for recovery of the company's losses).[13]

However, the clarifications given by VAS do not provide a clear-cut answer as to whether the succession of procedural rights will apply if shares are bought from the actual company and, if so, whether this will depend on the type of shares bought from the company. Three possible scenarios come to mind: (i) the acquisition of "treasury" shares that were already issued on the date that the Director performed the actions resulting in losses for the company, or on the date when the losses actually arose; (ii) the acquisition of "treasury" shares that were not already issued on the date when the losses actually arose for the company; and (iii) the "primary" acquisition of shares (*e.g.*, in the course of an additional share issue) after the losses actually arose for the company.

ii) The legal entity sues

Paragraph 10 of the Ruling also clarifies an important practical issue on calculating the statute of limitations on claims for the recovery of losses filed against Directors by the legal entity itself. This issue is of particular relevance for claims filed by a legal entity against its sole executive body since, as a general rule: (i) the sole executive body has the exclusive right to file claims on behalf of the legal entity (accordingly, if a claim is to be filed against the sole executive body on behalf of the legal entity, this generally requires that the sole executive body first be replaced), and (ii) the knowledge of the sole executive body is imputed to the legal entity (and, as a general rule, the sole executive body learns of the breach of his duty at the time that such breach is committed).

Thus, VAS clarified that in cases where the relevant claim for recovery of losses is filed by the legal entity itself, the statute of limitations is calculated not from the time when the Director is in breach of his duty, but from the onset of the earlier of the following events: (i) when the legal entity, *e.g.*, in the person of a new Director, acquired a genuine opportunity to learn of such breach; or (ii) when a controlling participant that had the

[13] Subject to certain conditions laid down by the law (*e.g.*, the minimum 1% ownership threshold for the outstanding ordinary shares of a company established by Art. 71.5 of the JSC Law).

capacity to terminate the powers of the Director learned or should have learned of such breach, other than where it was affiliated with such Director.

It can be assumed that although the general term "Director" is used, the above clarifications by VAS pertain only to the calculation of the statute of limitations in respect of breach of duty by a sole executive body (*i.e.*, the term "Director" is taken to mean only the sole executive body).[14]

It is also important to note that what is most likely meant by the capacity of a controlling participant to terminate the powers of the sole executive body is the "direct" capacity to terminate the powers of the sole executive body, *i.e.*, this pertains to situations where the formation and termination of the powers of the sole executive body fall within the competence of the general meeting of participants of the company. But if the formation and termination of the powers of the sole executive body do not fall within the competence of the general meeting of participants of the company, then the knowledge a controlling participant of any breach on the part of the sole executive body should not affect the calculation of the statute of limitations on any claims filed by the legal entity against such sole executive body.

For claims for the recovery of losses filed by the legal entity against other Directors (apart from the sole executive body), the general rule for calculating the statute of limitations set forth in Art. 200 of the Civil Code should be applied, namely: the statute of limitations commences from the time when the legal entity, in the person of the sole executive body, learned or should have learned of such breach of duty by a Director.

III. FACTS AT ISSUE AND APPORTIONMENT OF THE BURDEN OF PROOF

Pursuant to paragraphs 1 and 6 of the Ruling, for a claim against a Director to be successful, the plaintiff must prove (i) the existence of circumstances evidencing that the Director acted in bad faith and/or unreasonably, (ii) that the legal entity incurred losses and the amount of such losses,[15] and (iii) a causal relationship between the actions of the Director and the losses incurred by the legal entity.

In paragraph 6 of the Ruling, VAS explains that the *arbitrazh* courts cannot dismiss a claim outright for the recovery from a Director of losses inflicted on a legal entity for the sole

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[14] If we were to take the view that the term "Director" should also be taken to mean any member of a collective corporate body of a legal entity, then the phrase "the legal entity, *e.g.*, in the person of a new Director, acquired a genuine opportunity to learn of such breach" would have to be interpreted such that the knowledge of a member of a collective corporate body of a legal entity could be imputed to the legal entity.

[15] In paragraph 9 of the Ruling, VAS affirms that losses should be taken to mean both direct losses and loss of profits.

reason that the amount of such losses cannot be established with a reasonable degree of accuracy. In this case, the amount of the losses to be recovered should be determined by the court, taking into account all of the circumstances of the case and guided by the principle of justice and proportionality in liability.

It must be noted that culpability as an element of the facts at issue is not even mentioned in the Ruling; however, Art. 71.2 of the JSC Law refers to the Directors being liable to the company for losses incurred by the company through the culpable acts of Directors.

In its initial draft, the Ruling suggested that the presumption of culpability of a Director should be expressly implied if it is proven that he acted in bad faith and/or unreasonably. However, in the course of discussion of the draft Ruling at a meeting of the VAS *Presidium* on March 14, 2013 it was decided to delete this provision. A record of this meeting indicates that this decision was based on the fact that for purposes of the Civil Code bad faith and/or unreasonable actions and culpable acts are not identical concepts, since, in part, the former concept refers to the objective aspect of a Director's breach of his duty, while the second also characterizes the subjective aspect of the violation.

We also note that despite the obvious closeness of these concepts in terms of regulating Directors' liability for inflicting losses on a legal entity, treating them as completely identical could cause a conflicted reading of the Civil Code: Art. 10.5 of the Civil Code establishes that in civil law relations there is a presumption that participants act reasonably and in good faith, thus placing the burden of proof of acting in bad faith and/or unreasonably on the claimant, while Art. 401.2 of the Civil Code establishes that the absence of culpability must be proven by the person that breached the obligation.

We can therefore conclude that the claimant must (by virtue of Art. 10.5 of the Civil Code) prove the objective element in the Director's violation of his obligation, *i.e.*, the existence of circumstances evidencing that the actions of the Director were in bad faith and/or unreasonable. Should the claimant prove the existence of such circumstances, and that the legal entity incurred losses, as well as a causal relationship between the actions of the Director and the losses incurred, then the Director must (by virtue of Art. 401.2 of the Civil Code) prove that he is not guilty, and if he is unable to do this then he will be liable.

It should especially be noted that paragraph 1 of the VAS Ruling expressly sets forth the possibility that the court may place the burden of proving that no violation of any obligations took place on the Director. Thus, pursuant to paragraph 1 of the Ruling, if the claimant asserts that the Director acted unreasonably and/or in bad faith and provides evidence of the losses of the legal entity resulting from the actions of the Director, such

Director may give an explanation of his actions and point to the reasons for the losses (*e.g.*, adverse market conditions, a counterparty, employee or representative of the legal entity acting in bad faith, wrongful acts by third parties, accidents, natural catastrophes and other events, etc.), providing the relevant evidence. In the event that the Director refuses to provide an explanation or if the explanation is clearly deficient, and if the court deems such behavior as being in bad faith (Art. 1 of the Civil Code), the court may place the burden of proving that the Director did not violate his obligations on the Director.

IV. ACTIONS OF A DIRECTOR PERFORMED UNREASONABLY AND/OR IN BAD FAITH

In paragraph 4 of the Ruling, VAS explains that for a Director to act reasonably and in good faith in performing his obligations, he must take necessary and sufficient measures to achieve the aims of the activities for which the legal entity was established, noting in paragraph 2 of the Ruling that, in accordance with Art. 50.1 of the Civil Code, the primary goal of the activities of a commercial entity is to derive profit.

At the same time, VAS states in paragraph 1 of the Ruling that any adverse consequences arising for a legal entity during the time when the Director was a member of a corporate body of the legal entity do not of themselves prove that he acted unreasonably and/or in bad faith, since the possibility that such consequences could arise are a part of the risk inherent in business. Since judicial review is designed to protect the interests of legal entities and their participants, rather than to review the economic feasibility of decisions taken by Directors, a Director cannot be held liable for losses inflicted on a legal entity if the actions that resulted in the losses did not fall outside the ordinary course of business risk.

As discussed above, pursuant to Art. 10.5 of the Civil Code, the actions of a Director are presumed to be reasonable and in good faith, and as a general rule it falls upon the claimant to prove the existence of circumstances evidencing that the Director acted unreasonably and/or in bad faith. Given the considerable difficulties a claimant could face[16] in trying to disprove the above presumption, in attempting to somewhat equalize the positions of the claimant and the Director from the standpoint of allocating the burden of proof, VAS used the Ruling to introduce a number of "counter-presumptions" of the actions of a Director not being reasonable and/or in good faith by setting forth certain circumstances that it would be sufficient for a claimant to prove in order to have proven that a Director's actions were unreasonable and/or in bad faith.

[16] In particular, a shareholder in gathering evidence.

i) Bad Faith Actions of a Director

Pursuant to paragraph 2 of the Ruling, it is deemed proven that a Director has acted in bad faith when, among other things, the Director:

- acted despite a conflict between his personal interests or those of an affiliate of the Director and the interests of the legal entity, including an actual vested interest[17] of the Director in the legal entity entering into a transaction, other than where details of the conflict of interests were disclosed in advance and the actions of the Director were duly approved as prescribed by law;
- concealed information about a transaction in which he had been involved from the participants of the legal entity (*inter alia*, if details of such transaction were not included in the financial statements of the legal entity in violation of the law, or the charter or by-laws of the legal entity) or provided the participants of the legal entity with inaccurate information about the relevant transaction;
- performed a transaction without obtaining the approval of the relevant corporate bodies of the legal entity as required by law or the charter;
- after ceasing to be a Director withheld and evaded his obligation to surrender to the legal entity documents related to circumstances that gave rise to adverse consequences for the legal entity;
- knew or should have known that at the time his actions were not in the interests of the legal entity, *e.g.*, entered into a transaction or voted to approve a transaction on terms and conditions that were known to be unfavorable for the legal entity or with an entity that was known to be incapable of fulfilling its obligations (*e.g.*, a shell company, etc.).

A transaction on unfavourable terms and conditions is understood to mean a transaction, the price and/or other terms and conditions of which are materially worse for the legal entity compared to the price and/or other terms and conditions on which similar transactions are performed in comparable circumstances (*e.g.*, if the consideration received by the legal entity under the transaction is half or less the value of the consideration performed by the legal entity in favor of the counterparty). An unfavorable transaction is determined at the time of its performance; however, if a transaction is subsequently found to be unfavorable because of a violation of the obligations arising therefrom, then the Director is liable for the respective losses if it is proven that the transaction was concluded from the first with a view to not being performed or duly performed.

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[17] This provision leads us to conclude that both a real vested interest and a purely formal interest (*e.g.*, as contemplated in Art. 81.1 of the JSC Law) on the part of a Director or his affiliates may serve as grounds for the actions of the Director to be deemed to have been in bad faith.

A Director will not be held liable if he can prove that the transaction into which he entered, while unfavorable in itself, was part of a series of related transactions unified by a common commercial objective, as a result of which it was presumed the legal entity would benefit. He is also released from liability if he can prove that the unfavorable transaction was concluded to prevent even greater damage to the interests of the legal entity.

In determining what the interests of a legal entity are, it is important to bear in mind that the primary goal of the activities of a commercial entity is to derive profit (Art. 50.1 of the Civil Code); it is also necessary to take into account the relevant provisions of the constitutional documents and corporate decisions of the legal entity (*e.g.*, those determining its business priorities, approving its strategy and business plans, etc.). A Director cannot be deemed to have been acting in the interests of a legal entity if he was acting in the interests of one or more of its participants, but to the detriment of the legal entity.

ii) Unreasonable Actions of a Director

Pursuant to paragraph 3 of the Ruling, it is deemed proven that a Director has acted unreasonably when, among other things, the Director:

- made a decision without taking into account information known to him that is relevant to the given situation;
- took no action prior to the decision aimed at obtaining information necessary and sufficient to make such decision and consistent with customary business practice in similar circumstances; in particular, if it is proven that under such circumstances a reasonable director would have postponed making the decision until additional information was received;
- performed the transaction without adhering to the corporate procedures customarily required or laid down within the legal entity in question for the consummation of such transactions (*e.g.*, coordinating with the legal department, accounts department, etc.).

Here, VAS has made a special note that *arbitrazh* courts ought to assess to what extent the performance of one action or another was or should have been included, under usual business practices, in the remit of the Director, taking into account the scope of the activities of the legal entity, the nature of the relevant action, etc.

In addition, VAS pointed out in paragraph 7 of the Ruling that *arbitrazh* courts should bear in mind the limited opportunities that members of the corporate bodies of a legal entity have in accessing information about the legal entity to help them make their decisions.

iii) Directors' Liability for a Legal Entity Being Held Liable for a Public Liability Violation

In paragraph 4 of the Ruling, VAS explains that part of what constitutes a Director acting reasonably and in good faith in fulfilling his duties includes the proper performance of the public liability obligations imposed on the legal entity by applicable law. Thus, in the event of a public liability violation on the part of the legal entity (tax, administrative, etc.) because a Director has acted in bad faith and/or unreasonably, the Director may be sued for recovery of the resulting losses[18] of the legal entity.

At the same time, holding a legal entity liable for a public liability violation should be seen not as incontrovertible proof, but rather as one more refutable "counter-presumption" about the unreasonable and/or bad faith actions of a Director, in addition to those listed above in paragraphs IV(i) and IV(ii) of this Client Update.

Thus, in paragraph 4 of the Ruling, VAS expressly leaves room for proving that the actions of a Director were performed reasonably and in good faith despite the legal entity being held liable for a public liability violation, stating that in substantiating the reasonableness and good faith of his actions the Director may provide evidence that it was not obvious at the time the actions of the legal entity were performed that they would be qualified as an offense, *inter alia*, for the reason that there was no uniform approach in applying the law by the taxation, customs and other authorities, as a result of which it was impossible to draw an unequivocal conclusion about the wrongfulness of the relevant actions of the legal entity.

iv) Directors' Liability for Selection and Oversight of the Actions of Representatives, Employees and Counterparties of a Legal Entity

In paragraph 5 of the Ruling, VAS affirms the current practice whereby a Director is not released from his liability to a legal entity for losses incurred by the legal entity as a result of the actions of employees or representatives of such legal entity, stating that such losses may be recovered from the Director. Furthermore, VAS has expressly laid down that a Director may be sued for losses incurred by a legal entity as a result of the actions of counterparties under civil law contracts.

A Director may be held liable on this ground if the Director has acted unreasonably and/or in bad faith in performing his duties for the selection and oversight of the actions of

[18] Including fines and other penalties (default interest, etc.) imposed on and paid by the legal entity, as well as the court costs of the legal entity, etc.

representatives, counterparties and/or employees of the legal entity, respectively, or if the Director has failed to properly arrange for the management of the legal entity.

Here, VAS indicated that breaches by the Director of the customary procedures for selection and oversight implemented within this legal entity may, *inter alia*, serve as evidence that the actions of the Director on selection and oversight were unreasonable and performed in bad faith. This provision could be interpreted such that if a Director breached the customary procedures for selection and oversight implemented within a legal entity, the actions of the Director would be presumed to have been unreasonable and in bad faith.

In assessing the reasonableness and good faith of the actions of a Director, *arbitrazh* courts should consider whether such selection and oversight were or should have been included, under usual business practices, in the immediate remit of the Director, taking into account the scope of the activities of the legal entity, and whether the actions of the Director might not have been directed towards avoiding liability by engaging third parties.

V. APPROVAL OF THE ACTIONS OF A DIRECTOR BY COLLECTIVE CORPORATE BODIES AND/OR PARTICIPANTS OF A LEGAL ENTITY

In paragraph 7 of the Ruling, VAS states that of itself, the fact that the action of a Director resulting in adverse consequences for a legal entity, including the consummation of a transaction, was approved by the collective corporate bodies of a legal entity or by its participants, or that the Director was acting upon the instructions of such persons, does not serve as a ground to reject a claim for the recovery of losses from such Director. VAS explains that a Director has an individual duty to act reasonably and in good faith in the interests of the legal entity, and notes also that the members of such collective corporate bodies are jointly and severally liable together with such Director for any losses arising from the respective transaction.

In this paragraph, VAS also confirms that those members of the collective corporate bodies of a legal entity who voted against a resolution that resulted in the incurrence of losses or who did not take part in the voting are not liable for any losses incurred by the legal entity. Here, VAS also specially indicates, citing Art. 1 of the Civil Code, that only those members of the collective corporate bodies of a legal entity who did not take part in the voting will not be held liable who, in not taking part in the voting, were acting in good faith, *i.e.*, did not take part in the voting for sufficiently compelling reasons not related to an attempt to avoid voting so as to evade any possible liability.

VI. INDEMNIFICATION OF A LEGAL ENTITY FOR LOSSES FROM OTHER SOURCES

In paragraph 8, VAS once more emphasizes that a Director has an individual duty to reimburse a legal entity for losses incurred as a result of the unreasonable and/or bad faith actions of the Director regardless of the obligations of other persons to the legal entity and/or the relations of other persons with the legal entity, explaining that the award of a claim against a Director for recovery of losses does not depend on whether there was an opportunity to recover the material losses suffered by the legal entity using other civil law remedies, such as nullifying the transaction, reclamation of the property of the legal entity from unlawful possession by another party, recovery of unjust enrichment, or on whether the transaction that led to the incurrence of losses by the legal entity was invalidated or not. However, if the legal entity has already been indemnified for its material losses using other remedies at hand, including recovery of losses from the immediate perpetrator of the harm (*e.g.*, an employee or counterparty), any further claim for recovery of losses from the Director should be dismissed.

VII. PROCEDURAL MATTERS

In accordance with paragraph 9 of the Ruling, claims for the recovery of losses incurred by a legal entity through the actions of a Director of the legal entity should be heard in accordance with Art. 53.3 of the Civil Code, including those cases where the claimant or the defendant cite Art. 277 of the Labor Code of the Russian Federation in defense of their arguments. In accordance with Art. 225.1(4) of the *Arbitrazh* Procedure Code of the Russian Federation ("**APC**") disputes involving claims against persons who are or were members of the corporate bodies of a legal entity, including those pursuant to Art. 277, paragraph one of the Labor Code, are classified as corporate disputes and claims in connection with such disputes fall under the jurisdiction of *arbitrazh* courts (Art. 33.1(2) of the APC) and are heard in accordance with the rules laid down in Chapter 28.1 of the APC.

In paragraph 11, of the Ruling VAS explains that by virtue of Art. 225.8, part 2 of the APC judgments on claims filed by participants for the recovery of losses are handed down in favor of the legal entity on behalf of which the claim was filed. The writ of execution will show the participant who exercised the procedural rights and obligations of claimant as the judgment creditor, and the party in favor of which the recovery is effected will be shown as the legal entity on behalf of which the claim was filed.

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Please do not hesitate to contact us with any questions.

January 14, 2014