

Client Update

Changes to the Regulation of Major and Interested Party Transactions in Russia

MOSCOW

Natalia Drebezgina
nadrebezgina@debevoise.com

Alan Kartashkin
avkartashkin@debevoise.com

Alyona Kucher
ankucher@debevoise.com

Dmitri Nikiforov
dvnikiforov@debevoise.com

A number of significant changes to the regulation of major and interested party transactions in Russia will be coming into force on January 1, 2017.¹ These changes are intended to bring the concepts of major and interested party transactions in line with market needs. The Law substantially narrows the scope of transactions falling within the major and interested party transaction regulation regime and simplifies their approval process, while at the same time tightening the liability of interested parties.

A dedicated team of lawyers at Debevoise & Plimpton LLP, led by partner Alyona Kucher, was directly and closely involved in the development of the conceptual framework for these legislative changes, as well as in the drafting of the Law.

The key changes introduced by the Law are summarised below.

MAJOR TRANSACTIONS

Introduction of a concept of “ordinary course of business”

Transactions which meet the definition of “ordinary course of business” do not require approval as major transactions. For the purposes of the Law, a transaction is considered to be within the ordinary course of business of a company (or any another organisation) which conducts business of a similar type (regardless of whether or not the company has entered into such

¹ Federal Law No. 343-FZ on Amendments to the Federal Law on Joint Stock Companies and the Federal Law on Limited Liability Companies, dated July 2016, as they apply to the regulation of major transactions and interested party transactions (hereinafter, respectively, the “Law” and the “JSC Law”). We will consider the amendments contemplated in the Law as they apply to the JSC Law. The changes introduced by the Law to the Federal Law on Limited Liability Companies are substantially the same as those made to the JSC Law.

transactions previously) if it does not result in the cessation of the company's business, a change in the type of business undertaken by the company, or a material change in the scale of the company's business.

Clarification as to what economic terms of a transaction must be compared against the book value of a company's assets in order to ascertain whether or not it qualifies as a major transaction

The following terms must be compared against the book value of the company's assets:

- in respect of a disposal or a potential disposal of assets — the *greater* of: the book value of the assets being disposed of *and* the sale price of such assets (the current version of the JSC Law refers only to the book value of the property being disposed of);
- in respect of an acquisition — the purchase price of the asset in question (this is unchanged by the Law);
- in respect of a transfer of assets for temporary possession and use — the book value of assets being transferred (the existing version of the JSC Law does not expressly address this issue, however, the figure which is currently often used in practice is the amount of the usage fees, which can be substantially lower than the value of the assets to be transferred);
- in respect of acquisitions of shares or securities convertible into shares of a *public company* where such acquisition would give rise to an obligation to make a mandatory tender offer — the price of all of the shares and securities convertible into shares which may be acquired, both as a result of the proposed transaction *and* such mandatory tender offer (for example, where 35% of ordinary shares of a public company are being acquired, approval will be required for the acquisition of 100% of voting shares and securities convertible into the shares of such public company).

Shareholders' redemption rights confirmed

Shareholders who voted against an approval or who did not vote are entitled to demand that the company acquires their shares, even if a major transaction exceeding 50% of the book value of the company's assets is also an interested party transaction (this reflects the position taken by the courts in a number of cases).

Introduction of new exemptions from the major transactions regime (and clarification of the existing exemptions)

Certain transactions are not considered major transactions, including:

- transfers of property rights in connection with company reorganisations (the current version of the JSC Law contains such an exemption only with reference to the interested party transaction regime);
- transactions related to the public offering of, or the provision of services related to the public offering of, shares or securities convertible into shares, including arranging public offerings of such shares and securities (except, however, for any provisions relating to the calculation and payment of fees of any person providing such services).

Possibility to provide for additional powers of a company's general shareholder's meeting in respect of the approval of the company's transactions

The provisions of the JSC Law which allowed the major transactions approval regime to be extended to other transactions of the company have been repealed. However, the Law now permits a company to include in its charter a requirement that transactions which are not set out in the Law nevertheless be approved by the board of directors or the general shareholders' meeting. This makes it possible to expand the powers of a company's general shareholders' meeting relating to the approval of such company's transactions beyond what was previously permitted by the JSC Law and to provide for a procedure for the approval of such transactions.

Relaxation of requirements for the description of a major transaction in the approval

In line with existing case law, the Law clarifies that a resolution for the approval of a major transaction may:

- specify minimum and maximum limits in respect of a transaction (meaning the maximum purchase price and the minimum sale price of an asset) or a procedure for their determination;
- approve a number of similar transactions;
- set out alternative terms of a transaction; and
- approve a major transaction subject to the simultaneous conclusion of a number of transactions.

It is permissible not to name the counterparty to a transaction, or the beneficiary of a transaction in the following circumstances:

- where the transaction is entered into pursuant to an auction process, or
- where the counterparty to a transaction or the beneficiary of a transaction cannot otherwise be determined at the time of its approval.

It is also permitted to enter into a major transaction subject to a condition subsequent that such transaction will be approved.

The decision of the shareholders to approve, or to grant subsequent approval to, a major transaction must be based on an opinion of the company's board of directors

Where a major transaction requires the approval (or subsequent approval) of the general shareholders' meeting (for example, where the value of the transaction exceeds 50% of the book value of the company's assets), the documentation to be presented before the general meeting must include an opinion on such major transaction endorsed by the board of directors. Such opinion must include, among other things, information on the likely impact of such major transaction on the company's business and a determination as to whether or not such transaction is appropriate for the company. If the company has no board of directors, such opinion must be endorsed by the sole executive body of the company.

Introduction of new rules for the approval of major transactions which are also interested party transactions by the general shareholders' meeting

The procedure for the approval of such transactions by the general shareholders' meeting varies depending on the value of the assets subject to the transaction:

- if the value of the assets subject to the transaction to be approved by the general shareholders' meeting is between 25 and 50% of the book value of the company's assets, the approval of such major transaction must follow the procedure applicable to interested party transactions;
- if the value of the assets subject to the transaction is more than 50% of the book value of the company's assets, such major transaction will be approved if:
 - at least three quarters of holders of voting shares taking part in the general shareholders' meeting vote in favour of such transaction, and

- the majority of all holders of voting shares taking part in the general shareholders' meeting who do not have an interest in such transaction vote in favour of it.

Restriction of the classes of shareholders who are entitled to challenge major transactions

In order to file an application to have a major transaction declared to be invalid or in breach of the approval procedure, a shareholder (or shareholders) must hold at least 1% of the voting shares of the company.

INTERESTED PARTY TRANSACTIONS

Interested party transactions do not require mandatory prior approval

An interested party transaction may be approved in advance by the board of directors or the general shareholders' meeting at the request of:

- a member of a governing body of the company; or
- a shareholder (or shareholders) holding at least 1% of the voting shares of the company.²

The concept of "affiliation" used to establish interest in a transaction has been replaced by the concept of "control"

This substantially restricts the classes of persons who can be considered to have an interest in a transaction, as well as reducing the number of grounds on which such persons may be considered to have such an interest. For the purposes of regulating interested party transactions, a controlling person is a person who has the right to:

- directly or indirectly (through controlled entities) control more than 50% of the votes in the supreme governing body of the controlled entity; or
- appoint or elect the sole executive body and/or more than 50% of the collective executive body of the controlled entity.³

² The initial draft of the Law did not permit shareholders to require that prior approval be obtained for an interested party transaction. This was nevertheless included in the final version of the Law. Granting such a right to the shareholders appears to be inconsistent with the conceptual framework of reforming the institution of interested party transactions which underpinned the Law.

³ The definition of a controlling person fully replicates the definition set forth in Federal Law No. 39-FZ on the Securities Market, dated April 22, 1996.

A “controlled person” or a “controlled company” is the legal entity which is directly or indirectly controlled by the controlling person.

According to the above test, shareholders who hold, for example, 20% or more of the voting shares of a company fall outside the class of persons who may be considered interested parties. Instead, only those persons who control a company or who have the right to give binding instructions to a company may be regarded as interested parties.

There are different, stricter criteria for determining control over so-called “strategic companies”.⁴

Governmental units as interested parties

None of the Russian Federation, its constituent entities or municipal bodies are considered controlling persons for the purposes of the interested party transactions regime. None of these entities can therefore be regarded as interested parties to a transaction.

A company must notify the following persons of an interested party transaction

- members of the board of directors and the collective executive body; and
- company shareholders, where:
 - the company has no board of directors,
 - all members of the board of directors are interested parties to the transaction, or
 - the company charter contains an obligation to notify shareholders as well as members of the board of directors of any potential interested party transactions.

Such notice must be delivered at least 15 days prior to the date of the transaction.

⁴ For the purposes of regulating interested party transactions, the following companies are considered to be “strategic companies”: (i) companies included in the List of Strategic Enterprises and Strategic Joint Stock Companies approved by the President of the Russian Federation; (ii) companies in which 50% or more of the shares are held by the Russian Federation and/or in respect of which the Russian Federation has a special right to participate in the management of such company (“the so-called ‘golden share’”).

A public company must prepare a report on interested party transactions concluded by the company during the reporting year

Such reports must be made available to persons entitled to take part in the general shareholders' meeting as part of the preparation for the general shareholders' meeting of a public company. The report must be signed by the sole executive body of the company and approved by the board of directors of the company, while the accuracy of the information contained in the report must be confirmed by the company's audit commission or its auditor.

Resolutions approving interested party transactions must be passed in the following manner

- in a public company—by a majority vote of directors who are not interested parties to the transaction and who meet a number of additional criteria set forth in the JSC Law (the new version of the JSC Law sets the minimum quorum for meetings of the board of directors of a public company to approve such matters at two directors, whereas the current version of the JSC Law allows for such resolutions to be passed by one independent director who is not an interested party);
- in a non-public company—by a majority vote of directors who are not interested parties to the transaction.

The charter of both public and non-public companies may require a greater majority of the votes of the directors, as well as additional eligibility criteria for members of the board of directors to be entitled to vote on the approval of interested party transactions.

Increase of the value threshold for approval of a transaction by the general shareholders' meeting

Approval of an interested party transaction falls within the competence of the general shareholders' meeting if it involves assets with a value of over 10% of the book value of the company's assets (under the current version of the JSC Law this figure is 2%).

Reduction of the voting majority required for a general shareholders' meeting to approve an interested party transaction

Under the Law, a resolution to approve an interested party transaction is passed if the majority of all of the holders of the company's voting shares *who took part in the voting*, and who are not interested parties to the transaction, voted in its favour. The current requirement of the JSC Law that a transaction be approved by a majority of *all of the holders of the company's voting shares who are not*

interested parties (as opposed to only those shareholders who took part in the voting) means in practice that public companies with a large number of minority shareholders have not been able to approve interested party transactions because of the low turnout of such shareholders at general shareholders' meetings.

Approval of an interested party transaction in a non-public company

The charter of a non-public company:

- may stipulate a procedure for approving interested party transactions which differs from that established by the JSC Law; or
- may fully disapply the application of the provisions of the JSC Law relating to interested party transactions to such non-public company.

Expansion and clarification of the list of exemptions from the interested party transaction regime

Interested party transaction regime does not apply, for example, to:

- transactions in the ordinary course of business (provided that the company has entered into numerous similar transactions on comparable terms over an extended period of time and that such prior transactions were not interested party transactions);
- transactions in respect of assets whose price or book value does not exceed 0.1% of the book value of the company's assets, provided that the value of such transactions does not exceed the limits established by the Russian Central Bank;
- transactions concluded as part of a public tender or following a public tender, provided that the terms of participating in such tender or of holding such tender received the prior approval of the board of directors of the company.

Exemption from an interested party transaction regime where all shareholders are regarded interested parties

Transactions in which all shareholders are interested are not exempt from the interested party transaction regime if there are also other interested parties to that transaction. Prior to the Law being adopted, the law on this issue was not settled, however, in practice the courts often took the view that such transactions did not require an approval.

Stricter requirements for the provision of information by persons who may be deemed interested parties to a transaction

Members of the company's governing bodies, the company's controlling persons, and persons who have the right to give binding instructions to the company must provide the company with the information about the nature of their interest in a transaction set out in the JSC Law within two months from the day they became or should have become aware of circumstances by virtue of which they may be deemed to be interested parties. Furthermore, if such information changes, the company must be notified of such changes within 14 days from the day on which such relevant party became or should have become aware of the changes. If the person who may be deemed to be an interested party to the transaction is in breach of his duty to inform the company (as described above) as of the date on which such transaction is entered into, it will be presumed that such person is liable for causing any loss suffered by the company as a result of such transaction.

Clarification on information the company should provide on an interested party transaction entered into without approval

A company must provide information relating to an interested party transaction, including documents and other information confirming that such transaction does not prejudice the interests of the company (including that such transaction was entered into substantially on market terms) where such transaction is entered into without an approval. Such information must be provided at the request of a member of the board of directors of the company or a shareholder (or shareholders) holding at least 1% of the company's voting shares within not more than 20 days from the date on which such request is received by the company.

Changes to the procedure for challenging interested party transactions

An application for the invalidation of an interested party transaction may be filed by one or more shareholders together holding at least 1% of the company's voting shares. In addition to the shareholders, the company itself and members of its board of directors may also challenge interested party transactions. An interested party transaction may be invalidated if all of the following criteria are met:

- the transaction prejudices the interests of the company. For this purpose, there is a rebuttable presumption that the interests of a company are prejudiced if:

- the approval (or subsequent approval) of the transaction was not obtained, and
- information regarding the contested transaction was not made available to the claimant at his request (see the preceding bullet point);
- it can be proven that the counterparty to the transaction knew or should have known *a priori* that:
 - the transaction was an interested party transaction for the company, and/or
 - the transaction was not approved (however, the mere fact that a transaction was not approved does not in itself constitute grounds for the invalidation of such transaction).

* * *

The existing mechanisms for prior approval of major and interested party transactions are both overly formalistic and excessive. At present, Russian public companies are forced to pre-approve impracticably large numbers of transactions which, whilst falling within the definition of major or interested party transactions should not in practice require mandatory pre-approval of the board of directors or the shareholders of the company. The changes introduced by the Law substantially reduce this administrative burden on companies, thereby ensuring that business can be done more easily and effectively and will allow directors and shareholders to concentrate on the review of the more significant transactions.

We would be pleased to answer any questions you may have regarding the reform of the major and interested party transaction regime.