

The Supreme Court of Russia Issued a New Ruling on Disputing Major and Interested Party Transactions

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On 26 June 2018, the Plenary Session of the Supreme Court of the Russian Federation (the “Supreme Court”) issued Ruling No. 27 on Disputing Major Transactions and Interested Party Transactions (the “Ruling”).¹ In this Ruling the Supreme Court provided guidance on certain issues of applying new regulations to major and interested party transactions. Below we briefly review the most interesting and significant provisions of the Ruling.

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Procedure for challenging transactions. When considering a claim for the invalidation of a transaction as performed in breach of the procedure for its consummation set forth in the JSC Law² or LLC Law,³ Article 173¹ of the Civil Code⁴ should be applied in respect of major transactions and Article 174(2) in respect of interested party transactions subject to specific requirements set forth in the above Laws.⁵

Limitations period. The limitations period for challenging major and interested party transactions (together the “transactions”) is determined pursuant to the rules of Article 181(2) of the Civil Code and is one year. The limitations period begins:

- on the day when a person acting alone or in conjunction with other persons as chief executive officer (the “CEO”) became aware or should have become aware of a transaction made in breach of legal requirements, including if such person directly made such transaction;

¹ The text of the Ruling is available [here](#).

² Federal Law No. 208-FZ on Joint Stock Companies dated 26 December 1995.

³ Federal Law No. 14-FZ on Limited Liability Companies dated 8 February 1998.

⁴ The Civil Code of the Russian Federation.

⁵ It can be assumed that this guidance of the Supreme Court sought to prevent the courts from applying other articles of the Civil Code when major and interested party transactions are challenged based on the breach of procedure for the consummation thereof, in particular, to prevent the application of Article 168 of the Civil Code (“Invalidity of Transaction that Violates the Law or Other Legislative or Regulatory Act”) and to specify that the grounds for disputing set forth in the JSC Law and LLC Law are not self-sufficient, but rather such transactions should be challenged pursuant to Articles 173¹ and 174(2) of the Civil Code subject to specific requirements set forth in such Laws.

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- if the CEO acted in conspiracy with the other party to the transaction, on the day when the new CEO, or if there are more than one CEO in the company, the CEO that did not enter into such transaction, became aware of such circumstances;
 - if there is no new CEO or another CEO that did not enter into the disputed transaction prior to the filing of a claim by a member/shareholder (the “shareholder”) or a member of the Board of Directors (the “Board”), on the day when the shareholder or the Board member who filed such claim became aware of such circumstances.

If the limitations period begins on a day when the shareholder who filed the claim became aware or should have become aware of the breach of procedure for the consummation of transaction, the following should be taken into account:

- if more than one shareholder files a claim, such claim will not be time-barred if at least one of such shareholders filed the claim within the limitations period provided that such shareholder(s)⁶ holds the required number of voting shares/votes to file such claim;
- if a company publicly disclosed the disputed transaction as provided for by the securities market laws, shareholders of such company will be deemed to have become aware of the disputed transaction from the time of the public disclosure allowing them to conclude that such transaction had been made in breach of the procedure;
- it is assumed that a shareholder should have become aware of a transaction made in breach of the procedure for its consummation no later than the date of the annual general shareholders meeting (the “GSM”) for the year in which the disputed transaction was made (unless the transaction was concealed from shareholders and/or the materials circulated to the shareholders did not allow them to conclude that such transaction had been made);
- if the above rules cannot be applied, it is assumed that in any event a shareholder should have become aware of the disputed transaction more than one year ago if such shareholder has not participated in the GSM for a long time (two or more consecutive years) or has not requested any information about the company’s operations.

⁶ If there is more than one shareholder who did not let the statute of limitations to expire.

Right of action of a new shareholder. A claim for invalidation of transaction cannot be dismissed on the grounds that the shareholder commencing the action was not a shareholder of the company at the time when such transaction was made.

Scope of the ordinary course of business. A transaction will fall beyond the scope of the ordinary course of business, i.e. the consummation of the transaction will lead to the termination of the company's business or a change in the type of business or a substantial change in the scale of the company's business, in particular, in the event of sale/lease of the fixed production assets of the company or if such transaction results in a significant change of the region of its operations or its sales markets.

When evaluating the possibility of such consequences at the time of the transaction, courts should take into account not only the terms and conditions of the disputed transaction but also other circumstances related to the operations of the company at the time of the transaction. For example, a transaction for the acquisition of equipment that could be used for the existing operations should not lead to the change of the type of business.

Determination of the amount of a major transaction. The amount/sum of a major transaction will be determined without regard to the claims that may be made against the respective party for the failure to perform or improper performance of its obligations (e.g., penalties), unless it is established that the company did not originally intend to perform or properly perform such transaction.

The price of a contract providing for regular payments (e.g., lease, services, storage, agency, trust, insurance, franchise, licensing agreement, etc.) for a person required to make such regular payments should be determined on the basis of the total amount of such payments for its entire term (if it is a contract for an indefinite period, for one year; if payments vary, the greatest amount of payments for one year should be used).

It can be assumed that the above approaches for determining the contract price will be applied to the interested party transactions as well.

Conclusion on a major transaction. The Supreme Court clarified that the conclusion on a major transaction may contain a recommendation to enter into or not to enter into such transaction.

The fact that no conclusion was issued does not serve as ground for disputing such transaction as performed in breach of the approval procedure. However, it makes it possible to advance claims for damages caused to the company by such transaction against persons who failed to perform the obligation to prepare a respective conclusion.

Retired Board member. A member of the Board will be deemed to have retired, in particular, in the event of his/her death, if he/she has been declared legally incompetent or as having limited legal capacity or disqualified by order of the court or has notified the company of his/her resignation (such resignation must be made in writing in advance of the Board meeting).

Approval of a major transaction that is simultaneously an interested party transaction. Any major transaction that is simultaneously an interested party transaction is subject to approval both as a major transaction and an interested party transaction. However, according to the rules of approval of interested party transactions, such transaction is subject to approval if so expressly demanded only.

If the major transaction rules require that a transaction is approved by the Board, such transaction must be approved by the Board according to the rules of approval of major transactions and by the GSM according to the rules of approval of interested party transactions.⁷

Standards of good faith (implied knowledge). Generally, the law does not require any third party to verify prior to making a transaction whether such transaction is a major transaction or an interested party transaction for its counterparty and whether it has been properly approved.

Third parties relying on the information contained in the Unified State Register of Legal Entities (“EGRUL”) as to the persons authorised to represent a legal entity may generally assume that such persons are authorised to enter into any such transactions.

A representation/warranty by a person who entered into a transaction that all necessary corporate procedures have been complied with, etc., does not itself prove that the counterparty acted in good faith.

Knowledge that the transaction is a major transaction or an interested party transaction is assumed (unless proven otherwise):

- in respect of major transactions, if the counterparty, its controlling or controlled person is a shareholder of the company or its controlling entity or is a member of corporate bodies of the company or its controlling entity;

⁷ The literal reading of Article 79(5) of the JSC Law may lead to a conclusion that in this situation if it is demanded that a transaction is approved as an interested party transaction, such transaction is subject to approval by the GSM according to the rules of approval of interested party transactions only and no approval by the Board according to the rules of approval of major transactions is required.

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- in respect of interested party transactions, if the counterparty or its representative exercising its discretion in such transaction or their relatives are interested in such transaction.⁸

Voting by persons controlled by an interested party. It is not only interested parties⁹ that are not entitled to vote for the approval of an interested party transaction, but also corporate shareholders that are not formally interested in a transaction but rather are under control of interested parties (controlled entities).¹⁰

Requirements for approval of interested party transactions. The Supreme Court clarified that a GSM or a Board meeting for approval of an interested party transaction may be requested at any time both prior to and after the consummation of a transaction (in the latter case the respective corporate body of the company should decide on a subsequent approval of such transaction).

The above clarification means, in particular, that now any shareholder holding at least 1% of voting shares of the company may, upon becoming aware of an interested party transaction made by the company from media reports, documents disclosed by the company or other sources, request a subsequent approval of such transaction even if such transaction is apparently beneficial for the company.

In its turn, the company will be required to hold a Board meeting or a GSM as the list of grounds set forth in the JSC Law and the LLC Law contains only a few grounds for rejecting such request, which will not be applicable in most cases.

Therefore, the company will have to incur additional expenses for holding a Board meeting or a GSM. In addition, if the Board or the GSM adopts a resolution not to approve a transaction that has already been made, the legal consequences of such resolution are not clear. Will the company management be required to take action to unwind such transaction? But non-approval of an interested party transaction

⁸ Relatives include persons listed in paragraph 2 of Article 81(1) of the JSC Law and paragraph 2 of Article 45(1) of the LLC Law, specifically: spouse, parents, children, full and half siblings, adoptive parents and adopted children.

⁹ The interested parties interested in the consummation of such transaction include Board members, the sole executive body, members of the collective executive body, controlling persons of the company or persons that have the right to issue binding instructions to the company.

¹⁰ The legal society has expressed its view on numerous occasions that the literal reading of the provisions of the JSC Law and LLC Law suggests that only the interested parties themselves are not entitled to vote for the approval of an interested party transaction at the GSM. By its guidance the Supreme Court has entirely eliminated this legal uncertainty.

Unfortunately, providing guidance on the matter of voting by the controlled entities the Supreme Court would not resolve the issue of voting by relatives of the interested party or, more generally, the issue of possible recognition of common control exercised by such relatives over the company.

subsequent to its consummation is not sufficient ground for its termination. It is also unclear whether there is any preclusive term for requesting a subsequent approval of transaction or such request may be made at any time prior to the termination of the transaction.

The legal uncertainty caused by this Supreme Court guidance may result in the majority of interested party transactions being approved prior to their consummation “just in case” which will in fact reinstate the situation that existed prior to the reform of the institution of interested party transactions.

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Please do not hesitate to contact us with any questions.

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