Latest amendments to major and related party transactions and arbitration reform

July 2017 | EXPERT BRIEFING | LITIGATION & DISPUTE RESOLUTION

financierworldwide.com

BY

Anton Dzhuplin and Timur Akhundov

ALRUD

1 January 2017 was the enforcement day for new rules regarding the approval of major transactions and related party transactions concluded by joint stock companies and limited liability companies reducing the amount of transactions, which are required to be approved by the company, but at the same time introducing stricter liability for related parties.

A major transaction is a transaction considered to be a extraordinary, leading to an acquisition or disposal, or a transaction that could potentially result in the disposal of property or its transfer into temporary possession or use or to provisions of a right to a third-party to use the results of intellectual activity or means of individualisation under a licence, where the cost of the underlying transaction exceeds 25 percent of the book value of the total of the company's assets as of the date on which ended the accounting quarter preceding the date of the transaction.

A transaction may not be recognised as being major if it is executed in the ordinary course of business. Previously, it would be a tough challenge for a party to prove in court that a transaction would be treated as ordinary unless very well grounded, perhaps referring to a series of similar commercial transactions performed in the past and concluded within one of the main streams of the company's activities. According to the new rules applied to major transactions, if

a transaction does not lead to the cessation of the activities of the company or a change in the type of such activities or significant depreciation of its scale, it is presumed that the transaction is made within the ordinary course of business.

The approach to calculation has changed for certain types of transactions. Thus, currently: (i) where relevant property is disposed or could be disposed, the transaction value is determined as the greatest of two values – the book value of the property or the price of its alienation; and (ii) where the relevant property is transfered into temporary possession or is determined as the book value of such property.

The wording of the consent has been liberalised. Previously, the scope of transaction approval was limited to whether or not to approve the transaction. It has become possible to indicate the validity period of the consent to execute a major transaction (such term being one year by default), the approved range of the price and terms of the transaction to be negotiated, the approval of consecutive agreements arising out of the approved transaction and even conditions on which the relevant transaction will be considered as 'approved' by the relevant governing body.

Another novelty in the series of recent changes is the mandatory nature of 'major transactions'. In other words, it is no longer possible to avoid the necessity of approving major transactions or altering the terms of their corporate approval by introducing amendments, either in the company charter or the shareholders' agreement. In addition, the prior or subsequent approval of a major transaction at a general shareholders meeting, if this matter is in the competence of the shareholders meeting, will be made only upon review of a separate opinion of the company's board of directors (if the board of directors may be appointed, according to the charter of the relevant company).

A major transaction executed without the required approval may currently be challenged by the general director (CEO), a member of the board of directors or a shareholder holding 1 percent or more of the voting shares or who has a participatory interest in the company.

An important shift in the approach to dispute resolution related to major transactions is that a counteragent is no longer required to verify whether the transaction represents a major transaction for its counterparties. A claimant trying to invalidate a transaction on the basis of the lack of its approval as a major transaction will have to prove that the other party to the transaction was, or acting diligently must have been aware, that such a transaction represented major transaction.

New rules for approval of related party transactions

One of the serious changes to related party transaction regulation concerns the mandatory nature of approval. According to the new rules, the related party transaction need not necessarily be approved, since non-public joint stock companies and limited liability companies may exclude this necessity, or establish different approval terms and conditions, by introducing relevant amendments

in the charter of the company by unanimous vote of all the voting shareholders.

According to default rules, the related party transaction no longer requires prior approval for its validity. However, the company must notify the board of directors, members of the collegial executive body and, in certain cases, shareholders of the company no later than 15 days before the date of the transaction. The notice must contain details of the parties to the transaction, beneficiaries, consideration amount, subject-matter and other terms of the transaction. The notice also should contain details of the persons interested in the transaction, and the grounds of their 'related party' status. The charter may also contain an obligation to notify shareholders, along with the board of directors, about any such transactions. Related party transactions currently may be approved a *posteriori,* with the exception of instances where prior approval has been requested by the general director, a member of the collegial executive body or shareholders holding 1 percent or more of the voting shares or a participatory interest in the company.

The threshold for approving related party transactions by the shareholders has increased. Currently, a general shareholder's meeting is the sole body competent to approve a related party transaction, if the value of the transaction exceeds 10 percent of the book value of the company's assets (calculated in the same manner as for major transactions) while previously the threshold was 2 percent. Related party transactions are approved by a majority of votes of all non-related shareholders participating in the vote (against the previous quality of all non-related holders of the company's voting shares).

If the transaction is approved by the board of directors, it should be approved by the majority of the non-related members of the board of directors, and for public joint stock companies – by majority of the non-related and independent directors (under independent director criteria established by the law).

The list of potentially related persons was amended. The term 'controlling persons' has been introduced *in lieu* of the previously valid term of 'affiliated persons holding 20 percent or more of the voting shares of the company'. The person is considered a controlling person and potentially a related party if it has the right of direct or indirect disposal of more than 50 percent of votes in the supreme management body of the controlled company or the right to appoint or elect the general director or more than 50 percent of the collegial management body of the controlled company on the basis of shareholding in the controlled company, shareholding agreement and so on.

Potentially related parties, namely 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 notify the company of any interest causing the status of a related party transaction, within two months from the day they became or should have become aware of the circumstances.

A related party transaction may be challenged if: (i) the transaction prejudices the interests of the company (currently this is presumed in case of absence of notification about the existence of control or a company's failure to send notification of an upcoming related party transaction to the authorised persons); and (ii) the counterparty knew that the transaction is a related party transaction or approval was not obtained. The burden of proof for the second requirement is the same as for major transactions.

Arbitration reform

On 1 September 2016, several new laws came into force providing for a radical reform of the activities of arbitration courts in the Russian Federation, as well as international commercial arbitration.

Pursuant to the reform, the option to submit corporate disputes to arbitration starting from 1 February 2017 has officially been allowed. It should be noted that corporate agreements concluded before 1 February 2017 should be considered enforceable.

The arbitration reform determines the range of corporate disputes that can be submitted to an arbitration institution (arbitrable disputes), and an exhaustive list of corporate disputes that may not be submitted to arbitration institutions (non-arbitrable disputes).

Arbitrable corporate disputes might be divided into two subgroups: arbitrable and conditionally arbitrable. As a general rule, corporate disputes (for example, concerning ownership over shares in a charter or share capital, including disputes arising from SPAs, the activity of registrars, the establishment of encumbrances over shares and their enforcement) are arbitrable, provided they are administrated by a permanent arbitration institution (in accordance with general arbitrational rules and regardless of the place of the seat).

A set of corporate disputes related to, or arising out of, corporate agreement, establishment, reorganisation and liquidation of legal entities, claims of shareholders for recovery of damages caused to a legal entity, invalidation of transactions, invalidation of the decisions of governing bodies of a legal entity and issuance of securities, might be submitted to an arbitration institution subject to the following conditions: (i) it must be administrated only by a permanent arbitration institution (as opposed to an *ad hoc* arbitration); (ii) it must be considered within the territory of the Russian Federation; (iii) it must be considered under approved arbitration rules for corporate disputes; and (iv) an arbitration clause must be concluded both by all shareholders and the company.

Non-arbitrable disputes include corporate disputes, those resolved by class-action lawsuits, all disputes regarding legal entities with strategic importance for national security purposes, as well as disputes regarding convening general meetings of participants or shareholders, activities and acts of public bodies, expulsion of shareholders, and implementation of mandatory procedures provided for by corporate law, among others.

Foreign arbitral institutions are allowed to operate within the territory of the Russian Federation as a permanent arbitration

institution subject to obtaining a permit from the Russian government.

The awards of *ad hoc* arbitrations cannot be final and decisive and may be set aside by decision of a state court of the Russian Federation. Besides, arbitration institutions acting on an *ad hoc* basis are not allowed to consider corporate disputes, to appeal to state courts for assistance in obtaining evidence or to enforce provisions of arbitration agreements on the exclusion of applying to the state court for assistance.

Foreign institutions (compared to domestic arbitration institutions) may be granted the status of a permanent arbitration institution by the federal government, if they possess a "widely recognised international reputation" upon a simple application filed by the relevant arbitration institution. As of today, no foreign arbitration institution has applied for a permit; however, this may be partially caused by the need for foreign arbitration institutions to adapt their rules and regulations to the procedural requirements of Russian legislation. According to all available information, at least several renowned international arbitration institutions are believed to be considering applying for the permit. The situation is being monitored.

Anton Dzhuplin is a partner and Timur Akhundov is an associate at ALRUD.