***Dmitri Lovyrev, Partner, Monastyrsky, Zyuba, Stepanov & Partners.* Key Issues of Minority Shareholders' Rights in Russian Companies. – 2013.**

1. Mandatory Offer

The broad court practice on application of the mandatory offer procedure, which exposed deficiencies in the existing regulation, has developed in Russia over past six years. The Chapter highlights the following ways of evading the obligation to send a mandatory offer:-

- obtaining control indirectly;
- subsequent reduction of a person's shareholding below the statutory threshold; and
- creation of artificial affiliation**.**

Considered below is a group of abuses in pricing securities subject to acquisition. In practice, Russian company law is interpreted in such a way that when an offer is *delayed*, the mandatory offer should be priced with due regard to the share purchase transactions and stock exchange deals with shares made within 6 months preceding to *the date when the mandatory offer was actually sent*. This allows a majority shareholder to deliberately defer sending the offer for as long as possible, so that the majority shareholder's transactions for acquisition of the company's majority stake, often priced much higher than the stock exchange price by including the so-called control premium, would fall outside of the 6-month period.

Another common manipulation with the mandatory offer price is using the obtained control for de-listing of the company's shares in order to eliminate the intrinsic market indicators (weighted average quotations) from the pricing formula and to employ services of a formally independent appraiser that is actually biased.

The Chapter also dwells on the abuses pertaining to execution of a mandatory offer, in particular:-

- deficiencies of existing share transfer/payment procedures when payment for securities is conditional upon their prior crediting to the offeror's account;

- disputing by a major stake purchaser of securities sale/purchase agreements on the grounds of their alleged violation of public law, which violation in turn results from unfair practices of the purchaser itself (e.g. the purchaser's evasion from having the transaction cleared by competent governmental authority).

Much attention is paid to the remedies protecting minority shareholders from unfair practices of major stake purchasers:-

- possibility of forcing a major stake purchaser to send a mandatory offer;
- a minority shareholder's right to dispute the mandatory offer price;
- deficiencies in the voting right limitation procedure resulting extremely formal interpretation by courts of on the rule of law on the time when the major stake purchaser's duty to send the mandatory offer is deemed to have been performed.

2. Related Party Transactions. Affiliation and Control.

Stripping a company of assets in favor of entities affiliated with the majority shareholder (by entering into transactions at a price deviating from the fair market value) is the most common form of abuse of shareholding in a company.

The first and foremost problem is to determine whether or not there is a conflict of interest in the company's entering into a transaction. In particular, it is noted that the a key issue with the law currently in force is that it relies on determination of conflict of interest on the basis of formal and exhaustive list of criteria for affiliation and interest, with the nature of actual relations between economic agents being disregarded. Since it is possible to exercise control over a company by methods that go beyond the formal statutory criteria, it is often impossible to prove existence of interest in a particular situation. The first way to handle the problem is, in the author's opinion, to make sure that courts interpret the existing interest and affiliation criteria more flexibly. However, the problem can only be resolved by adopting a bill of the new Civil Code of the Russian Federation recently passed by the State Duma in the first reading. The bill

proposes a new system of provisions on affiliation and control which should be uniform for all corporate law matters.

Described further in the Chapter are difficulties with enforcing statutory procedure for aligning the related party transactions price with the arm's length price. Here are the most significant difficulties:-

- any price designated by the board of directors is perceived by courts as the arm's length price *a priori*;

- even if an independent appraiser's report which the board of directors has relied upon is recognized false, courts may dismiss a claim on the grounds of an appraisal being optional.

Another problem is allocation of the burden of proof when related party transactions are disputed. For instance, a defendant is often unjustifiably relieved of the burden of proof with regard to lack of adverse effects of a related party transaction, which if otherwise imposed on them by legal position of the Russian Federation Higher Arbitration Court Presidium. The plaintiff's failure to prove the fact of violation of its rights is one of the most popular grounds for dismissing a claim.

This Section of the Chapter ends with a review of application by courts of such transaction invalidity recognition criterion as the shareholder plaintiff's ability to influence the voting on the related party transaction.

3. Shareholders' Right to Obtain Information on the Company's Business

Adoption by the Russian Higher Arbitration Court Presidium of Information Letter No. 144, which ensured uniformity of the extremely contradictory legal practice in this category of disputes, on January 18, 2011, was a milestone in the company law evolution. That said, the issue of whether all shareholders have a right to access the most critical documents - the company's agreements,- is yet to be settled. Even though the Russian Higher Arbitration Court Presidium pointed out the need to disclose these agreements to shareholders, the ambiguous wording did not make it clear if they might be classified as accounting documents or not, and

whether for that reason access to them might be denied to the shareholders holding less than a 25% stake.

In the author's opinion, another key issue is that shareholders do not have access to documents of subsidiaries of the companies. Nowadays, there is a apparent contradiction between economic and legal aspects of big companies' operations: a group of companies acting as a single business entity on the market strives to present itself as a set of self-sustaining and mutually independent legal entities almost always when it comes to legal responsibility. Even though under these circumstances exercising proper control over the subsidiaries necessitates for the shareholders to be able to obtain necessary information from the subsidiaries, , such a right has not yet been granted to minority shareholders.

4. Delisting

Cases of an issuer's delisting its own shares become increasingly more common in Russian business practice. The minority shareholders' rights are obviously violated in this situation: by investing into a company, a person expects to indefinitely enjoy the benefits of public circulation of high liquidity securities; however, conditions of his/her admission to the company are changed unilaterally, at will of the person that controls the issuer. The author dwells on the recent legal amendments intended to establish special procedures for making share delisting decisions and also describes certain deficiencies of the adopted concept.

5. Additional Share Issue

Existing drawbacks in regulation of the additional share issue procedure transformed this tool of raising extra money for a company into the main tool of unfair share capital re-allocation for the benefit of the controlling shareholder. An abuse which has become very frequent is to sell initially issued preferred shares, or preferred shares of the types other than those already issued by the company, to the majority shareholder's affiliates. In this situation there is in fact no way for minority shareholders to protect their rights, because applicable law does not confer either the right of first refusal to purchase newly issued shares, or the right to call for redemption of their

shares. The Chapter investigates into the reasons why courts refuse to recognize respective rights of these shareholders, and also analyzes legal substantiation of these reasons.

Special attention is also paid to another common form of violation of shareholders' rights, namely placement of ordinary shares at a very low price to a person not formally affiliated with the majority shareholder, subject to in-kind payment for them.

6. Reorganization

This Section substantiates the idea that Russian law does not contain sufficient guarantees enabling protection of shareholders' interests in a company's reorganization. In particular, it:-

- Does not envisage any requirements with regard to key reorganization conditions, such as conversion rates for reorganized company's shares;
- Does not allow particular shareholders' categories, such as holders of preferred shares or shareholders which are not related parties in a reorganization transaction, to affect respective decision making process due to the rules of joint voting of holders of ordinary and preferred shares in case of reorganization, and also due to non-applicability of the related party transactions approval rule to reorganizations;
- Does not envisage any procedure for, and consequences of contesting a reorganization process ('reversal').

7. Claims against Members of Management Bodies

The author draws a conclusion that general company law provisions on bringing corporate management to liability are currently insufficient for effective control over their operations and for claiming damages inflicted on the company by their actions.

The following enforcement shortcomings are studied in detail:-

- Imposing the burden of proving unfairness and unreasonableness of director actions, as well as of there actually being loss caused by these actions, on the shareholder claimant;

- Imposing on the shareholder claimant obligation to substantiate the precise amount of loss incurred;
- Impossibility to hold a director liable for any transactions entered into by subsidiaries.

This Section of the Chapter touches upon the most recent trends in judicial practice and covers the main provisions of the Russian Higher Arbitration Court Plenum's Resolution on liability of business entities' management body members.

8. Conclusions

Having analyzed the existing state of affairs with minority shareholders' rights in the main fields of corporate governance, the author highlights several differently directed trends. On the one hand, both the lawmaker and the Russian Higher Arbitration Court pay increasing attention to guarantees of minority shareholders' rights by introducing efficient remedies and, on the other hand, Russian lower-level courts are rigid to changes in law and in the established court practice and largely advocate formal and conservative approach to disputes involving minority shareholders.