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A legal update from Dechert's Corporate and Securities Group

New Russian Law Recognizes Shareholders' Agreements in Joint Stock Companies

Russia enacted a new law on June 4, 2009 Federal Law No. 115-FZ "On the Making of Amendments to the Federal Law 'On Joint Stock Companies' and Article 30 of the Federal Law 'On the Securities Market'" ("the Amendments"), which recognizes the right of shareholders to enter into a shareholders' agreement ("SHA") to govern their relations in a joint stock company ("JSC"). The Amendments, which came into force on June 10, 2009, will allow shareholders more flexibility in structuring relations among themselves, and provide for judicial recognition of provisions relating to corporate governance, shareholding, voting arrangements and other matters normally addressed in SHAs in other jurisdictions. This is a major breakthrough in Russia, where the enforceability of SHAs has long been uncertain. This update provides a brief overview of the principal changes introduced by the Amendments.

SHA

Parties

Some or all of the shareholders of a JSC may be parties to an SHA. The Amendments provide that the JSC itself cannot be a party to the SHA. Accordingly, the SHA is not enforceable against the JSC.

Formal Requirements

An SHA must be concluded as a single document. The implication of this requirement is that signing in counterparts through exchange of signature pages would not be possible. Furthermore, rules related to entering into a contract through exchange of an offer and acceptance would likewise be inapplicable to an SHA. There is no requirement to notarize or register the SHA, or to reflect provisions of the SHA in a JSC charter.

Subject Matter of the SHA

Generally, the Amendments provide that the SHA is to regulate the exercise of rights attached to the shares. In addition, all shares held by a party

to the SHA must be subject to the SHA. This seems to imply that a shareholder can only be party to one SHA with respect to a JSC.

The Amendments do not establish an exhaustive list of matters potentially governed by an SHA. However, the Amendments expressly state that the SHA may contractually regulate the following areas.

Voting matters, including undertaking to vote in a certain manner. The SHA may not obligate a party to the SHA to vote in a certain way under the instructions of any management bodies of the JSC, whose shares happen to be subject to the SHA. The Amendments do not appear to establish any other restrictions on the voting arrangements that may be agreed to in the SHA. However, one potential cause for concern is how the courts would view voting arrangements between some of the shareholders in cases where not all shareholders are parties to the SHA, which could result in those shareholders not party to the SHA claiming that such arrangements breached their rights as shareholders.

Share transfers, including share retention undertakings. The Amendments provide that the SHA may provide for sale or purchase of the shares at a pre-agreed price should certain events occur. This appears to be the first attempt to recognize a share option structure (as opposed to traded options, which are recognized) under Russian law.

However, there is a discrepancy between the Amendments and Article 157 of the Civil Code of the Russian Federation, according to which a conditional transaction is deemed to be entered into if at the time of the execution of the agreement it is not known whether a particular event will occur. Since the SHA makes provision in this respect only for events dependent on the actions of a party to the SHA or events that are specified, it is not clear what position a court would take, and there is a risk that the courts might invalidate such provisions of the SHA.

The management, activity, reorganization or liquidation of a JSC. The Amendments do not appear to establish any restrictions on agreements that may be reached in the SHA in respect of these matters. However, these matters are mostly regulated by imperative rules of Russian law, which may not be amended by the SHA. Accordingly, it seems highly unlikely that agreements reached without regard to such imperative rules would be enforceable.

Remedies for Breach

Corporate decisions: corporate decisions cannot be invalidated pursuant to the terms of an SHA. A breach of the SHA may not constitute grounds for invalidating decisions of the management bodies of a JSC.

Contracts in breach of the SHA: a contract entered into between a party to the SHA and a third party in violation of the SHA may be deemed void if it is proven that said third party knew or should have known about restrictions specified by the SHA. Other parties to the SHA or shareholders of (or participants in) the parties to the contract in dispute may seek invalidation of such contracts in court.

Damages: the Amendments expressly state that a party to the SHA has the right to claim for damages caused by a breach of the SHA.

Penalty: apart from damages, the Amendments specify that the SHA may provide for liability for non-performance or improper performance of obligations under the SHA, including penalties, compensation or other measures of liability. The Amendments do not specify other such possible measures of liability; in the absence of specific

prescriptions, it seems reasonable to assume that specific performance might be one such measure.

Security for performance: the Amendments provide that the SHA may stipulate specific measures to secure performance of obligations under the SHA. It appears that the Amendments establish a non-exhaustive list of such measures and other security measures (e.g., pledge) that may be stipulated in the SHA.

Regulatory Matters

Filing Requirements

The Amendments contain certain requirements to notify a third party or parties, as follows:

- written notification must be sent: (i) to the JSC under Federal Law No. 208-FZ “On Joint Stock Companies”, dated December 26, 1995, as amended (the “JSC Law”), and (ii) to the JSC and the state authority for the securities market under Federal Law No. 39-FZ “On the Securities Market”, dated April 22, 1996, as amended;
- notification must be sent by a party that has acquired the right, according to the SHA, to control the votes at a meeting of the shareholders of the JSC, issuance of shares in which was accompanied by the registration of a share prospectus, provided that such a party and its affiliates directly or indirectly control 5, 10, 15, 20, 25, 30, 50 or 75% of the votes of the JSC’s issued common shares;
- said party must provide the JSC and the state authority for the securities market with the following information, *inter alia*: (i) the party’s name; (ii) the date of entering into, and effective date of the SHA; (iii) the term of the SHA; (iv) the number of shares owned by the parties to the SHA; and (v) the number of voting shares;
- notifications should be submitted not later than five days after the SHA is entered into; and
- failure to submit notification will render the relevant party unable to control the votes at a meeting of the shareholders as contemplated under the SHA.

Disclosure Requirements

The Amendments do not require disclosure of the full text of the SHA to the JSC, other shareholders (not party to the SHA), state authorities or any other

third parties. At the same time, upon receiving the required information described above, the JSC must distribute this information to the shareholders in the course of preparing for the annual shareholders' meeting.

Antimonopoly Clearance

In accordance with the Amendments, the shareholders may coordinate and agree on certain aspects of the management of a JSC. Such actions in concert may give rise to a need to obtain antimonopoly clearance (prior approval or post factum notification) in connection with the conclusion of the SHA if the SHA provides for coordinated actions with respect to voting and other aspects of the management of the JSC or otherwise falls under antimonopoly regulations.

Strategic Sectors Law Requirements

The Amendments expressly state that the SHA may contractually regulate actions of the shareholders related to management and activity of the JSC, including undertaking to vote in a particular manner. If a proposed SHA entitles a foreign investor to control, directly or indirectly, a company that is subject to Federal Law No. 57-FZ "On the Procedure for Foreign Investment in Companies of Strategic Significance for State Defense and Security", dated April 29, 2008, it may require the prior approval of the Government Commission for Control over Foreign Investment in Russia.

Other Matters

Unresolved Issues

Interested party rules: under the JSC Law, if a shareholder holding more than 20% of the voting shares is a party to or a beneficiary of a transaction with a company, said shareholder is held to be an interested party and accordingly is unable to vote. If an SHA grants Shareholder A the right to control Shareholder B's votes, and Shareholder A would then control more than 20% of the votes, but not more than 20% of the voting shares themselves, it seems that Shareholder A would not be regarded as an interested party and would be able to vote, since Shareholder A does not hold more than 20% of the voting shares themselves. However, if Shareholder B is an interested party, it is not clear whether Shareholder A would be able to vote.

Mandatory tender offer: according to the JSC Law, if a party and its affiliates acquire more than 30% of the JSC's issued common shares and preferred voting

shares, said party must make a mandatory tender offer to the other shareholders. It is unclear from the Amendments whether this requirement applies to a party who is entitled under the SHA to control the voting at a meeting of the JSC's shareholders of more than 30% of the votes of the JSC's issued shares. Since the JSC Law uses the word "acquire" in relation to the threshold of more than 30% of the voting shares, it seems likely that, as with the interested party transaction rules described above, the requirement only applies if the party in question owns the shares themselves, as opposed to merely controlling the related votes.

Choice of law: the ability to choose foreign law as the governing law of the SHA remains unclear. At the same time, since the JSC Law now recognizes SHAs and public order arguments generally used to challenge the application of foreign law may no longer be relevant, it is unclear how Russian courts will address this issue.

Existing agreements: it is also unclear from the Amendments whether any actions (e.g., providing the aforementioned notifications to the JSC and the state authority for the securities market) must be taken with respect to existing SHAs.

Other Amendments: the Amendments introduce some other changes to the JSC Law, including new provisions that should help to resolve a deadlock in case of the dismissal and election of a sole executive body (in Russia, typically the General Director) by the board of directors of the JSC. In particular, the Amendments provide for the option of electing a sole executive body at the shareholders' meeting (instead of a board of directors) under certain circumstances. However, if under such circumstances, the SHA makes provisions other than those specified by the JSC Law, nonperformance or improper performance of the SHA may not discharge parties from liability provided for by the SHA or from execution of measures securing performance of obligations under the SHA.

JSC Law v. LLC Law

Earlier this year, participation agreements, which are similar to SHAs, were allowed in limited liability companies ("LLCs"). The legal status of an SHA as defined by the JSC Law is practically the same as the legal status of a participation agreement under Federal Law No. 14-FZ "On Limited Liability Companies", dated February 8, 1998, as amended (the "LLC Law"). At the same time, the JSC Law contains more detailed provisions with respect to SHAs; in particular, the JSC Law includes provisions

regarding regulatory issues (notification filing) and remedies for breach. There are no such provisions in the LLC Law, and it is not clear whether the JSC Law provisions may apply by analogy. Finally, due to the requirement to notarize agreements on the transfer of participatory interests in the LLC, it appears that a participation agreement that provides for transfer of participatory interests (e.g., put and/or call options over the participatory interests) may need to be notarized. With SHAs, no such notarization is required.

Overall, the Amendments contribute to the improvement of the current JSC Law and provide shareholders with greater clarity. On the other hand,

the Amendments leave open a number of questions, such as whether foreign law may govern an SHA. It also remains to be seen how the amended JSC Law will work in practice. At this early stage, it does not appear that the Amendments provide sufficient comfort for shareholders to apply Russian law to their shareholder arrangements, instead of better-tested foreign-law-governed agreements.



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